NW Natural
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December 19, 2006

VIA ELECTRONIC FILING

Public Utility Commission of Oregon
550 Capitol Street, N.E., Suite 215
P.O. Box 2148
Salem, Oregon 97308-2148

Attn: Filing Center

Re: Docket UF ________: Application for an Order Authorizing Various Arrangements with Financial Institutions to Manage Exposure to Interest Rate Fluctuations

Submitted herewith for filing is the above-referenced application. If you have any questions regarding this matter or require any additional information, please contact me at (503) 220-2435 or Stephen Feltz at (503) 220-2345.

Very truly yours,

/s/ Shawn M. Filippi

Shawn M. Filippi

Enclosure

Cc w/Encl.: Stephen P. Feltz, NWN
C.J. Rue, NWN
Margaret D. Kirkpatrick, NWN
Ming Peng, OPUC

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

In the Matter of the Application of NORTHWEST NATURAL GAS COMPANY for an Order Authorizing Various Arrangements with Financial Institutions to Manage Exposure to Interest Rate Fluctuations	)))))))))	APPLICATION Docket No. UF __________

Northwest Natural Gas Company ("NW Natural" or the "Company") hereby applies for an order of the Public Utility Commission of Oregon ("OPUC" or the "Commission"), pursuant to ORS 757.410 and 757.415 and OAR 860-027-0030, authorizing the Company to enter into interest rate swaps, caps, floors, collars and other derivative products with financial institutions to manage exposure to interest rate fluctuations. These products are hereinafter referred to as "Interest Rate Hedge Products." The Company requests that this authority remain in effect so long as NW Natural's senior secured debt has investment grade ratings from two nationally recognized rating agencies and the notional principal amount outstanding of Interest Rate Hedge Products entered into pursuant to such authorization does not exceed $200,000,000 or more than 30 percent of the total debt outstanding.

I. Application for Authorization

The following information is furnished in support of the Application for an order authorizing Interest Rate Hedge Products, following the format of OAR 860-027-0030.

(1)(a) <u>Name and Address</u>. The exact name of the Applicant and the address of its principal business office are as follows:

> Northwest Natural Gas Company
> 220 NW Second Avenue
> Portland, Oregon 97209

(1)(b) <u>State of Incorporation and States Authorized to Transact Utility Business</u>. The Company is a corporation duly organized and validly existing under the laws of the State of Oregon. The Company was incorporated January 10, 1910 and its duration is perpetual. It has duly qualified and is authorized to transact its business in the State of Washington and is in good standing as a foreign corporation under the laws of that State.

(1)(c) <u>Person Authorized to Receive Notices</u>. The name and address of the person authorized, on behalf of the Company, to receive notices and communications in respect to this Application is:

> C.J. Rue, Secretary
> NW Natural
> 220 NW Second Avenue
> Portland, Oregon 97209
> Telephone: (503) 220-2411
> Facsimile: (503) 220-2584
> Email: cjr@nwnatural.com

The Company respectfully requests that the Commission send copies of all such notices and communications to:

> Stephen P. Feltz
> Treasurer and Controller
> NW Natural
> 220 NW Second Avenue
> Portland, Oregon 97209
> Telephone: (503) 220-2345
> Facsimile: (503) 220-2584
> Email: steve.feltz@nwnatural.com

(1)(d) Principal Officers. The names, titles and addresses of the principal officers of the Company are:

Mark S. Dodson	President and Chief Executive Officer	220 NW Second Avenue Portland, Oregon 97209
Michael S. McCoy	Executive Vice President of Customer and Utility Operations	" " "
Margaret D. Kirkpatrick	Vice President and General Counsel	" " "
Gregg S. Kantor	Executive Vice President	" " "
David H. Anderson	Senior Vice President and Chief Financial Officer	" " "
Lea Anne Doolittle	Vice President, Human Resources	" " "
Stephen P. Feltz	Treasurer and Controller	" " "
C.J. Rue	Secretary and Assistant Treasurer	" " "

(1)(e) General Character of the Business. The Company is engaged principally in the business of distributing and selling natural gas to residential, commercial, institutional and industrial customers in various cities and unincorporated areas in 15 counties in the State of Oregon and three counties in the State of Washington. A map of the Company's service territory is attached as Exhibit AA.

(1)(f) Capital Stock. As of September 30, 2006, the date of the balance sheet submitted herewith (see Exhibit E), the authorized and outstanding capital stock of the Company was as follows:

Preferred Capital Stock: authorized, 3,500,000 shares, without par value; none issued and outstanding. The amount of Preferred Stock authorized in the Company's most recent Oregon Jurisdictional Rate Case is provided in Exhibit CC.

The Preferred Stock is entitled in preference to the Common Stock to cumulative dividends at the applicable rate for each series, which shall be set by the Board of

Directors, from time to time, in accordance with the Company's Restricted Articles of Incorporation. The Preferred Stock is entitled in preference to the Common Stock, upon voluntary liquidation, to such amounts per share that are determined by the Board of Directors, from time to time, in accordance with the Company's Restated Articles of Incorporation.

None of the Preferred Stock is held in the treasury or as reacquired securities; none is pledged by the Company; none is held by affiliated interests; and none is held in any fund owned or controlled by the Company.

Common Capital Stock: authorized, 60,000,000 shares; issued and outstanding, 27,568,896 shares; reserved for future issue to employees under the Company's Employee Stock Purchase Plan, 275,803 shares; reserved for future issuance to common shareholders under the Company's Dividend Reinvestment and Direct Stock Purchase Plan, 778,835 shares; reserved to accommodate the Restated Stock Option Plan (formerly the 1985 Stock Option Plan), 1,504,000 shares; and reserved for future grants under the Long-Term Incentive Plan, 388,506. The amount of Common Stock authorized and included in the Company's most recent Oregon Jurisdictional Rate Case is provided in Exhibit CC.

The Common Stock is entitled to dividends when and as declared by the Board of Directors subject to the preferences of the Preferred Stock outlined above, and subject to the restrictions, if any, of the Company's Mortgage.

Generally, only the Common Stock has voting rights, subject to the special voting rights of the Preferred Stock, if any. Holders of Common Stock are entitled to cumulative voting for the election of directors.

None of the Common Stock is held in the treasury or as reacquired securities; none is pledged by the Company; none is held by affiliated interests; and none is held in any fund owned or controlled by the Company.

(1)(g) Long-Term Debt. As of September 30, 2006, the date of the balance sheet submitted herewith (see Exhibit E), the classes and series of long-term debt or notes of the Company were as listed in the following table (the principal amount includes sinking fund requirements (of which there are none), and maturities due within one year, shown as current liabilities on the balance sheet):

Authorized First Mortgage Bonds (including Secured Medium-Term Notes), secured by a first mortgage lien on substantially all of the utility property now owned, or hereafter acquired by the Company, were outstanding in the amounts shown below, the interest rate and maturity being shown in the title of each series:

	ORIGINALLY AUTHORIZED	OUTSTANDING
MEDIUM-TERM NOTES		
Secured Notes (First Mortgage Bonds):		
6.310% Series B Due 2007	20,000,000	20,000,000
6.800% Series B Due 2007	10,000,000	9,500,000
6.500% Series B Due 2008	5,000,000	5,000,000
4.110% Series B Due 2010	10,000,000	10,000,000
7.450% Series B Due 2010	25,000,000	25,000,000
6.665% Series B Due 2011	10,000,000	10,000,000
7.130% Series B Due 2012	40,000,000	40,000,000
8.260% Series B Due 2014	10,000,000	10,000,000
4.700% Series B Due 2015	40,000,000	40,000,000
7.000% Series B Due 2017	40,000,000	40,000,000
6.600% Series B Due 2018	22,000,000	22,000,000
8.310% Series B Due 2019	10,000,000	10,000,000
7.630% Series B Due 2019	20,000,000	20,000,000
9.050% Series A Due 2021	10,000,000	10,000,000
5.620% Series B Due 2023	40,000,000	40,000,000
7.720% Series B Due 2025	20,000,000	20,000,000
6.520% Series B Due 2025	10,000,000	10,000,000
7.050% Series B Due 2026	20,000,000	20,000,000
7.000% Series B Due 2027	20,000,000	20,000,000
6.650% Series B Due 2027	20,000,000	20,000,000
6.650% Series B Due 2028	10,000,000	10,000,000
7.740% Series B Due 2030	20,000,000	20,000,000
7.850% Series B Due 2030	10,000,000	10,000,000
5.820% Series B Due 2032	30,000,000	30,000,000
5.660% Series B Due 2033	40,000,000	40,000,000
5.250% Series B Due 2035	10,000,000	10,000,000

The amount of long-term debt authorized in the Company's most recent Oregon Jurisdictional Rate Case is provided in Exhibit CC.None of the long-term debt securities described above is held in treasury, or held as reacquired securities, and none is held by affiliated interests.

(1)(h) Description of the Securities. Many hedge strategies and products have been developed that permit companies to manage interest rate exposures, integrating these products into a company's risk management strategy and capital structure. The securities covered by this Application are referred to as Interest Rate Hedge Products, which include interest rate swaps, caps, floors, collars and other derivative products entered into with financial institutions and designed to manage exposure to interest rate fluctuations related to the Company's debt issuances. These products can be used to increase or decrease the Company's percentage of floating-rate or fixed-rate debt. The notional principal amount outstanding of Interest Rate Hedge Products proposed pursuant to this Application would not exceed $200,000,000 or more than 30 percent of the total debt outstanding. The Interest Rate Hedge Products are more completely described in Section (1)(i) below.

(1)(i) Description of the Proposed Transaction. The proposed interest rate hedge transactions are intended to provide protection against material adverse market events and provide opportunities to take advantage of favorable market conditions. The Company's use of Interest Rate Hedge Products is not intended for speculative purposes. The Company would only use such Interest Rate Hedge Products after a specific interest rate exposure was identified and deemed to be unavoidable because it related to an existing or expected borrowing requirement with respect to capital structure, working capital, customer growth or capital improvements.

The following are the more common types of Interest Rate Hedge Products that the Company is likely to use:

Interest rate swap - a basic interest rate swap transaction is designed to allow two parties to contractually make payment arrangements to each other, where one party's floating rate obligation is effectively converted into a fixed rate payment and the other party's fixed rate obligation is effectively converted into a floating rate payment.

In addition to a basic interest rate swap transaction, other interest rate swap-type products exist such as forward treasury locks, forward-starting swaps and swaptions. The Company believes that these interest rate swap products can reduce interest rate risk and provide opportunities to lower its cost of existing or prospective debt issues. Swap transactions are expected to provide the Company with enhanced flexibility to manage its exposure to interest rates and volatile market conditions.

One example of an interest rate swap transaction the Company might use under the authority granted by this Application, if approved, would be to enter into a forward-starting swap to lock-in the interest rate on an expected future long-term debt issue. For instance, if the Company was faced with a long-term debt maturity in 12 months and wanted to lock-in a new long-term debt security at current rates so that it could refinance the debt redemption at today's lower rates and reduce the Company's cost of capital, then the Company could do so by entering into a fixed-rate forward-starting swap that would be effective 12-months from now, thereby protecting against any increase in interest rates between now and then, avoiding any negative carrying cost for monies borrowed in advance of when the funds would be needed for debt redemption, and preventing the deterioration of certain debt to capital ratios that could adversely affect the Company's credit ratings. [Note: Even with a relatively flat interest rate yield curve, the rate on the Company's short-term debt is most often lower than the rate on its new long-term debt because of the credit spread associated with longer-term debt securities. The flat yield curve, however, does create favorable opportunities for the Company to manage its interest rate exposure for an expected future long-term debt issuance.] Based on the current market opportunity, the Company could enter into a 12-month, fixed-rate forward-starting swap today to hedge the interest rate volatility on a projected debt issue, which is not expected to be sold until December 1, 2007, without paying any or very little forward premiums. The fixed-rate on a forward-starting swap is estimated to be about 5.25% based on the current Forward 10-year AA Swap Rate, including the Company's credit spread which is expected to remain reasonably highly correlated to movements in the "AA" credit spreads. In this example, if benchmark interest rates increase by 0.50% (e.g. from 5.25% to 5.75%) between the date of issuance of the forward-starting swap and the date when the hedged debt is sold 12 months later, then the Company would issue its debt on or about December 1, 2007 at a higher coupon rate of about 5.75% but would receive a settlement payment (i.e. a hedge gain) from its swap counterparty, which represents the present value of the 0.50% rate difference on all future interest payments, thereby offsetting the higher coupon rate on the new debt issue. If on the other hand interest rates decrease by 0.50% (e.g. from 5.25% to 4.75%), then the Company would issue its new debt at the lower interest rate of 4.75% but would make a settlement payment (i.e. a hedge loss) to its swap counterparty, which offsets the interest cost savings from the lower rate on the new debt issue. In the interim, the Company would continue to pay short-term interest rates until the new long-term debt proceeds are received, which could represent additional interest rate savings below long-term rates based on credit spreads, while still locking in a fixed long-term rate to protect against potentially higher long-term interest rates a year from now. For accounting purposes, the forward starting swap would be designated and documented as a cash flow hedge under Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Certain Hedging Activities," with all changes in market value for each reporting period being presented on the balance sheet as Other Comprehensive Income (OCI), net of tax. In the above example, the hedge gain (or loss) at settlement would be recorded in Accumulated OCI and amortized to current earnings as a decrease (or increase) to interest expense over the life of the new debt, which would offset the higher (or lower) interest expense from the new debt issue.

Interest rate cap, floor and collar – The structure of these products involves two parties that enter into an agreement where one party purchases from the other party protection from interest rate volatility. Interest rate caps are purchased by an issuer of floating rate obligations to protect against cost increases from higher interest rates, while still benefiting from cost savings when interest rates decline. Conversely, the purchaser of an interest rate floor seeks to establish a minimum rate its floating rate securities would earn during a declining interest rate period. In both cases, an up-front fee is paid to the party that provides such protection. From time to time, a party may simultaneously purchase an interest rate cap and sell an interest rate floor to create an interest rate collar, which provides protection from increasing interest rates above the cap but limits the benefit from declining interest rates below the floor. The principal benefit to the Company of selling an interest rate floor to create an interest rate collar is to receive a premium to partially offset the cost of purchasing an interest rate cap.

The term for each type of hedge transaction would be limited by the existing term of the underlying debt instrument or the expected term of the underlying future debt issue.

(A) **Proposed Method of Selling/Issuing Securities.** The proposed transactions would be subject to the policy limits and approvals set forth in the Company's Derivatives Policy – Financial Products (see Exhibit BB). The Company would strive to competitively bid each transaction from amongst its list of approved derivative counterparties. A negotiated process may be utilized when competitive conditions or market conditions justify such a process. The conditions under which a negotiated process may be used in selecting the approved financial counterparty include:

- Demand for the desired product is weak or non-existent among approved counterparties;
- Market timing would not allow a sufficient amount of time for receiving competitive bids; and
- Coordination of multiple criteria for structuring the hedge transaction is required and not easily put out for competitive bid.

In any event, if a negotiated process is utilized rather than competitively bid, then the Company would provide the analysis necessary to demonstrate the market competitiveness of the bid and the cost effectiveness of the transaction.

(B) **Pro Rata or Preemptive Rights**. The Interest Rate Hedge Products are not issued *pro rata* to existing holders of any other securities of the Company, and are not subject to any preemptive right or in connection with any liquidation or reorganization.

(C) **Rationale for Entry Into Interest Rate Hedge Products in Manner Proposed.** The proposed transactions would be part of an overall financing strategy to minimize the cost of financings which support the Company's ongoing

The Company views its outstanding debt as a portfolio of liabilities to be managed. The use of Interest Rate Hedge Products will help the Company to capture the economic benefits associated with changes in capital markets, and decrease the risks associated with such changes. It is expected that the use of Interest Rate Hedge Products will, on average, decrease the volatility in interest rates on new debt issues, lower the interest costs and improve financing flexibility. As a result, the Company should be able to lower its cost of debt, which would benefit its customers and shareholders.

(D) **Competitive Bidding**. No exemption from the competitive bidding requirements of any federal or other state regulatory body has been requested. See item (1)(i)(A), "Proposed Method of Selling/Issuing Securities," above.

(1)(j) Fees for Services. Fees for services, if any, will be negotiated on a case-by-case basis at the time the Company enters into an Interest Rate Hedge Product. In most cases, the Company anticipates that, apart from pricing, there will be no separate fee for service for Interest Rate Hedge Products. On occasion, entry into an Interest Rate Hedge Product may involve the engagement of an underwriting firm. In such case, it is the Company's intent to identify the Interest Rate Hedge Product with the most competitively priced fees for services. Therefore, the fees for services paid by the Company, if any, in connection with the Interest Rate Hedge Products, will be customary for such services in arms-length transactions and reasonable in light of the cost of rendering the service.

(1)(k) Price and Proceeds. The price for the Interest Rate Hedge Products, if any, will be established on a case-by-case basis when the Company enters into such products. It is the Company's intent to identify the most competitively priced Interest

Rate Hedge Product, and therefore the price paid by the Company, if any, will be customary for such product as in arms-length transactions and reasonable in light of the cost of rendering the service.

The proposed transactions are not financings and do not normally generate any financing proceeds. However, to the extent that up-front fees are received by the Company they will be credited to unamortized premium or discount on long-term debt and used for the following purposes: the acquisition of utility property or the construction, extension or improvement of utility facilities; the improvement or maintenance of service; the discharge or lawful refunding of its debt obligations; or, refunding the Company's treasury expended on utility purposes.

Any ongoing cash received (or paid) during the term of the hedge transaction, or at settlement, will be accounted for as a decrease (or increase) in the cost of the underlying securities along with the amortization of up-front fees, if any. These amounts will be amortized to expense over the term of the underlying securities in accordance with generally accepted accounting principles.

No significant change is expected in the capitalization of the Company as a result of it using Interest Rate Hedge Products. Any upfront fees and ongoing payments received (or paid) from these hedge transactions will be included in the all-in effective cost of the underlying securities. NW Natural understands that its accounting treatment of the upfront fees and ongoing payments (or receipts), if any, would not constitute pre-authorization of any future ratemaking treatment of the Interest Rate Hedge Products.

(1)(l) <u>Purposes for the Securities</u>. The purpose for using Interest Rate Hedge Products is to provide opportunities where the Company could capture the economic benefits associated with changes in the capital markets while decreasing the risks associated with such changes. Some of the benefits include being able to hedge against adverse changes in interest rates, reduce borrowing costs through a more efficient mix of fixed and floating rate debt, and manage debt duration in response to the yield curve environment. For more details describing the purpose of these securities, see Section (1)(i) of this Application.

(1)(m) Other Regulatory Requirements. A statement will be filed with the Washington Utilities and Transportation Commission establishing compliance with RCW 80.08.040 prior to the use of any Interest Rate Hedge Product. No Registration Statement is required to be filed with the Securities and Exchange Commission pursuant to the Securities Act of 1933.

(1)(n) Summary and Approval Standards. Based on the facts and for the reasons stated herein, the Interest Rate Hedge Products, as described in this Application: are for a lawful object within the corporate purpose of the applicant; are compatible with the public interest; are necessary or appropriate for or consistent with the proper performance by the applicant of service as a utility; will not impair the Company's ability to perform its service; and are reasonably necessary or appropriate for such purposes. This application is not filed under ORS 757.495.

(1)(o) and (1)(p) Other Requirements. The requirements of Rule 860-27-0030(1)(o) and (1)(p) are not applicable.

WHEREFORE, NW Natural respectfully requests an Order of the Commission, granting authority to the Company to enter into interest rate swaps, caps, floors, collars and other derivative products with financial institutions in an aggregate amount outstanding not to exceed $200,000,000 or more than 30 percent of its total debt outstanding. The Company requests that this authority remain in effect so long as the Company's senior secured debt has investment grade ratings from two nationally recognized rating agencies.

REQUIRED EXHIBITS

Filed with this Application and Petition, as part hereof, are the following Exhibits:

Exhibit A	A copy of the Company's Restated Articles of Incorporation, as amended.
Exhibit B	A copy of the Company's Bylaws, as amended.
Exhibit C	A certified copy of resolutions from the Board of Directors meeting held on April 27, 2006, relating to the proposed use of interest rate hedge transactions. Shareholder approval is not required.
Exhibit D	There is no current agreement regarding the Interest Rate Hedge Products. Attached is an extract from a presentation by JPMorgan defining and illustrating the use of interest rate swap and other interest rate hedge transactions.
Exhibit E	Balance Sheets of the Company at September 30, 2006 and December 31, 2005, and financial notes thereto. The balance sheets do not currently reflect Interest Rate Hedge Products. Upon the Company's entry into Interest Rate Hedge Products, such products will be reflected on the balance sheet to the extent appropriate under Generally Accepted Accounting Principles in the United States of America, but the impact is not expected to be material.
Exhibit F	See Exhibit E, Note 9, "Commitments and Contingencies," excerpted from the Company's Form 10-Q for the period ended September 30, 2006 for a list of all known contingent liabilities, other than minor items such as damages, claims and similar items involving relatively small amounts, as of the date of the Statement and Application. No material events have occurred from the date of the report referred to above through the date of this Statement and Application that would require any additions or modifications.
Exhibit G	Comparative Income Statements for the three and nine months ended September 30, 2006 and the 12 months ended December 31, 2005. (See Exhibit E for notes to the consolidated financial statements). The Interest Rate Hedge Products do not have an effect on the Income Statements except to the extent that they increase or decrease interest charges, which effectively offsets the impact of interest expense changes in the underlying hedged item.
Exhibit H	Consolidated Statements of Shareholders' Equity and Comprehensive Income as of December 31, 2005 showing an analysis of surplus for that

period. See Exhibit E for information describing surplus for the nine months ended September 30, 2006.

Exhibit I	No registration statement for the Interest Rate Hedge Products currently contemplated is required to be filed with the Securities and Exchange Commission.
Exhibits J & K	There is no current agreement regarding the Interest Rate Hedge Products. See Exhibit D for a presentation by J.P. Morgan Securities, Inc. defining and illustrating the use and value of interest rate swap and other interest rate hedge transactions.
Exhibit AA	Map of the Company's service territories.
Exhibit BB	Company's Derivatives Policy-Financial Products
Exhibit CC	Company's capital structure and weighted average cost of capital as authorized in Oregon Jurisdictional Rate Case – UG 152

WHEREFORE, the Applicant respectfully requests that the Public Utility Commission of Oregon enter an appropriate Order granting the within Application.

Dated at Portland, Oregon this 19 day of December 2006.

NORTHWEST NATURAL GAS COMPANY

By Stephen P. Feltz
Stephen P. Feltz
Treasurer & Controller

STATE OF OREGON)
) ss
County of Multnomah)

Stephen P. Feltz, being first duly sworn, deposes and says that he is Treasurer & Controller of Northwest Natural Gas Company, the Applicant in the foregoing Application, that he has read said Application, including exhibits thereto, knows the content thereof, and that the same are true to the best of his knowledge and belief.

Stephen P. Feltz
Stephen P. Feltz

Subscribed and sworn to before me this 19 day of December 2006.

Linda M. Warren
Notary Public for Oregon
My commission expires: June 21, 2008

OFFICIAL SEAL
LINDA M. WARREN
NOTARY PUBLIC-OREGON
COMMISSION NO. 381962
MY COMMISSION EXPIRES JUNE 21, 2008

EXHIBIT A

A copy of the Company's Restated Articles of Incorporation, as amended.

Exhibit A

RESTATED ARTICLES OF INCORPORATION

of

NORTHWEST NATURAL GAS COMPANY

as Filed and Amended May 31, 2006

RESTATED ARTICLES OF INCORPORATION
OF
NORTHWEST NATURAL GAS COMPANY

(These Restated Articles of Incorporation of Northwest Natural Gas Company supersede its theretofore existing Restated Articles of Incorporation and all amendments thereto.)

ARTICLE I

The name of this corporation is NORTHWEST NATURAL GAS COMPANY, and its duration shall be perpetual.

ARTICLE II

The purposes of the corporation are to engage in any lawful activity for which corporations may be organized under the Oregon Business Corporation Act.

ARTICLE III

A. The aggregate number of shares of capital stock which the corporation shall have authority to issue is 63,500,000 shares, divided into 3,500,000 shares of Preferred Stock, issuable in series as hereinafter provided, and 60,000,000 shares of Common Stock.

B. A statement of the preferences, limitations and relative rights of each class of capital stock of the corporation, namely, the Preferred Stock and the Common Stock, of the variations in the relative rights and preferences as between series of the Preferred Stock, insofar as the same are fixed by these Restated Articles of Incorporation, and of the authority vested in the board of directors of the corporation to establish series of Preferred Stock and to fix and determine the variations in the relative rights and preferences as between series insofar as the same are not fixed by these Restated Articles of Incorporation, is as follows:

Preferred Stock

1. The shares of the Preferred Stock may be divided into and issued in series. Each series shall be so designated as to distinguish the shares thereof from the shares of all other series of the Preferred Stock and all other classes of capital stock of the corporation. To the extent that these Restated Articles of Incorporation shall not have established series of the Preferred Stock and fixed and determined the variations in the relative rights and preferences as between series, the board of directors shall have authority, and is hereby expressly vested with authority, to divide the Preferred Stock into series and, within the limitations set forth in these Restated Articles of Incorporation and such limitations as may be provided by law, to fix and determine the relative rights and preferences of any series of the Preferred Stock so established. Such action by the board of directors shall be expressed in a resolution or resolutions adopted by it prior to the issuance of shares of each series, which resolution or resolutions shall also set forth the distinguishing designation of the particular series of the Preferred Stock established thereby. Without limiting the generality of the foregoing, authority is hereby expressly vested in the board of directors so to fix and determine with respect to any series of the Preferred Stock:

   (a) The rate of dividend and the relative preference of each series in the payment of dividends;

   (b) The price at which and the terms and conditions on which shares may be redeemed;

   (c) The amount payable upon shares in the event of voluntary and involuntary liquidation and the relative preference of each series on liquidation;

   (d) Sinking fund provisions, if any, for the redemption or purchase of shares;

   (e) The terms and conditions, if any, on which shares may be converted if the shares of any series are issued with the privilege of conversion; and

(f) Any other relative right or preference as permitted by law.

All shares of the Preferred Stock of the same series shall be identical except that shares of the same series issued at different times may vary as to the dates from which dividends thereon shall be cumulative; and all shares of the Preferred Stock, irrespective of series, shall constitute one and the same class of stock and shall be identical except as to the designation thereof, the date or dates from which dividends on shares thereof shall be cumulative, and the relative rights and preferences set forth above in clauses (a) through (f) of this subdivision, as to which there may be variations between different series. Except as otherwise may be provided by law or by the resolutions establishing any series of Preferred Stock in accordance with the foregoing provisions of this subdivision, whenever the written consent, affirmative vote, or other action on the part of the holders of the Preferred Stock may be required for any purpose, such consent, vote or other action shall be taken by the holders of the Preferred Stock as a single class irrespective of series and not by different series.

2. The holders of shares of the Preferred Stock of each series shall be entitled to receive dividends, when and as declared by the board of directors, out of any funds legally available for the payment of dividends, at the annual rate fixed and determined with respect to each series either by these Restated Articles of Incorporation or in accordance with subdivision III. B. 1., and no more, payable quarterly on the 15th day of February, May, August and November in each year or on such other date or dates as the board of directors shall determine in the resolutions establishing such series. Such dividends shall be cumulative in the case of shares of each series either from the date of issuance of shares of such series or from the first day of the current dividend period within which shares of such series shall be issued, as the board of directors shall determine, so that if dividends on all outstanding shares of each particular series of the Preferred Stock, at the annual dividend rates fixed and determined either by these Restated Articles of Incorporation or in accordance with subdivision III. B. 1., shall not have been paid or declared and set apart for payment for all past dividend periods and for the then current dividend periods, the deficiency shall be fully paid or dividends equal thereto declared and set apart for payment at said rates before any dividends on the Common Stock shall be paid or declared and set apart for payment. No interest, or sum of money in lieu of interest, shall be payable in respect of any dividend payment or payments which may be in arrears.

3. In the event of any dissolution, liquidation or winding up of the corporation, before any distribution or payment shall be made to the holders of the Common Stock, the holders of the Preferred Stock of each series then outstanding shall be entitled to be paid out of the net assets of the corporation available for distribution to its shareholders the respective amounts per share fixed and determined with respect to each series either by these Restated Articles of Incorporation or in accordance with subdivision III. B. 1., and no more. If upon dissolution, liquidation or winding up of the corporation, whether voluntary or involuntary, the net assets of the corporation available for distribution to its shareholders shall be insufficient to pay the holders of all outstanding shares of Preferred Stock of all series the full amounts to which they shall be respectively entitled as aforesaid, the net assets of the corporation so available for distribution shall be distributed to the holders of Preferred Stock in accordance with the relative preferences of each series of Preferred Stock established either by these Restated Articles of Incorporation or in accordance with subdivision III. B. 1. For the purposes of this subdivision, any dissolution, liquidation or winding up which may arise out of or result from the condemnation or purchase of all or a major portion of the properties of the corporation by (i) the United States Government or any authority, agency or instrumentality thereof (ii) a State of the United States or any political subdivision, authority, agency or instrumentality thereof, or (iii) a district, cooperative or other association or entity not organized for profit, shall be deemed to be an involuntary dissolution, liquidation or winding up; and a consolidation, merger or amalgamation of the corporation with or into any other corporation or corporations shall not be deemed to be a dissolution, liquidation or winding up of the corporation, whether voluntary or involuntary.

4. The holders of shares of the Preferred Stock shall have no right to vote in the election of directors or for any other purpose, except as may be otherwise provided by law or by resolutions establishing any series of Preferred Stock in accordance with subdivision III. B. 1. Holders of Preferred Stock shall be entitled to notice of each meeting of shareholders at which they shall have any right to vote, but shall not be entitled to notice of any other meeting of shareholders.

Common Stock

5. Subject to the limitations set forth in subdivisions III. B. 2. (and subject to the rights of any class of stock hereafter authorized), dividends may be paid upon the Common Stock when and as declared by the board of directors of the corporation out of any funds legally available for the payment of dividends.

6. Subject to the limitations set forth in subdivisions III. B. 3. (and subject to the rights of any other class of stock hereafter authorized), upon any dissolution, liquidation or winding up of the corporation, whether voluntary or involuntary, the net assets of the corporation shall be distributed ratably to the holders of the Common Stock.

7. Except as may be otherwise provided by law or by the resolutions establishing any series of Preferred Stock in accordance with subdivision III. B. 1., the holders of the Common Stock shall have the exclusive right to vote for the election of directors and for all other purposes. In the election of directors of the corporation, every holder of record of any share or shares of the Common Stock of the corporation shall have the right to cast as many votes for one candidate as shall equal the number of such shares multiplied by the number of directors to be elected, or to distribute such number of votes among any two or more candidates for such election.

8. Upon the issuance for money or other consideration of any shares of capital stock of the corporation, or of any security convertible into capital stock of the corporation, no holder of shares of the capital stock, irrespective of the class or kind thereof, shall have any preemptive or other right to subscribe for, purchase or receive any proportionate or other amount of such shares of capital stock, or such security convertible into capital stock, proposed to be issued; and the board of directors may cause the corporation to dispose of all or any of such shares of capital stock, or of any such security convertible into capital stock, as and when said board may determine, free of any such right, either by offering the same to the corporation's then shareholders or by otherwise selling or disposing of such shares of other securities, as the board of directors may deem advisable.

ARTICLE IV

A. The business and affairs of the corporation shall be managed by a board of directors. Except as provided in subdivision B. below, the number of members of the board, their classifications and terms of office, and the manner of their election and removal shall be as follows:

1. The number of directors shall be that number, not less than nine or more than thirteen, determined from time to time by resolution adopted by affirmative vote of a majority of the entire board of directors. The directors shall be divided into three classes, designated Class I, Class II, and Class III. Each class shall consist, as nearly as possible, of one-third of the total number of directors. At the 1984 annual meeting of shareholders, Class I directors shall be elected for a one-year term, Class II directors for a two-year term, and Class III directors for a three-year term. At each succeeding annual meeting of shareholders, successors to directors whose terms expire at that annual meeting shall be of the same class as the directors they succeed, and shall be elected for three-year terms. If the number of directors should be changed by resolution of the board of directors, any increase or decrease shall be apportioned among the classes so as to maintain the number of directors in each class as nearly equal as possible, but in no case shall a decrease in the number of directors shorten the term of any incumbent director.

2. A director shall hold office until the annual meeting for the year in which his or her term shall expire and until his or her successor shall have been elected and qualified, subject, however, to prior death, resignation, retirement or removal from office. Any newly created directorship resulting from an increase in the number of directors and any other vacancy on the board of directors, however caused, may be filled by the affirmative vote of a majority of the directors then in office, although less than a quorum, or by a sole remaining director.

3. One or more of the directors may be removed with or without cause by the affirmative vote of the holders of not less than two-thirds of the shares entitled to vote thereon at a meeting of the shareholders called

expressly for that purpose; provided, however, that for as long as the corporation shall have cumulative voting, if fewer than all the directors should be candidates for removal, no one of them shall be removed if the votes cast against his or her removal would be sufficient to elect him or her if then cumulatively voted at an election of the class of directors of which he or she shall be a part.

4. No person, except those persons nominated by the board, shall be eligible for election as a director at any annual or special meeting of shareholders unless a written request that his or her name be placed in nomination shall be received from a shareholder of record entitled to vote at such election by the secretary of the corporation not later than the latter of (a) the thirtieth day prior to the date fixed for the meeting, or (b) the tenth day after the mailing of notice of that meeting, together with the written consent of the nominee to serve as a director.

B. Notwithstanding the provisions of subdivision A. above, whenever the holders of any one or more classes of the capital stock of the corporation shall have the right, voting separately as a class or classes, to elect directors at an annual or special meeting of shareholders, the election, term of office, filling of vacancies and other features of such directorships shall be governed by the provisions of these Restated Articles of Incorporation applicable thereto. Directors so elected shall not be divided into classes unless expressly provided by such provisions, and during their prescribed terms of office, the board of directors shall consist of such directors in addition to the directors determined as provided in subdivision A. above.

C. This Article IV may not be repealed or amended in any respect unless such action shall be approved by the affirmative vote of the holders of not less than two-thirds of the shares entitled to vote at an election of directors determined as provided in subdivision A. above, at a meeting of the shareholders called expressly for that purpose.

ARTICLE V

A. For purposes of this Article V:

1. The term "Affiliate", as used to indicate a relationship with a specified "Persons" (as hereinafter defined), shall mean a Person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the Person specified.

2. The term "Associate", as used to indicate a relationship with a specified Person, shall mean (a) any Person (other than the corporation) of which such specified Person is a director, officer, partner, trustee, guardian, fiduciary or official or is, directly or indirectly, the beneficial owner of 10% or more of any class of equity securities or any beneficial interest, (b) any Person who is a director, officer, partner, trustee, guardian, fiduciary or official or is, directly or indirectly, the beneficial owner of 10% or more of any class of equity securities or any beneficial interest of or in such specified Person (other than the corporation), and (c) any relative or spouse of such specified Person, or any relative of such spouse who has the same home as such specified Person.

3. The term "Beneficial Owner" shall have the meaning set forth in Rule 13d-3 of the General Rules and Regulations under the Securities Exchange Act of 1934 as in effect on April 9, 1984; provided, however, that, notwithstanding the provisions of such Rule, a Person shall be deemed to be the Beneficial Owner of any share of the capital stock of the corporation that such Person shall have the right to acquire at any time pursuant to any agreement, contract, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise, and any such share of capital stock shall be deemed to be outstanding for purposes of subdivision V.A.9.

4. The term "Business Transaction" shall include, without limitation, (a) any merger, consolidation or plan of exchange of the corporation, or any Person controlled by or under common control with the corporation, with or into any "Related Person" (as hereinafter defined), (b) any merger, consolidation or plan of exchange of a Related Person with or into the corporation or any Person controlled by or under common control with the corporation, (c) any sale, lease, exchange, transfer or other disposition (in one transaction or a series of transactions) including without limitation a mortgage or any other security device, of all or

any "Substantial Part" (as hereinafter defined) of the property and assets of the corporation, or any Person controlled by or under common control with the corporation, to or with a Related Person, (d) any purchase, lease, exchange, transfer or other acquisition (in one transaction or a series of transactions), including without limitation a mortgage or any other security device, of all or any Substantial Part of the property and assets of a Related Person, by or with the corporation or any Person controlled by or under common control with the corporation, (e) any recapitalization of the corporation that would have the effect of increasing the voting power of a Related Person, (f) the issuance, sale, exchange or other disposition of any securities of the corporation, or of any Person controlled by or under common control with the corporation, by the corporation or by any Person controlled by or under common control with the corporation, (g) any liquidation, spinoff, splitoff, splitup or dissolution of the corporation, and (h) any agreement, contract or other arrangement providing for any of the transactions described in this subdivision.

5. The term "Continuing Director" shall mean a director who was a director of the corporation on April 9, 1984 and a director who shall become a director subsequent thereto whose election, or whose nomination for election by the shareholders, shall have been approved by a vote of a majority of the then Continuing Directors.

6. The term "Highest Purchase Price" shall mean, with respect to the shares of any class or series of the capital stock of the corporation, the highest amount of consideration paid by a Related Person for a share of the same class and series at any time regardless of whether the share was acquired before or after such Related Person became a Related Person; provided, however, that the Highest Purchase Price shall be appropriately adjusted to reflect the occurrence of any reclassification, recapitalization, stock split, reverse stock split or other readjustment in the number of outstanding shares of that class or series, or the declaration of a stock dividend thereon. The Highest Purchase Price shall include any brokerage commissions, transfer taxes and soliciting dealers' fees paid by such Related Person with respect to any shares of the capital stock acquired by such Related Person.

7. The term "Other Consideration" shall include, without limitation, capital stock to be retained by the shareholders of the corporation in a Business Transaction in which the corporation shall be the survivor.

8. The term "Person" shall mean any natural person, corporation, partnership, trust, firm, association, government, governmental. agency or any other entity whether acting in an individual, fiduciary or other capacity.

9. The term "Related Person" shall mean (a) any Person which, together with its Affiliates and Associates, shall be the Beneficial Owner in the aggregate of 10 percent or more of the capital stock of the corporation, and (b) any Affiliate or Associate (other than the corporation or a wholly owned subsidiary of the corporation) of any such Person. Two or more Persons acting in concert for the purpose of acquiring, holding or disposing of the capital stock of the corporation shall be deemed to be a "Related Person". A Related Person shall be deemed to have acquired a share of capital stock at the time when such Related Person became the Beneficial Owner thereof. With respect to the shares of the capital stock of the corporation owned by any Related Person, if the price paid for such shares cannot be determined by a majority of the Continuing Directors, the price so paid shall be deemed to be the market price of the shares in question at the time when such Related Person became the Beneficial Owner thereof.

10. The term "Substantial Part" shall mean 10% or more of the fair market value of the total assets of a Person, as reflected on the most recent balance sheet of such Person available to the Continuing Directors on the date of mailing of the notice of the meeting of shareholders called for the purpose of voting with respect to a Business Transaction involving the assets constituting any such Substantial Part.

B. The corporation shall not enter into any Business Transaction with a Related Person or in which a Related Person shall have an interest (except proportionately as a shareholder of the corporation) without first obtaining both (1) the affirmative vote of the holders of not less than two-thirds of the outstanding shares of the capital stock of the corporation not held by such Related Person, and (2) the determination of a majority of the Continuing Directors that the cash or fair market value of the property, securities or Other Consideration to be received per share by the holders, other than such Related Person, of the shares of each class or series of the capital stock of the corporation in such Business Transaction shall not be less than the Highest Purchase Price paid by such Related Person in acquiring any of its holdings of shares of the same class or series, unless the Continuing Directors by a majority vote shall either (a) have expressly approved the acquisition of the shares of the capital stock of the corporation that caused such Related Person to become a Related Person, or (b) have expressly approved such Business Transaction.

C. For the purposes of this Article V, a majority of the Continuing Directors shall have the power to make a good faith determination, on the basis of information known to them, of: (1) the number of shares of capital stock of the corporation of which any Person shall be the Beneficial Owner, (2) whether a Person is an Affiliate or Associate of another Person, (3) whether a Person has an agreement, contract, arrangement or understanding with another Person as to the matters referred to in subdivision V.A.3. or clause (h) of subdivision V.A.4., (4) the Highest Purchase Price paid by a Related Person for shares of any class or series of the capital stock, (5) whether the assets subject to any Business Transaction constitute a Substantial Part, (6) whether any Business Transaction is one in which a Related Person has an interest (except proportionately as a shareholder of the corporation), and (7) such other matters with respect to which a determination may be required under this Article V.

D. In determining whether to give their approval as provided in subdivision V.B., the Continuing Directors shall give due consideration to all relevant factors involved, including, without limitation, (1) the value of the corporation in a freely negotiated transaction and its future value as an independent entity, (2) the recognition of gain or loss to the corporation for tax purposes or the postponement of such recognition in a tax-free transaction, (3) the anticipated developments of the business of the corporation not yet reflected in the price of its shares, and (4) the impact on employees, customers, suppliers and the public generally within the geographical area it serves.

E. This Article V may not be repealed or amended in any respect unless such action shall be approved by the affirmative vote of the holders of not less than two-thirds of the capital stock of the corporation not held by a Related Person at a meeting of the shareholders called expressly for that purpose.

ARTICLE VI

No director of the corporation shall be personally liable to the corporation or its shareholders for monetary damages for conduct as a director; provided that this Article VI shall not eliminate the liability of a director for any act or omission for which such elimination of liability is not permitted under the Oregon Business Corporation Act. No amendment to the Oregon Business Corporation Act that further limits the acts or omissions for which elimination of liability is permitted shall affect the liability of a director for any act or omission which occurs prior to the effective date of such amendment.

ARTICLE VII

The corporation shall indemnify to the fullest extent then permitted by law any person who is made, or threatened to be made, a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative, investigative or otherwise (including an action, suit or proceeding by or in the right of the corporation) by reason of the fact that the person is or was a director or officer of the corporation or is or was serving at the request of the corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise against all judgments, amounts paid in settlement, fines and such expenses (including attorneys' fees), actually and reasonably incurred in connection therewith. This Article shall not be deemed exclusive of any other provisions for indemnification of directors and officers that may be included in any statute, bylaw, agreement, vote of shareholders or directors or otherwise, both as to action in any official capacity and as to action in another capacity while holding an office.

As amended May 31, 2006.

Exhibit B

A copy of the Company's Bylaws, as amended.

Exhibit B

BYLAWS

of

NORTHWEST

NATURAL

GAS

COMPANY

As Adopted by the Board of Directors

July 17, 1975

As Amended through July 22, 2004

CONTENTS

The following Bylaws were adopted by Northwest Natural Gas Company on July 17, 1975 superseding amended Bylaws originally adopted in conformity with an order of the District Court of the United States for the District of Oregon enforcing a plan for rearrangement of the Company's capital structure effective December 31, 1951, and subsequently amended by the stockholders on May 17, 1954, May 20, 1957, May 21, 1973, and May 20, 1974.

BYLAWS
OF
NORTHWEST NATURAL GAS COMPANY

ARTICLE I.

OFFICES

Section 1. Office. The principal office of the company shall be located in the City of Portland, Oregon. The company also may have offices at such other places both within and without the State of Oregon as the board of directors from time to time may determine.

Section 2. Registered Office. The registered office of the company required by law to be maintained in the state shall be at the same location as the principal office unless otherwise designated by resolution of the board of directors.

ARTICLE II.

MEETINGS OF SHAREHOLDERS

Section 1. Annual Meeting. The annual meeting of shareholders of the company for the election of directors and for the transaction of other business shall be held at the company's office in the City of Portland, Oregon, or such other place in that City as shall be determined by the board of directors, on the fourth Thursday of May in each year, unless such day shall be a legal holiday, in which event such meeting shall be held on the next business day. If such meeting shall not be held on such day in any year, it shall be held within 60 days thereafter on such day as shall be fixed by the board of directors and be specified in the notice of the meeting. Every such meeting shall be held at the hour of two o'clock p.m., or at such other hour as shall be fixed by the board and specified in such notice. Amended 1/1/85

Section 2. Special Meetings. Special meetings of the shareholders of the company may be called by the board of directors or the holders of not less than one-tenth of all shares entitled to vote at the meeting. Each special meeting shall be held for such purposes, at such place in the City of Portland, Oregon, and at such time as shall be specified in the notice thereof.

Section 3. Notice. Written or printed notice stating the place, day and hour of the meeting and, in case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered not less than 10 nor more than 50 days before the date of the meeting, either personally or by mail, by or at the direction of the board of directors or the persons calling the meeting, to each shareholder of record entitled to vote at such meeting.

Section 4. Fixing Record Date. For the purpose of determining shareholders entitled to notice of or to vote at any meeting of shareholders, or any adjournment thereof, or entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other proper purpose, the board of directors may fix in advance a date as the record date for any such determination of shareholders, such date in any case to be not more than 50 days and, in the case of a meeting of shareholders, not less than 10 days prior to the date on which the particular action requiring such determination of shareholders is to be taken. If no record date is fixed for the determination of shareholders entitled to notice of or to vote at a meeting of shareholders, or shareholders entitled to receive payment of a dividend, the date on which notice of the meeting is mailed or the date on which the resolution of the board declaring such dividend is adopted, as the case may be, shall be the record date for such determination of shareholders. When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment thereof.

Section 5. Record of Shareholders. The officer or agent having charge of the transfer books for shares of the company shall make, at least 10 days before each meeting of shareholders, a complete record of the shareholders entitled to vote at such meeting or any adjournment thereof, arranged in alphabetical order with the address of and the number of shares held by each, which record, for a period of 10 days prior to such meeting, shall be kept on file at the registered office of the company and shall be subject to inspection by any shareholder at any time during usual business hours. Such record also shall be produced and kept open at the time and place of the meeting and shall be subject to the inspection of any shareholder during the whole time of the meeting. The original transfer books for shares shall be prima facie evidence as to who are the shareholders entitled to examine such record or transfer books or to vote at any meeting of the shareholders.

Section 6. Quorum. A majority of the shares of the company entitled to vote, represented in person or by proxy, shall constitute a quorum at all meetings of shareholders. If a quorum is present, in person or by proxy, the affirmative vote of a majority of the shares represented at the meeting and entitled to vote on the subject matter shall be the act of the shareholders, unless the vote of a greater number, or voting by classes, is required by law or the Restated Articles of Incorporation.

If a quorum shall not be represented at any meeting of shareholders, the shareholders represented may adjourn the meeting from time to time without further notice. At such adjourned meeting, at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally noticed. The shareholders represented at a duly organized meeting may continue to transact business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum.

Amended 12/13/01

Section 7. Voting. Each outstanding share, regardless of class, shall be entitled to one vote on each matter submitted to a vote at a meeting of shareholders, except to the extent that the voting rights of the shares of any class or classes are limited or denied by law or the Restated Articles of Incorporation. At each election of directors holders of shares of common stock have the right to cumulative voting as provided for in the Restated Articles of Incorporation. A shareholder may vote either in person or by proxy. A shareholder may authorize a person or persons to act for the shareholder as proxy in any manner permitted by law. An authorization of a proxy is effective when received by the secretary of the company or other officer or agent authorized to tabulate votes.

Amended 5/23/02

Section 8. Conduct of Meetings. Every meeting of shareholders shall be presided over by the chairman of the board, in his or her absence by the president, in their absence by a vice president or, if none be present, by a chairman appointed by the shareholders present at the meeting. The minutes of such meeting shall be recorded by the secretary or an assistant secretary but, if neither be present, by a secretary appointed for that purpose by the chairman of the meeting. The board of directors may adopt by resolution such rules and regulations for the conduct of meetings of shareholders as it shall deem appropriate. Except to the extent inconsistent with such rules and regulations as adopted by the board of directors, the chairman of any meeting of shareholders shall have the exclusive right and authority to prescribe such rules, regulations and procedures and to do all such acts as, in the judgment of such chairman, are appropriate for the proper conduct of the meeting. Such rules, regulations or procedures, whether adopted by the board of directors or prescribed by the chairman of the meeting, may include, without limitation, the following: (a) the establishment of an agenda or order of business for the meeting; (b) rules and procedures for maintaining order at the meeting and the safety of those present; (c) limitations on attendance at or participation in the meeting to shareholders of record of the company, their duly authorized and constituted proxies or such other persons as the chairman of the meeting shall determine; (d) restrictions on entry to the meeting after the time fixed for the commencement thereof; and (e) limitations on the time allotted to questions or comments by participants. Unless and to the extent determined by the board of directors or the chairman of the meeting, meetings of shareholders shall not be required to be held in accordance with the rules of parliamentary procedure.

Amended 5/23/02

Section 9. Proper Business for Meetings. (a) No business shall be conducted at any meeting of shareholders that has not been properly brought before the meeting. To be properly brought before a special meeting of shareholders, business must be specified in the notice of meeting (or any supplement thereto) given by or at the direction of the board of directors or the persons calling the meeting. To be properly brought before an annual meeting of shareholders, business must be either (i) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the board of directors, (ii) otherwise brought before the meeting by or at the direction of the board of directors or

JPMorgan continues to be the top derivatives dealer

Risk AWARDS 2005

After polling over 1,600 corporate end-users worldwide, *Risk* magazine has named JPMorgan as the top corporate derivatives dealer for a second year

JPMorgan is the leading corporate derivatives dealer by a considerable margin…

The leading corporate dealers		Number of banks cited: 144	
2005	2004	Bank	% of votes
1	**1**	**JPMorgan**	**14.17**
2	2	Citigroup	10.76
3	3	Deutsche Bank	7.43
4	12	Barclays Capital	5.72
5	7	HSBC	4.77
6	17	Morgan Stanley	4.52
7	10	BNP Paribas	4.30
8	9	Bank of America	4.20
9	6	Royal Bank of Scotland	4.04
10	4	UBS	3.83

… ranking either first or second in each of the 10 "Overall" categories

- #1 Interest rate swaps overall
- #1 Forward rate agreements overall
- #1 Cross-currency swaps overall
- #1 Credit derivatives overall
- #2 Currency forwards overall
- #1 Interest rate options overall
- #1 Exotic interest rate products overall
- #1 Exotic currency swaps overall
- #2 Currency options overall
- #2 Equity derivatives overall

"… JPMorgan has its finger on the pulse of corporates' needs…"

Risk, April 2005

Northwest Natural's Risk Management Team

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EXHIBIT E

Balance Sheets of the Company at September 30, 2006, and December 31, 2005.

NORTHWEST NATURAL GAS COMPANY
PART I. FINANCIAL INFORMATION
Consolidated Balance Sheets

Thousands	Sept. 30, 2006 (Unaudited)	Sept. 30, 2005 (Unaudited)	Dec. 31, 2005
Assets:			
Plant and property:			
Utility plant	$ 1,939,673	$ 1,857,053	$ 1,875,444
Less accumulated depreciation	566,972	532,667	536,867
Utility plant – net	1,372,701	1,324,386	1,338,577
Non–utility property	41,662	39,450	40,836
Less accumulated depreciation and amortization	6,684	5,755	5,990
Non–utility property – net	34,978	33,695	34,846
Total plant and property	1,407,679	1,358,081	1,373,423
Other investments	55,695	57,939	58,451
Current assets:			
Cash and cash equivalents	5,685	3,408	7,143
Accounts receivable	31,791	30,518	84,418
Accrued unbilled revenue	19,316	16,787	81,512
Allowance for uncollectible accounts	(2,060)	(1,553)	(3,067)
Gas inventory	94,808	90,961	77,256
Materials and supplies inventory	9,723	7,855	8,905
Income taxes receivable	12,052	21,145	13,234
Prepayments and other current assets	44,125	36,106	54,309
Total current assets	215,440	205,227	323,710
Regulatory assets:			
Income tax asset	66,757	65,622	65,843
Deferred environmental costs	22,836	17,456	18,880
Deferred gas costs receivable	5,183	5,414	6,974
Unamortized costs on debt redemptions	6,564	6,987	6,881
Unrealized loss on non–trading derivatives	31,317	—	—
Other	—	4,182	—
Total regulatory assets	132,657	99,661	98,578
Other assets:			
Fair value of non–trading derivatives	11,164	346,158	178,653
Other	8,781	8,748	9,216
Total other assets	19,945	354,906	187,869
Total assets	$ 1,831,416	$ 2,075,814	$ 2,042,031

See Notes to Consolidated Financial Statements

NORTHWEST NATURAL GAS COMPANY
PART I. FINANCIAL INFORMATION
Consolidated Balance Sheets

Thousands	Sept. 30, 2006 (Unaudited)	Sept. 30, 2005 (Unaudited)	Dec. 31, 2005
Capitalization and liabilities:			
Capitalization:			
Common stock	$ 383,897	$ 87,230	$ 87,334
Premium on common stock	—	296,376	296,471
Earnings invested in the business	210,457	189,417	205,687
Unearned stock compensation	—	(703)	(650)
Accumulated other comprehensive income (loss)	(1,911)	(1,818)	(1,911)
Total common stock equity	592,443	570,502	586,931
Long-term debt	492,000	521,500	521,500
Total capitalization	1,084,443	1,092,002	1,108,431
Current liabilities:			
Notes payable	103,300	72,500	126,700
Long-term debt due within one year	29,500	8,000	8,000
Accounts payable	64,511	81,711	135,287
Taxes accrued	12,071	10,867	12,725
Interest accrued	11,454	11,493	2,918
Other current and accrued liabilities	35,065	33,928	40,935
Total current liabilities	255,901	218,499	326,565
Regulatory liabilities:			
Accrued asset removal costs	182,725	165,917	169,927
Unrealized gain on non-trading derivatives – net	—	338,667	171,777
Customer advances	2,245	1,733	1,847
Other	10,054	—	661
Total regulatory liabilities	195,024	506,317	344,212
Other liabilities:			
Deferred income taxes	221,265	213,126	222,331
Deferred investment tax credits	4,527	5,415	5,069
Fair value of non-trading derivatives	41,469	7,491	6,876
Other	28,787	32,964	28,547
Total other liabilities	296,048	258,996	262,823
Commitments and contingencies (see Note 9)	—	—	—
Total capitalization and liabilities	$ 1,831,416	$ 2,075,814	$ 2,042,031

See Notes to Consolidated Financial Statements

NORTHWEST NATURAL GAS COMPANY
PART I. FINANCIAL INFORMATION
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Financial Statements

The consolidated financial statements include the accounts of Northwest Natural Gas Company (NW Natural), a regulated utility, and its non–regulated wholly–owned subsidiary business, NNG Financial Corporation (Financial Corporation).

The information presented in the interim consolidated financial statements is unaudited, but includes all material adjustments, including normal recurring accruals, that management considers necessary for a fair statement of the results for each period reported. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our 2005 Annual Report on Form 10–K (2005 Form 10–K). A significant part of our business is of a seasonal nature; therefore, results of operations for interim periods are not necessarily indicative of the results for a full year.

Certain amounts from prior years have been reclassified to conform, for comparison purposes, to the current financial statement presentation. The current year's presentation of the Consolidated Statements of Income includes the reclassification of revenue taxes as a component of net operating revenues. Revenue taxes are expenses primarily related to the utility's franchise agreements and are based on gross operating revenues. Since revenue taxes are a direct cost of utility sales, the financial statement classification was changed to improve the presentation of net operating revenues and operating expenses. In prior years, revenue taxes were included under operating expenses as part of taxes other than income taxes. The reclassifications had no impact on the prior year's income from operations or net income.

2. New Accounting Standards

Adopted Standards

Share Based Payment. Effective Jan. 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123R, "Share Based Payment," using the Modified Prospective Application method without restatement of prior periods. Prior to implementation of SFAS No. 123R, we accounted for stock–based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123R requires companies to recognize compensation expense for all equity–based compensation awards issued to employees that are expected to vest. Under this method, we began to amortize compensation cost for the remaining portion of outstanding awards for which the requisite service was not yet rendered at Jan. 1, 2006. Compensation cost for these awards was based on the fair value of the awards at the grant date which was determined under the intrinsic value method. We determine the fair value of and account for awards that are granted, modified or settled after Jan. 1, 2006 in accordance with SFAS No. 123R. The adoption of SFAS No. 123R did not have a material impact on our financial condition, results of operations or cash flows. See Note 4 for a discussion of stock–based compensation.

Accounting for Changes and Error Corrections. Effective Jan. 1, 2006, we adopted SFAS No. 154, "Accounting for Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3," which provides guidance on the accounting for and reporting of accounting changes and error corrections. The statement requires retrospective application to prior periods' financial statements of changes in accounting principles, unless it is impracticable to determine the period–specific effects or the cumulative effect of the change. The guidance provided in APB Opinion No. 20 for reporting the correction of an error in previously issued financial statements remains unchanged and requires the restatement of previously issued financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after Dec. 15, 2005. The adoption of SFAS No. 154 did not have a material impact upon our financial condition, results of operations or cash flows.

Inventory Costs. Effective Jan. 1, 2006, we adopted SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4," which amends the guidance on inventory pricing to require that abnormal amounts of idle facility expense, freight, handling costs and wasted material be charged to current period expense rather than capitalized as inventory costs. The adoption of SFAS No. 151 did not have a material impact on our financial condition, results of operations or cash flows.

Purchases and Sales of Inventory with the Same Counterparty. In September 2005, the Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) reached a final consensus on Issue 04–13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty." EITF 04–13 requires that two or more legally separate exchange transactions with the same counterparty be combined and considered a single arrangement for purposes of applying APB Opinion No. 29, "Accounting for Nonmonetary Transactions," when the transactions are entered into in contemplation of one another. EITF 04–13 is effective for new arrangements entered into, or modifications or renewals of existing arrangements, in interim or annual periods beginning after March 15, 2006. Adoption of this standard did not have a material impact on our financial condition, results of operations or cash flows.

Variable Interest Entities. In April 2006, the FASB issued a staff position (FSP) interpreting variable interest entities (VIE) under FASB Interpretation No. (FIN) 46(R)–6, "Determining the Variability to be Considered in Applying FIN 46(R)." This FSP emphasizes that preparers should use a "by design" approach in determining whether an interest is variable. A "by design" approach includes evaluating whether an interest is variable based on a thorough understanding of the design of the potential VIE, including the nature of the risks that the potential VIE was designed to create and pass along to interest holders in the entity. Consolidation of a VIE by the primary beneficiary is required if it is determined that the VIE does not effectively disperse risks among the parties involved. FSP No. FIN 46(R)–6 must be applied prospectively to all entities with which the company first becomes involved and to all entities previously required to be analyzed under FIN 46(R) when a reconsideration event has occurred effective on or after July 1, 2006. Adoption and implementation of FSP No. FIN 46(R)–6 did not have a material impact on our financial condition, results of operations or cash flows.

Recent Accounting Pronouncements

Accounting for Certain Hybrid Instruments. In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Instruments," which amends SFAS Nos. 133 and 140. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. The statement is effective for all financial instruments acquired or issued after Jan. 1, 2007. We are in the process of evaluating the effect of the adoption and implementation of SFAS No. 155, which is not expected to have a material impact on our financial condition, results of operations or cash flows.

Accounting for Uncertainty in Income Taxes. In July 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. Preparers must determine whether it is "more–likely–than–not" that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets the more–likely–than–not recognition threshold, the position is measured to determine the amount of benefit to recognize in the financial statements. FIN 48 applies to all tax positions related to income taxes subject to SFAS No. 109, "Accounting for Income Taxes." FIN 48 is effective for fiscal years beginning after Dec. 15, 2006. We do not anticipate that the adoption of this statement will have a material effect on our financial condition, results of operations or cash flows.

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides a common definition for the measurement of fair value for use in applying generally accepted accounting principles in the United States (GAAP) and in financial statement disclosures. SFAS No. 157 is effective for fiscal years beginning after Nov. 15, 2007. We are in the process of evaluating the effect of the adoption and implementation of SFAS No. 157, which is not expected to have a material impact on our financial condition, results of operations or cash flows.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)." SFAS No. 158 requires balance sheet recognition of the overfunded or underfunded status of pension and other postretirement benefit plans. For pension plans, the liability will be based on the projected benefit obligation (PBO). Under SFAS No. 158, any actuarial gains and losses, prior service costs and transition assets or obligations that were not recognized under previous accounting standards must be recognized in accumulated other comprehensive income (AOCI) under common stock equity, net of tax, until they are amortized as a component of net periodic benefit cost. In addition, the measurement date, which is the date when plan assets and the benefit obligations are measured, is required to be the company's fiscal year end. This measurement date change will have no effect on our plan assets or benefit liabilities because we have been using our fiscal year end, December 31, as our measurement date. SFAS No. 158 is effective for us for the fiscal years ending after Dec. 15, 2006.

We are evaluating the effect of the adoption and implementation of SFAS No. 158. We intend to request regulatory deferral approval from our state commissions for deferred asset recognition of AOCI related to the funded status of certain plans under SFAS No. 71, "Accounting for Certain Types of Regulation." If regulatory asset deferral of AOCI is approved, then we will recognize the change in actuarial gains and losses, prior service costs and transition assets or obligations each year as an adjustment to the regulatory AOCI asset or liability account as these amounts are recognized as components of net periodic pension costs each year. In prior years, regulatory deferral recognition was not necessary for us because we had maintained plan assets in excess of accumulated benefit obligations (ABO) for certain plans, and under the previous accounting standards the recognition of the unfunded status was not required based on PBO. Based on our unfunded obligations as of Dec. 31, 2005, the adoption of SFAS No. 158 would increase pension and postretirement liabilities by approximately $41 million, decrease deferred income tax liabilities by approximately $31 million, reduce prepayments and other current assets related to the elimination of our $37 million prepaid pension asset and decrease total common stock equity by approximately $47 million. Alternatively, if regulatory deferral is approved, our regulatory AOCI assets would increase by $47 million and total common stock equity would decrease by a negligible amount. The adoption of SFAS No. 158 is not expected to have a material impact on our results of operations or cash flows. We also do not expect adoption of SFAS No. 158 to effect our ability to meet financial debt covenants. By the time of adoption at Dec. 31, 2006, actual plan performance and actuarial assumptions could have a material impact on the actual amounts recorded.

3. Capital Stock

In connection with the restatement of NW Natural's Restated Articles of Incorporation, effective May 31, 2006, the par value of NW Natural's common stock was eliminated. As a result, NW Natural's "common stock" and "premium on common stock" account balances are now reflected on the balance sheet as "common stock."

4. Stock–Based Compensation

Effective Jan. 1, 2006, we adopted SFAS No. 123R, "Share Based Payment," to account for all stock–based compensation plans. Our stock–based compensation plans consist of the Long–Term Incentive Plan (LTIP), the Restated Stock Option Plan (Restated SOP), the Employee Stock Purchase Plan (ESPP) and the Non–Employee Directors Stock Compensation Plan (NEDSCP). These plans are designed to promote stock ownership by employees and officers and, in the case of the NEDSCP, non–employee directors (see Part II, Item 8., Note 4, in the 2005 Form 10–K).

Long–Term Incentive Plan. A total of 500,000 shares of NW Natural's common stock has been authorized for awards under the terms of the LTIP as stock bonus, restricted stock or performance–based stock awards. At Sept. 30, 2006, performance–based awards on 99,994 shares, based on meeting target performance levels, and restricted stock awards on 11,500 shares, including 10,500 shares subject to vesting requirements, were outstanding, with the remaining 388,506 shares available for future grants.

Performance–based Stock Awards. At Sept. 30, 2006, the aggregate number of performance–based shares awarded and outstanding under our LTIP at the threshold, target and maximum levels were as follows:

Year Awarded	Performance Period	Threshold	Target	Maximum
2004	2004–06	5,130	27,000	54,000
2005	2005–07	6,333	33,332	66,664
2006	2006–08	7,536	39,662	79,324
	Total	18,999	99,994	199,988

For each of the performance periods shown above, awards will be based on total shareholder return relative to a peer group of gas distribution companies over the three–year performance period and on performance results relative to our core and non–core strategies. For awards granted prior to Jan. 1, 2006, we recognize compensation expense and liability for the LTIP awards based on performance levels achieved and expected to be achieved, and the estimated market value of the common stock as of the distribution date. For awards granted on or after Jan. 1, 2006, we recognize compensation expense in accordance with SFAS No. 123R, based on performance levels achieved and an estimated fair value using a binomial model. For the quarter and nine months ended Sept. 30, 2006, the amount accrued and expensed as compensation under the three LTIP grants was $0.6 million. On a cumulative basis, $0.9 million, $1.0 million and $0.1 million have been accrued for the 2004–06, 2005–07 and 2006–08 performance periods, respectively.

Restricted Stock Awards. Restricted stock awards also have been granted under the LTIP. A restricted stock award consisting of 5,000 shares was granted in 2004, which vests ratably over the period 2005–09. On July 26, 2006, a restricted stock award was granted consisting of 6,500 shares, which will vest ratably over the period 2007–09.

Restated Stock Option Plan. We have reserved a total of 2,400,000 shares of common stock for issuance under the Restated SOP. At Sept. 30, 2006, options on 1,134,400 shares were available for grant and options to purchase 369,600 shares were outstanding. Options are granted with an exercise price equal to the closing market price of the common stock on the day preceding the date of grant, have 10–year terms and vest ratably over a three– or four–year period following the date of grant. Shares issued under the Restated SOP upon the exercise of stock options are original issue shares. The fair value of our stock–based awards was estimated as of the date of grant using the Black–Scholes option pricing model based on the following weighted–average assumptions:

	2006	2005
Risk–free interest rate	4.5%	4.2%
Expected Life (in years)	6.2	7.0
Expected market price volatility factor	22.8%	24.6%
Expected dividend yield	4.0%	3.6%

The simplified formula for "plain vanilla" options was utilized to determine the expected life as defined and permitted by Staff Accounting Bulletin No. 107. The risk–free interest rate was based on the implied yield currently available on U.S. Treasury zero–coupon issues with a life equal to the expected life of the options. Historical data was employed in order to estimate the volatility factor, measured on a daily basis, for a period equal to the expected life of the option awards. The dividend yield was based on management's current estimate for dividend payout at the time of grant. A forfeiture rate of 3 percent was applied to the calculation of compensation expense based on historical experience.

During 2006, we implemented SFAS No. 123R and, therefore, the pro forma effect of stock–based options and ESPP is as reported. However, the following table presents the effect on net income and earnings per share of outstanding stock options and stock awards for the 2005 periods:

Pro Forma Effect of Stock–Based Options and ESPP: **Thousands, except per share amounts**	Three Months Ended Sept. 30, 2005	Nine Months
Net income (loss) as reported	$ (8,671)	$ 32,356
Deduct: Pro forma stock–based compensation expense determined under the fair value based method – net of related tax effects	(84)	(247)
Pro forma net income (loss) – basic and diluted	$ (8,755)	$ 32,109
Basic earnings (loss) per share		
As reported	$ (0.31)	$ 1.17
Pro forma	$ (0.32)	$ 1.16
Diluted earnings (loss) per share		
As reported	$ (0.31)	$ 1.17
Pro forma	$ (0.32)	$ 1.16

Summarized information for stock option grants is as follows:

	Option Shares	Price per Share: Range	Price per Share: Weighted-Average Exercise Price
Balance Outstanding at Dec. 31, 2005	308,500	$20.25–38.30	$ 29.26
Granted	97,800	34.29	34.29
Exercised	(34,300)	20.25–31.34	27.20
Expired	(2,400)	31.34–34.29	32.82
Balance Outstanding at Sept. 30, 2006	369,600	$20.25–38.30	$ 30.76
Exercisable at Dec. 31, 2005	189,500	$20.25–32.02	$ 27.63
Exercisable at Sept. 30, 2006	213,700	$20.25–38.30	$ 28.80

The weighted–average grant–date fair value of equity awards granted during 2005 and 2006 was $7.85 and $6.29, respectively. By Dec. 31, 2006, an additional 1,000 options will vest for a total of 214,700 exercisable options at year–end, assuming no additional option exercises or forfeitures.

During the three and nine months ended Sept. 30, 2006, pre–tax compensation expense amounted to $0.1 million and $0.5 million, respectively, relating to options granted under the Restated SOP. This expense was recognized in operations and maintenance expense under the fair value method in accordance with SFAS No. 123R. In addition, $0.1 million of pre–tax compensation expense related to the ESPP was recognized for the nine months ended Sept. 30, 2006. As of Sept. 30, 2006, there was $0.5 million of unrecognized compensation cost related to the unvested portion of outstanding stock option awards expected to be recognized over a period extending through 2009.

In the nine months ended Sept. 30, 2006, 34,300 option shares were exercised with a total intrinsic value of $0.3 million. Cash of $1.1 million was received for these exercises and a $0.1 million related tax benefit was realized. The total intrinsic value of options exercised in the first nine months of 2005 was $1.2 million, and the total fair value of options that vested in the first nine months of 2006 and 2005 was $0.3 million and $0.5 million, respectively.

The following table summarizes additional information about stock options outstanding and exercisable at Sept. 30, 2006:

	Outstanding		Exercisable			
Range of Exercise Prices	Stock Options	(In millions) Aggregate Intrinsic Value	Stock Options	(In millions) Aggregate Intrinsic Value	Weighted–Average Exercise Price	Weighted–Average Remaining Life in Years
$20.25 –38.30	369,600	$ 3.1	213,700	$ 2.2	$ 28.80	5.8

5. Long–Term Debt

In June 2006, we redeemed $8.0 million of secured 6.05% Series B Medium–Term Notes at maturity.

6. Use of Derivative Instruments

We enter into forward contracts and other related financial transactions for the purchase of natural gas that qualify as derivative instruments under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 and SFAS No. 149 (collectively referred to as SFAS No. 133). We primarily utilize derivative financial instruments to manage commodity prices related to natural gas supply requirements (see Part II, Item 8., Note 11, in the 2005 Form 10–K).

At Sept. 30, 2006 and 2005, unrealized gains or losses from mark–to–market valuations of our derivative instruments were primarily reported as regulatory liabilities or regulatory assets because the realized gains or losses at settlement are included in utility gas costs, pursuant to regulatory deferral mechanisms. The estimated fair values of unrealized gains and losses on derivative instruments outstanding, determined using a discounted cash flow model, were as follows:

	Sept. 30,		Dec. 31,
Thousands	**2006**	**2005**	**2005**
Fair Value Gain (Loss):			
Natural gas commodity–based derivative instruments:			
Fixed–price financial swaps	$(29,122)	$321,119	$ 173,790
Fixed–price financial call options	—	19,394	1,871
Indexed–price physical supply	(2,342)	(5,281)	(5,454)
Fixed–price physical supply	—	3,158	820
Physical supply contracts with embedded options	43	—	567
Foreign currency forward purchases	104	277	183
Total	$(31,317)	$338,667	$ 171,777

In the third quarter of 2006, we realized net losses of $12.4 million from the settlement of fixed–price financial swap contracts which were recorded as increases to the cost of gas, compared to net gain of $20.5 million in 2005. Realized losses were offset by lower gas purchase costs from the underlying hedged floating rate physical supply contracts. The foreign exchange gain or loss on foreign currency forward contracts is included in cost of gas at settlement; therefore, no gain or loss was recorded from the settlement of those contracts.

As of Sept. 30, 2006, all natural gas commodity price swap contracts mature no later than Oct. 31, 2008.

7. Segment Information

Our primary business segment, "Utility," consists of the distribution and sale of natural gas. Another segment, "Interstate Gas Storage," represents natural gas storage services provided to interstate and intrastate customers and asset optimization activities performed by an unaffiliated energy marketing company primarily through the use of commodity transactions and temporary releases of portions of NW Natural's upstream pipeline transportation capacity and gas storage capacity (see Part II, Item 8., Note 2, in the 2005 Form 10–K). The remaining segment, "Other," primarily consists of non–utility operating activities and non–regulated investments.

The following table presents information about the reportable segments. Inter-segment transactions are insignificant.

Thousands	Three Months Ended Sept. 30, Utility	Interstate Gas Storage	Other	Total	Nine Months Ended Sept. 30, Utility	Interstate Gas Storage	Other	Total
2006								
Net operating revenues	$ 38,085	$ 3,211	$ 45	$ 41,341	$ 218,476	$ 9,961	$ 115	$ 228,552
Depreciation and amortization	15,975	221	—	16,196	47,327	661	—	47,988
Income (loss) from operations	(8,634)	2,720	(176)	(6,090)	71,480	8,653	(599)	79,534
Income from financial investments	399	—	255	654	2,196	—	314	2,510
Net income (loss)	(11,408)	1,496	188	(9,724)	28,258	4,762	283	33,303
Total assets at Sept. 30, 2006	1,784,762	35,844	10,810	1,831,416	1,784,762	35,844	10,810	1,831,416
2005								
Net operating revenues	$ 38,765	$ 3,126	$ 49	$ 41,940	$ 213,377	$ 7,107	$ 91	$ 220,575
Depreciation and amortization	15,289	163	—	15,452	45,469	490	—	45,959
Income (loss) from operations	(8,196)	2,766	15	(5,415)	70,531	6,046	(20)	76,557
Income from financial investments	436	—	68	504	1,410	—	139	1,549
Net income (loss)	(10,473)	1,571	231	(8,671)	28,383	3,313	660	32,356
Total assets at Sept. 30, 2005	2,028,389	34,697	12,728	2,075,814	2,028,389	34,697	12,728	2,075,814

8. Pension and Other Postretirement Benefits

NW Natural maintains two qualified non–contributory defined benefit pension plans covering all regular employees with more than one year of service. In July 2006, the Board of Directors approved changes to the defined benefit pension plan covering non–bargaining unit employees, closing participation to any new employees hired on or after Jan. 1, 2007. For affected employees, we will provide an enhanced benefit under our existing Retirement K Savings Plan, which is a defined contribution plan under Internal Revenue Code Section 401(k).

Net Periodic Benefit Cost

The following table provides the components of net periodic benefit cost for the qualified and non–qualified pension plans and other postretirement benefit plans (see Part II, Item 8., Note 7, in the 2005 Form 10–K for a discussion of the assumptions used in measuring these costs and benefit obligations).

Thousands	Pension Benefits		Other Postretirement Benefits	
	Three Months Ended Sept. 30,			
	2006	2005	2006	2005
Service cost	$ 1,784	$ 1,564	$ 142	$ 114
Interest cost	3,761	3,377	322	308
Special termination benefits	—	63	—	—
Expected return on plan assets	(4,403)	(3,776)	—	—
Amortization of transition obligation	—	—	103	103
Amortization of prior service cost	245	361	48	—
Recognized actuarial loss	805	599	—	72
Net periodic benefit cost	$ 2,192	$ 2,188	$ 615	$ 597

Thousands	Pension Benefits		Other Postretirement Benefits	
	Nine Months Ended Sept. 30,			
	2006	2005	2006	2005
Service cost	$ 5,706	$ 4,741	$ 417	$ 342
Interest cost	11,277	9,903	888	924
Special termination benefits	—	189	—	—
Expected return on plan assets	(13,210)	(10,837)	—	—
Amortization of transition obligation	—	—	309	309
Amortization of prior service cost	735	807	146	—
Recognized actuarial loss	2,638	1,562	—	216
Net periodic benefit cost	$ 7,146	$ 6,365	$ 1,760	$ 1,791

Employer Contributions

We are not required to make cash contributions to our qualified non-contributory defined benefit plans in 2006, but cash contributions in the form of ongoing benefit payments will be required for the unfunded non-qualified supplemental pension plans and other postretirement benefit plans in 2006. See Part II, Item 8., Note 7, in the 2005 Form 10-K for a discussion of future payments.

9. Commitments and Contingencies

Environmental Matters

We own, or have previously owned, properties that may require environmental remediation or action. We accrue all material loss contingencies relating to these properties that we believe to be probable of assertion and reasonably estimable. We continue to study the extent of potential environmental liabilities, but due to the numerous uncertainties surrounding the course of environmental remediation and the preliminary nature of several environmental site investigations, the range of potential loss beyond the amounts currently accrued, and the probabilities thereof, cannot be reasonably estimated. We regularly review our remediation liability for each site where we may be exposed to remediation responsibilities. The costs of environmental remediation are difficult to estimate. A number of steps are involved in each environmental remediation effort, including site investigations, remediation, operations and maintenance, monitoring and site closure. Each of these steps may, over time, involve a number of alternative actions, each of which can change the course of the effort. In certain cases, in addition to NW Natural, there are a number of other potentially responsible parties, each of which, in proceedings and negotiations with other potentially responsible parties and regulators, may influence the course of the remediation effort and associated cost estimates. The allocation of liabilities among the potentially responsible parties is often subject to dispute and highly uncertain. The events giving rise to environmental liabilities often occurred many decades ago, which complicates the determination of allocating liabilities among potentially responsible parties. Site investigations and remediation efforts often develop slowly over many years. To the extent reasonably estimable, we estimate the costs of environmental liabilities using current technology, enacted laws and regulations, industry experience gained at similar sites and an assessment of the probable level of involvement and financial condition of other potentially responsible parties. Unless there is a more likely estimate within this range of probable cost, we record the liability at the lower end of this range. It is likely that changes in these estimates will occur throughout the remediation process for each of these sites due to uncertainty concerning our responsibility, the complexity of environmental laws and regulations, and the selection of compliance alternatives. The status of each of the sites currently under investigation is provided below. Also, see Part II, Item 8., Note 12, in the 2005 Form 10–K for a description of these properties and further discussion.

Gasco site. We own property in Multnomah County, Oregon that is the site of a former gas manufacturing plant that was closed in 1956 (the Gasco site). We have been investigating the Gasco site for environmental contamination under the Oregon Department of Environmental Quality's (ODEQ) Voluntary Clean–Up Program. In June 2003, we filed a Feasibility Scoping Plan and an Ecological and Human Health Risk Assessment with the ODEQ, which outlined a range of remedial alternatives for the most contaminated portion of the Gasco site. In the third quarter of 2006, we accrued an additional $0.3 million to be used for the upgrade of the water treatment system in conjunction with source control, replacement of a well, ongoing consultant and investigation fees for in–river groundwater and source control studies and to cover cost estimates of remedial alternatives identified in the Feasibility Scoping Plan and Ecological and Human Health Risk Assessment for the most contaminated portion of the site. The liability balance at Sept. 30, 2006 is $2.7 million, which is at the low end of the probable and reasonably estimable liability range. We are not able to estimate the high end of a liability range.

Siltronic site. We previously owned property adjacent to the Gasco site that now is the location of a manufacturing plant owned by Siltronic Corporation (the Siltronic site). We had previously agreed to an addendum to the Voluntary Clean–up Agreement with the ODEQ, which will require additional investigation of potential manufactured gas plant wastes on the Siltronic site. Since the scope of work is unknown, there is not enough information to reasonably estimate the additional liability. The additional amount accrued for this work in the third quarter of 2006 was negligible.

Portland Harbor site. In 1998, the ODEQ and the U.S. Environmental Protection Agency (EPA) completed a study of sediments in a 5.5–mile segment of the Willamette River (the Portland Harbor) that includes the area adjacent to the Gasco site and the Siltronic site. The Portland Harbor was listed by the EPA as a Superfund site in 2000 and we were notified that we are a potentially responsible party. Subsequently, the EPA approved a Programmatic Work Plan, Field Sampling Plan and Quality Assurance Project Plan for the Portland Harbor Remedial Investigation/Feasibility Study (RI/FS). In the third quarter of 2006, we accrued an additional $0.7 million to reflect our current estimate of liability of $1.9 million related to the RI/FS for consultant fees, technical work and other costs. Information is not sufficient to reasonably estimate additional liabilities, if any, or the range of potential liabilities for environmental remediation and monitoring after the RI/FS work plan is completed, except for the early action removal of a tar deposit in the river sediments discussed below.

In April 2004, we entered into an Administrative Order on Consent providing for early action removal of a deposit of tar in the Willamette River sediments adjacent to the Gasco site. The removal of the tar deposit in the Portland Harbor was completed in October 2005, and in November 2005, the EPA approved the completed project. In the third quarter of 2006, we accrued an additional $0.1 million to reflect our current estimate of liability of $0.9 million for costs related to the tar deposit, including oversight, consultant and legal fees, and ongoing monitoring. To date, $9.4 million has been spent for work related to the removal of the tar deposit.

Central Gas Storage Tanks. On Sept. 22, 2006, we received notice from the ODEQ that our Central Service Center has been assigned a high priority for further environmental investigation. Previously there were three manufactured gas storage tanks on the premises. The ODEQ believes there could be site contamination associated with releases of condensate from stored manufactured gas, or through historic gas handling practices. In the early 1990s, we excavated waste piles and much of the contaminated surface soils and removed accessible waste from some of the abandoned piping. A negligible accrual was recorded in September 2006 for the ODEQ site assessment and legal and technical costs to investigate and determine the appropriate action, if any. We intend to seek regulatory deferral of environmental costs related to this site (see "Regulatory and Insurance Recovery for Environmental Matters," below).

Oregon Steel Mills site. See "Legal Proceedings," below.

Regulatory and Insurance Recovery for Environmental Matters. In May 2003, the Oregon Public Utility Commission (OPUC) approved our request for deferral of environmental costs associated with specific sites. The authorization, which has been extended through January 2007, allows us to defer and seek recovery of unreimbursed environmental costs in a future general rate case. In April 2006, the OPUC authorized us to accrue interest on deferred balances effective Jan. 27, 2006, subject to an annual demonstration to the OPUC that we have maximized our insurance recovery or made substantial progress in securing insurance recovery for unrecovered environmental expenses. As of Sept. 30, 2006, we have paid a cumulative total of $17.1 million relating to the covered sites since the effective date of the deferral authorization.

On a cumulative basis, we have recognized a total of $27.7 million for environmental costs, including legal, investigation, monitoring and remediation costs. Of this total, $22.0 million has been spent to–date and $5.7 million is reported as an outstanding liability. During the third quarter of 2006, we increased regulatory assets by $1.1 million for additional environmental cost estimates related to sites authorized for deferral treatment, and at Sept. 30, 2006 we had a total environmental regulatory asset of $22.8 million, which includes $17.1 million of total expenditures to date and additional accruals of $5.7 million. We believe the recovery of these costs is probable through the regulatory process after first pursuing recovery of costs from insurance. We also have an insurance receivable of $1.1 million, which is not included in the regulatory asset amount. We intend to pursue recovery of these environmental costs from our general liability insurance policies, and the regulatory asset will be reduced by the amount of any corresponding insurance recoveries. We consider insurance recovery probable based on a combination of factors, including a review of the terms of our insurance policies, the financial condition of the insurance companies providing coverage, a review of successful claims filed by other utilities with similar gas manufacturing facilities and Oregon law, which allows an insured party to seek recovery of "all sums" from one insurance company. We have notified the insurance companies but have not yet filed claims for recovery, nor have the insurance companies approved or denied coverage of these claims.

Legal Proceedings

We are subject to claims and litigation arising in the ordinary course of business. Although the final outcome of any of these legal proceedings, including the matters described below and in Part II, Item 8., Note 12, in the 2005 Form 10–K, cannot be predicted with certainty, we do not expect that the ultimate disposition of these matters will have a material adverse effect on our financial condition, results of operations or cash flows.

Georgia–Pacific Corporation vs. Northwest Natural Gas Company. On Feb. 3, 2006, Georgia–Pacific Corporation filed suit against NW Natural (*Georgia–Pacific Corporation v. Northwest Natural Gas Company*, Case No. CV06–151–PK, United States District Court, District of Oregon), alleging that we offered to sell natural gas to Georgia–Pacific under the interruptible sales service provisions of Rate Schedule 32 at a commodity rate set at our Weighted Average Cost of Gas. Georgia–Pacific further alleged that it accepted this offer and that we failed to perform as promised when, in October 2005, we notified Georgia–Pacific that we would have to charge Georgia–Pacific the incremental costs of acquiring gas on the open market. Georgia–Pacific also alleged breach of contract, promissory estoppel, fraudulent misrepresentation and breach of the duty of good faith and fair dealing.

On Feb. 23, 2006, we filed a motion for summary judgment on all claims. On June 30, 2006, an order was issued by the U.S. District Court for the District of Oregon dismissing the lawsuit with prejudice and denying all pending motions, if any, as moot. On July 27, 2006, Georgia–Pacific appealed this ruling to the Ninth Circuit Court of Appeals. We do not expect the outcome of this appeal to have a material adverse effect on our financial condition, results of operations or cash flows.

Independent Backhoe Operator Action. Since May 2004, five lawsuits have been filed against NW Natural by 11 independent backhoe operators who performed backhoe services for NW Natural under contract. These five lawsuits have been consolidated into one case, *Law and Zuehlke, et. al. v. Northwest Natural Gas Co.*, CV–04–728–KI, United States District Court, District of Oregon). Plaintiffs allege violation of the Fair Labor Standards Act for failure to pay overtime and also assert state wage and hour claims. Plaintiffs claim that they should have been considered "employees," and seek overtime wages and interest in amounts to be determined, liquidated damages equal to the overtime award, civil penalties and attorneys' fees and costs. Additionally, with one exception, plaintiffs allege that the failure to classify them as employees constituted a breach of contract and a tort under and with respect to certain employee benefits plans, programs and agreements. With the one exception, plaintiffs seek an unspecified amount of damages for the value of what they would have received under these employee benefit plans if they had been classified as employees. We expect that the remaining plaintiff will amend his complaint to include breach of contract and tort claims for unspecified damages.

In October 2005, the court granted NW Natural's motion to stay plaintiffs' claims pending exhaustion of the administrative review process with regard to each of the plans under which plaintiffs allege that they would have been eligible to receive benefits. The litigation is still stayed pending plaintiffs' exhaustion of the administrative review process. There is insufficient information at this time to reasonably estimate the range of liability, if any, from these claims. We will continue to vigorously contest these claims and do not expect that the outcome of this litigation will have a material adverse effect on our financial condition, results of operations or cash flows.

Oregon Steel Mills site. In 2004, we were served with a third–party complaint by the Port of Portland (Port) in a Multnomah County Circuit Court case, *Oregon Steel Mills, Inc. v. The Port of Portland.* The Port alleges that in the 1940s and 1950s petroleum wastes generated by NW

Natural's predecessor, Portland Gas & Coke Company, and ten other third–party defendants disposed of waste oil in a disposal facility operated by the United States or Shaver Transportation Company on property then owned by the Port and now owned by Oregon Steel Mills. The Port's complaint seeks contribution for unspecified past remedial action costs incurred by the Port regarding the former waste oil disposal facility as well as a declaratory judgment allocating liability for future remedial action costs. In March 2005, motions to dismiss by NW Natural and other third–party defendants were denied on the basis that the failure of the Port to plead and prove that we were in violation of law was an affirmative defense that may be asserted at trial, but did not provide a sufficient basis for dismissal of the Port's claim. No date has been set for trial and discovery is ongoing. We do not expect that the ultimate disposition of this matter will have a material adverse effect on our financial condition, results of operations or cash flows.

Pipeline Safety Inspection. On Sept. 22, 2006, the Washington Utilities and Transportation Commission (WUTC) issued a Standard Natural Gas Pipeline Safety Inspection report on our facilities in Clark County, Washington. Based on the findings of the inspection report and regulatory action taken with other gas distribution companies, enforcement action is expected. We are in the process of taking corrective action and do not expect the impact of this action to have a material adverse effect on our financial condition, results of operations or cash flows.

10. Comprehensive Income

For the three and nine months ended Sept. 30, 2006 and 2005, reported net income was equivalent to total comprehensive income. Items that are excluded from net income and charged directly to common stock equity are included in accumulated other comprehensive income (loss), net of tax. The amount of accumulated other comprehensive loss in total common stock equity is $1.9 million at Sept. 30, 2006, which is related to our minimum pension liability (see "Consolidated Statements of Capitalization," above).

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS

Thousands (December 31)	2005	2004
Assets:		
Plant and property:		
Utility plant	$ 1,875,444	$ 1,794,972
Less accumulated depreciation	536,867	505,286
Utility plant – net	1,338,577	1,289,686
Non–utility property	40,836	33,963
Less accumulated depreciation and amortization	5,990	5,244
Non–utility property – net	34,846	28,719
Total plant and property	1,373,423	1,318,405
Other investments	58,451	60,618
Current assets:		
Cash and cash equivalents	7,143	5,248
Accounts receivable	84,418	60,634
Accrued unbilled revenue	81,512	64,401
Allowance for uncollectible accounts	(3,067)	(2,434)
Gas inventory	77,256	58,015
Materials and supplies inventory	8,905	8,462
Income taxes receivable	13,234	15,970
Prepayments and other current assets	54,309	26,821
Total current assets	323,710	237,117
Regulatory assets:		
Income tax asset	65,843	64,734
Deferred environmental costs	18,880	6,325
Deferred gas costs receivable	6,974	9,551
Unamortized costs on debt redemptions	6,881	7,332
Other	–	3,321
Total regulatory assets	98,578	91,263
Other assets:		
Fair value of non–trading derivatives	178,653	16,399
Other	9,216	8,393
Total other assets	187,869	24,792
Total assets	$ 2,042,031	$ 1,732,195

See Notes to Consolidated Financial Statements.

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS

Thousands (December 31)	2005	2004
Capitalization and liabilities:		
Capitalization:		
Common stock	$ 87,334	$ 87,231
Premium on common stock	296,471	300,034
Earnings invested in the business	205,687	183,932
Unearned stock compensation	(650)	(862)
Accumulated other comprehensive income (loss)	(1,911)	(1,818)
Total common stock equity	586,931	568,517
Long-term debt	521,500	484,027
Total capitalization	1,108,431	1,052,544
Current liabilities:		
Notes payable	126,700	102,500
Long-term debt due within one year	8,000	15,000
Accounts payable	135,287	102,478
Taxes accrued	12,725	10,242
Interest accrued	2,918	2,897
Other current and accrued liabilities	40,935	34,168
Total current liabilities	326,565	267,285
Regulatory liabilities:		
Accrued asset removal costs	169,927	153,258
Unrealized gain on non-trading derivatives, net	171,777	10,912
Customer advances	1,847	1,529
Other	661	–
Total regulatory liabilities	344,212	165,699
Other liabilities:		
Deferred income taxes	222,331	211,080
Deferred investment tax credits	5,069	5,660
Fair value of non-trading derivatives	6,876	5,487
Other	28,547	24,440
Total other liabilities	262,823	246,667
Commitments and contingencies (see Note 12)	–	–
Total capitalization and liabilities	$ 2,042,031	$ 1,732,195

See Notes to Consolidated Financial Statements.

NORTHWEST NATURAL GAS COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization and Principles of Consolidation

The consolidated financial statements include the accounts of Northwest Natural Gas Company (NW Natural), a regulated utility, and its non–regulated wholly–owned subsidiary business, NNG Financial Corporation (Financial Corporation).

Together these businesses are referred to herein as the "Company." In this report, the term "utility" is used to describe the regulated gas distribution business of the Company and the term "non–utility" is used to describe the interstate gas storage business and other non–regulated activities (see Note 2). Intercompany accounts and transactions have been eliminated.

Investments in corporate joint ventures and partnerships in which the Company's ownership interest is 50 percent or less and over which the Company does not exercise control are accounted for by the equity method or the cost method (see Note 9).

Certain amounts from prior years have been reclassified to conform, for comparison purposes, with the current financial statement presentation. The current year's presentation of the Consolidated Statements of Income includes the reclassification of revenue taxes as a component of net operating revenues. Revenue taxes are expenses primarily related to the utility's franchise agreements and are based on gross operating revenues. Since revenue taxes are a direct cost of utility sales, the financial statement classification was changed to improve the presentation of net operating revenues and operating expenses. In prior years, revenue taxes were included under operating expenses as part of other taxes. The reclassifications had no impact on prior years' income from operations or consolidated net income.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect reported amounts in the consolidated financial statements and accompanying notes. Actual amounts could differ from those estimates, and changes would be reported in future periods. Management believes that the estimates and assumptions used are reasonable.

Industry Regulation

The Company's principal business is the distribution of natural gas, which is regulated by the Public Utility Commission of Oregon (OPUC) and the Washington Utilities and Transportation Commission (WUTC). Accounting records and practices of the regulated business conform to the requirements and uniform system of accounts prescribed by these regulatory authorities in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." The utility business segment is authorized by the OPUC and the WUTC to earn a reasonable return on invested capital.

In applying SFAS No. 71, NW Natural capitalizes certain costs and revenues as regulatory assets and liabilities pursuant to orders of the OPUC or WUTC in general rate or expense deferral proceedings, to provide for recovery of revenues or expenses from, or refunds to, utility customers in future periods, including a return or a carrying charge.

At Dec. 31, 2005 and 2004, the amounts deferred as regulatory assets and liabilities were as follows:

	Dec. 31,	
Thousands	2005	2004
Deferred regulatory assets	$ 98,578	$ 91,263
Deferred regulatory liabilities	(174,285)	(12,441)
Accumulated removal costs	(169,927)	(153,258)
Net deferred assets (liabilities)	$(245,634)	$ (74,436)

NW Natural believes that continued application of SFAS No. 71 for regulated activities is appropriate and consistent with the current regulatory environment, and that all regulated assets and liabilities at Dec. 31, 2005 and 2004 are recoverable or refundable through future utility rates. NW Natural also believes that it will continue to be able to earn a reasonable rate of return or a carrying charge on regulated assets, net of regulatory liabilities. If NW Natural should determine that all or a portion of these regulatory assets or liabilities no longer meet the criteria for continued application of SFAS No. 71, then it would be required to write off the net unrecoverable balances against earnings.

New Accounting Standards

Adopted Standards

Nonmonetary Transactions. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 153, "Exchanges of Nonmonetary Assets—An Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions," which redefines the types of non–monetary exchanges that require fair value measurement. The Company is required to adopt SFAS No. 153 for nonmonetary transactions entered into after June 30, 2005. Adoption of this new standard did not have a material impact on the Company's financial condition or results of operations.

Conditional Asset Retirement Obligations. In March 2005, the FASB issued FASB Interpretation No. (FIN) 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS No. 143." FIN 47 clarifies that an entity is required to recognize a liability for a legal obligation to perform an asset retirement activity if the fair value can be reasonably estimated even though the timing and/or method of settlement are conditional on a future event. FIN 47 is required to be adopted for annual reporting periods ending after Dec. 15, 2005. The Company has evaluated all potential conditional asset retirement obligations and has concluded that the Company's only estimable conditional asset retirement obligation as defined in FIN 47 is the purging and sealing of pipe greater than 4 inches in diameter. Adoption of the new standard did not have a material impact on the Company's financial condition or results of operations.

Recent Accounting Pronouncements

Inventory Costs. In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4." SFAS No. 151 amends the guidance on inventory pricing to require that abnormal amounts of idle facility expense, freight, handling costs and wasted material be charged to current period expense rather than capitalized as inventory costs.

SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is evaluating the effect of the adoption and implementation of SFAS No. 151, which is not expected to have a material impact upon the Company's financial condition, results of operations or cash flows.

Share Based Payments. In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share Based Payments" (SFAS No. 123R), that requires companies to expense the fair value of employee stock options and similar awards. Under SFAS No. 123R, share based payment awards will be measured at fair value on the date of grant based on the estimated number of awards expected to vest. The estimated fair value will be recognized as compensation expense over the vesting period during which an employee is required to provide service in exchange for the award. The expense would be adjusted for actual forfeitures that occur before vesting, but would not be adjusted for awards that expire or terminate after vesting. The Company is evaluating different option–pricing models to determine the most appropriate measure of fair value under the new standard. Estimated fair value and compensation expense are currently calculated using the Black–Scholes option pricing model, and its corresponding impact on the financial statements is provided in Note 4 below. The Company is required to adopt SFAS No. 123R in the first quarter of 2006. SFAS No. 123R permits the use of either the modified retrospective or the modified prospective method of adoption. The Company has elected to use the modified prospective method for adopting this standard. Under this method, the Company will recognize the fair value of all share–based awards as compensation expense for all awards granted after Jan. 1, 2006 and any unvested awards previously granted and outstanding as of Jan. 1, 2006. The Company is evaluating the effect of the adoption and implementation of SFAS No. 123R, which is not expected to have a material impact on the Company's financial condition, results of operations or cash flows.

Accounting for Changes and Error Corrections. In May 2005, the FASB issued SFAS No. 154, "Accounting for Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3," which provides guidance on the accounting for and reporting of accounting changes and error corrections. The statement requires retrospective application to prior periods' financial statements of changes in accounting principles, unless it is impracticable to determine the period–specific effects or the cumulative effect of the change. The guidance provided in Accounting Principles Board (APB) Opinion No. 20 for reporting the correction of an error in previously issued financial statements remains unchanged and requires the restatement of previously issued financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after Dec. 15, 2005.

Purchases and Sales of Inventory with the Same Counterparty. In September 2005, the FASB's Emerging Issues Task Force (EITF) reached a final consensus on Issue 04–13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty." EITF 04–13 requires that two or more legally separate exchange transactions with the same counterparty be combined and considered a single arrangement for purposes of applying APB Opinion No. 29, "Accounting for Nonmonetary Transactions," when the transactions are entered into in contemplation of one another. EITF 04–13 is effective for new arrangements entered into, or modifications or renewals of existing arrangements, in interim or annual periods beginning after March 15, 2006. The Company is evaluating the effect of the adoption of EITF 04–13, which is not expected to have a material impact on the Company's financial condition, results of operations or cash flows.

Plant and Property

Plant and property is stated at cost, including labor, materials and overhead (see Note 9). The cost of constructing utility plant and interstate gas storage assets includes an allowance for funds used during construction, which represents the net cost during the period of funds used for construction purposes (see "Allowance for Funds Used During Construction," below).

NW Natural's provision for depreciation of utility property is computed under the straight–line, age–life method in accordance with independent engineering studies and as approved by regulatory authorities. The weighted average depreciation rate for utility plant in service was approximately 3.4 percent for the years ended Dec. 31, 2005 and 2004 and 3.5 percent for 2003, reflecting the approximate economic life of the property.

Effective Jan. 1, 2003, the Company adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." Among other things, SFAS No. 143 requires that future asset retirement costs (removal costs) that meet the requirements of SFAS No. 71 be classified as a regulatory liability. In accordance with long–standing industry practice, the Company accrues for future removal costs on many long–lived assets through a charge to depreciation expense allowed in rates. At the time removal costs are incurred, accumulated depreciation is charged with the costs of removal and the book cost of the asset. At Dec. 31, 2005 and 2004, the Company recognized accrued asset removal costs of $169.9 million and $153.2 million, respectively, through depreciation expense. The Company's estimate of accumulated removal costs is based on rates using our most recent depreciation study. The Company will continue to accrue future asset removal costs through depreciation expense, with a corresponding credit to regulatory liabilities—accrued asset removal costs. When the Company retires depreciable utility plant and equipment, it charges the associated original costs to accumulated depreciation and amortization, and any related removal costs incurred are charged to regulatory liabilities— accrued asset removal costs. No gain or loss is recognized upon normal retirement. In the rate setting process, the accrued asset removal costs are treated as a reduction to the net rate base.

Allowance for Funds Used During Construction

Certain additions to utility plant include an allowance for funds used during construction, which represents the cost of funds used during construction and is calculated using actual commercial paper interest rates. If commercial paper borrowings are less than the total costs of construction work in progress, then a composite rate of interest on all debt, shown as a reduction to interest charges, and a return on equity funds, shown as other income, is used to compute the allowance. While cash is not realized currently from allowance for funds used during construction, it is realized in future years through increased revenues from rate recovery resulting from higher rate base and higher depreciation expense. Our composite allowance for funds used during construction rates were 3.1 percent in 2005, 3.0 percent in 2004 and 4.5 percent in 2003.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and highly liquid temporary investments with original maturity dates of three months or less.

Revenue Recognition and Accrued Unbilled Revenues

Utility revenues, derived primarily from the sale and transportation of natural gas, are recognized when the gas is delivered to and received by the customer. Revenues include accruals for gas delivered but not yet billed to customers based on estimates of gas deliveries from meter reading dates to month end (accrued unbilled revenues). Accrued unbilled revenues are dependent upon a number of factors that require management's judgment, including total gas receipts and deliveries, customer use and weather. Accrued unbilled revenues are reversed the following month when actual billings occur. The Company's accrued unbilled revenues at Dec. 31, 2005 and 2004 were $81.5 million and $64.4 million, respectively.

Non–utility revenues, derived primarily from gas storage services, are recognized upon delivery of the service to customers. Revenues from optimization of excess storage and transportation capacity are recognized over the life of the contract for guaranteed amounts under the contract, or are recognized as they are earned for amounts above the guaranteed value based on estimates provided by the independent energy marketing company (see Note 2).

Accounts Receivable and Allowance for Uncollectible Accounts

Accounts receivable consist primarily of amounts due for gas sales and transportation services to residential, commercial and industrial customers, plus amounts due for interstate gas storage services and other miscellaneous receivables. With respect to these trade receivables and accrued unbilled revenues, the Company establishes an allowance for uncollectible accounts (allowance) based on the aging of receivables, collection experience of past due accounts on payment plans, and historical trends of write–offs as a percent of revenues. With respect to large individual customer receivables, a specific allowance is established and added to the general allowance when amounts are identified as unlikely to be recovered. Inactive accounts are written–off against the allowance after 120 days past due or when deemed to be uncollectible. Differences between our estimated allowance and actual write–offs will occur based on changes in general economic conditions, customer credit issues and the level of natural gas prices. Each quarter the allowance for the uncollectible accounts is adjusted, if necessary, based on the most current information available.

Inventories

Inventories, which consist primarily of natural gas in storage for the utility, are generally stated at the lower of average cost or net realizable value. The regulatory treatment of gas inventories provides for full cost recovery in customer rates, subject to a prudency review, including any differences between the actual purchase cost of gas injected into inventory and the embedded cost of inventory in current rates. All gas that is injected into storage is priced into inventory at the actual purchase cost based on a regulatory dispatch model for our gas purchases. All gas that is withdrawn from inventory is charged to cost of gas during the current period at the weighted average cost of inventory embedded in customer rates, which is established in our annual purchased gas adjustment filing. All inventories other than gas are stated at the lower of average cost or net realizable value.

Derivatives Policy

NW Natural's Derivatives Policy sets forth the guidelines for using selected financial derivative products to support prudent risk management strategies within designated parameters. The

Derivatives Policy allows for the use of derivatives to manage natural gas commodity prices related to natural gas purchases, foreign currency prices related to gas purchase commitments from Canada, oil or propane commodity prices related to gas sales and transportation services under rate schedules pegged to other commodities, and interest rates related to long–term debt maturing in less than five years or expected to be issued in future periods. NW Natural's objective for using derivatives is to decrease the volatility of earnings and cash flows associated with changes in commodity prices, foreign currency prices and interest rates. The use of derivatives is permitted only after the commodity price, exchange rate, and interest rate exposures have been identified, are determined to exceed acceptable tolerance levels and are considered to be unavoidable because they are necessary to support normal business activities (see Note 11). The Derivatives Policy is intended to prevent speculative risk. NW Natural does not enter into derivative instruments for trading purposes and believes that any increase in market risk created by holding derivatives should be offset by the exposures they modify.

In accounting for derivative activities, the Company applies SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," (collectively referred to as SFAS No. 133). SFAS No. 133 requires that the Company recognize derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. SFAS No. 133 also requires that changes in the fair value of a derivative be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS No. 133 provides an exception for contracts intended for normal purchases and normal sales, other than a financial instrument or derivative instrument for which physical delivery is probable. Prior to March 31, 2005, the Company's forward gas supply contracts were excluded from the fair value measurement requirement of SFAS No. 133 because these contracts were eligible for the normal purchase and normal sale exception. In 2005, NW Natural entered into a series of exchange transactions with an unaffiliated energy marketing company which resulted in a change in the Company's accounting treatment for its forward gas supply contracts under SFAS No. 133. These contracts are now accounted for as derivative instruments and marked–to–market based on fair value pursuant to SFAS No. 133.

Due to the forward gas supply contracts being classified as derivatives for accounting purposes, the corresponding derivative financial contracts originally designated as cash flow hedges no longer qualify for hedge accounting under SFAS No. 133, even though these contracts continue to hedge the financial risk exposure of the forward gas supply contracts. However, due to regulatory deferral accounting under SFAS No. 71, the change in classification had no impact on the Company's financial condition, results of operations or cash flows.

Unrealized gains and losses from mark–to–market valuations of these contracts are not recognized in current income but are reported as derivative assets or liabilities and offset by a corresponding deferred account balance included under "regulatory liabilities" or "regulatory assets." Due to their regulatory deferral treatment, effective portions of changes in the fair value of these derivatives are not recorded in other comprehensive income but are recognized as a regulatory asset or liability.

Income Taxes

NW Natural accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of items that have been included in the financial statements or tax returns. Deferred income taxes represent the future net tax effects resulting from temporary differences between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse (see Note 8).

SFAS No. 109 also requires recognition of the additional deferred income tax assets and liabilities for temporary differences where regulators prohibit deferred income tax treatment for ratemaking purposes. The Company has recorded a deferred tax liability equivalent to $65.8 million and $64.7 million at Dec. 31, 2005 and 2004, to recognize future taxes payable resulting from transactions that have previously been reflected in the financial statements for these temporary differences. Regulatory assets or liabilities corresponding to such additional deferred income tax assets or liabilities may be recorded to the extent the Company believes they will be recoverable from or payable to customers through the ratemaking process. Pursuant to SFAS No. 71, a corresponding regulatory asset has been recorded which represents the probable future revenue that will result from inclusion in rates charged to customers of taxes which will be paid in the future. The probable future revenue to be recorded takes into consideration the additional future taxes which will be generated by that revenue. Amounts applicable to income taxes due from customers primarily represent differences between the book and tax bases of net utility plant in service and actual removal costs incurred.

Investment tax credits on utility plant additions and leveraged leases, which reduce income taxes payable, are deferred for financial statement purposes and amortized over the life of the related plant or lease. Investment and energy tax credits generated by the non–regulated subsidiary are amortized over a period of one to five years.

Other Income (Expense)

Other income (expense) consists of interest income, gain on sale of investments, investment income of Financial Corporation and other miscellaneous income from merchandise sales, rents, leases and other items.

Earnings Per Share

Basic earnings per share are computed based on the weighted average number of common shares outstanding each year. Diluted earnings per share reflect the potential effects of the conversion of convertible debentures and the exercise of stock options. Diluted earnings per share are calculated as follows:

Thousands, except per share amounts	2005	2004	2003
Net income	$ 58,149	$ 50,572	$ 45,983
Redeemable preferred stock dividend requirements	–	–	294
Earnings applicable to common stock – basic	58,149	50,572	45,689
Convertible debenture interest less taxes	–	200	257
Earnings applicable to common stock – diluted	$ 58,149	$ 50,772	$ 45,946
Average common shares outstanding – basic	27,564	27,016	25,741
Stock options	57	40	28
Convertible debentures	–	227	292
Average common shares outstanding – diluted	27,621	27,283	26,061
Earnings per share of common stock – basic	$ 2.11	$ 1.87	$ 1.77
Earnings per share of common stock – diluted	$ 2.11	$ 1.86	$ 1.76

For the years ended Dec. 31, 2005, 2004 and 2003, 6,000 shares, 201,800 shares and 77,500 shares, respectively, representing the number of stock options the exercise prices for which were greater than the average market prices for the common stock for such years, were excluded from the calculation of diluted earnings per share because the effect was antidilutive.

Stock–Based Compensation

The Company periodically provides stock–based compensation to employees in the form of stock options and similar awards. As permitted by SFAS No. 123, "Share Based Payment," the Company currently applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," to account for its stock–based compensation. Accordingly, the Company does not recognize compensation expense for the fair value of its stock option grants. In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share–Based Payment," which revises SFAS No. 123, and supersedes APB Opinion No. 25. SFAS No.123R requires all share–based payments to be recognized as compensation expense in the financial statements. The Company will implement the new standard in the first quarter of 2006 by applying the modified prospective transition method. The impact on net income of this new standard had it been adopted in 2005 is reflected in the pro forma amounts in Note 4. The Company currently recognizes and will continue to recognize compensation expense for the fair value of stock awards granted under its Long–Term Incentive Plan and the Non–Employee Directors Stock Compensation Plan in the period when the shares are earned (see "New Accounting Standards—Recent Accounting Pronouncements—Share Based Payments," above, and Note 4).

2. CONSOLIDATED SUBSIDIARY OPERATIONS AND SEGMENT INFORMATION:

At Dec. 31, 2005, the Company had one active, direct wholly-owned subsidiary, Financial Corporation.

Our core business segment, local gas distribution, also referred to as the "utility," involves the distribution and sale of natural gas. Another segment, interstate gas storage, represents natural gas storage services provided to interstate customers, including asset optimization services under a contract with an independent energy marketing company. The remaining business segment, "other," primarily consists of non-regulated investments in alternative energy projects in California (see "Financial Corporation," below), a Boeing 737-300 aircraft leased to Continental Airlines and low-income housing in Portland, Oregon (see Note 9).

Interstate Gas Storage

Interstate gas storage services are provided to off-system interstate customers using Company-owned storage capacity that has been developed in advance of core utility customers' (residential, commercial and industrial firm) requirements. NW Natural retains 80 percent of the income before tax from gas storage services and credits the remaining 20 percent to a deferred regulatory account for sharing with core utility customers. For each of the years ended Dec. 31, 2005, 2004 and 2003, this business segment derived a majority of its revenues from fewer than five customers. The largest of these customers is served under a long-term contract.

Results for the interstate gas storage segment also include revenues, net of amounts shared with core utility customers, from a contract with an independent energy marketing company that optimizes the use of the Company's assets by engaging in trading activities using temporarily unused portions of its upstream pipeline transportation capacity and gas storage capacity. In Oregon, NW Natural retains 80 percent of the pre-tax income from the optimization of storage and pipeline transportation capacity when the costs of such capacity have not been included in core utility rates, and retains 33 percent of the pre-tax income from such capacity when the costs have been included in core utility rates. The remaining 20 percent and 67 percent, respectively, are credited to a deferred regulatory account for distribution to core utility customers. NW Natural has a similar sharing mechanism in Washington for revenue derived from interstate gas storage services and third party optimization services.

Financial Corporation

Financial Corporation has several financial investments, including investments as a limited partner in windpower electric generating projects and low-income housing projects. Financial Corporation's total assets were $3.3 million and $7.6 million at Dec. 31, 2005 and 2004, respectively. On Jan. 31, 2005, Financial Corporation sold limited partnership interests in three solar electric generating systems for approximately $3 million, which resulted in a $0.5 million write-down of these systems in the fourth quarter of 2004.

Segment Information Summary

The following table presents summary financial information about the reportable segments for 2005, 2004 and 2003. Inter–segment transactions are insignificant.

Thousands	Utility	Interstate Gas Storage	Other	Total
2005				
Net operating revenues	$ 315,248	$ 9,609	$ 136	$ 324,993
Depreciation and amortization	60,935	710	–	61,645
Income (loss) from operations	118,794	8,158	(5)	126,947
Income from financial investments	1,856	–	57	1,913
Net income	52,759	4,557	833	58,149
Total assets at Dec. 31, 2005	1,994,595	34,574	12,862	2,042,031
2004				
Net operating revenues	$ 284,904	$ 6,423	$ 168	$ 291,495
Depreciation and amortization	56,899	472	–	57,371
Income (loss) from operations	104,781	5,299	(54)	110,026
Income from financial investments	2,855	–	181	3,036
Net income	47,090	2,880	602	50,572
Total assets at Dec. 31, 2004	1,688,688	28,361	15,146	1,732,195
2003				
Net operating revenues	$ 264,206	$ 9,036	$ 174	$ 273,416
Depreciation and amortization	53,798	451	–	54,249
Income from operations	94,439	7,781	52	102,272
Income from financial investments	3,406	–	474	3,880
Net income	40,913	4,312	758	45,983
Total assets at Dec. 31, 2003	1,551,817	19,036	14,526	1,585,379

3. CAPITAL STOCK:

Common Stock

At Dec. 31, 2005, NW Natural had reserved 75,803 shares of common stock for issuance under the Employee Stock Purchase Plan, 867,072 shares under its Dividend Reinvestment and Direct Stock Purchase Plan, 1,538,300 shares under its Restated Stock Option Plan (see Note 4), and 3,000,000 shares under the Shareholder Rights Plan.

In April 2004, the Company issued and sold 1,290,000 shares of its common stock in an underwritten public offering and used the net proceeds of $38.5 million from the offering primarily to reduce short–term indebtedness and to fund, in part, NW Natural's utility construction program.

Expiration of Common Share Purchase Rights

In February 2006, the Company's Board of Directors decided to allow all of the common stock purchase rights ("Rights") issued under the Rights Agreement, dated as of February 27, 1996, as amended, between NW Natural and American Stock Transfer and Trust Company, to expire in accordance with their terms at the close of business on March 15, 2006.

the chairman of the board, or (iii) otherwise properly brought before the meeting by a shareholder. In addition to any other applicable requirements, for business to be properly brought before an annual meeting by a shareholder, the shareholder must have given timely notice thereof in writing to the secretary of the company. To be timely, a shareholder's notice must be delivered to the secretary at the principal executive office of the company not less than 90 days prior to the first anniversary of the previous year's annual meeting of shareholders; provided, however, that in the event that the date of the annual meeting is advanced by more than 30 days or delayed (other than as a result of adjournment) by more than 30 days from the anniversary of the previous year's annual meeting, notice by a shareholder to be timely must be delivered not later than the close of business on the later of the 90th day prior to such annual meeting or the 10th day following the day on which public announcement of the date of such meeting is first made. For purposes of this section, "public announcement" shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press or comparable national news service or in a document publicly filed by the company with the Securities and Exchange Commission; (b) A shareholder's notice to the secretary shall set forth (i) one or more matters appropriate for shareholder action that the shareholder proposes to bring before the meeting, (ii) a brief description of the matters desired to be brought before the meeting and the reasons for conducting such business at the meeting, (iii) the name and record address of the shareholder, (iv) the class and number of shares of the company that the shareholder owns or is entitled to vote and (v) any material interest of the shareholder in such matters; and (c) The chairman of the meeting shall have the power and duty (i) to determine whether any proposed business was properly brought before the meeting in accordance with the procedures set forth in this Section 9, and (ii) if the chairman determines that any proposed business was not brought before the meeting in compliance with this Section 9, to declare that such proposed business shall not be transacted.

ARTICLE III.

BOARD OF DIRECTORS

Section 1. Directors. The business and affairs of the company shall be managed by its board of directors. The number of members of the board, their classification and terms of office, and the manner of their election and removal shall be determined as provided by the Restated Articles of Incorporation. Directors need not be residents of the State of Oregon or shareholders of the company. Effective July 1, 2002, no person who has reached the age of 70 years shall be eligible to be elected a director.

Amended 5/17/84
Amended 5/23/02
Amended 12/18/03

Section 2. Chairman of the Board. The board of directors may elect one of its members as chairman of the board. The chairman of the board, if that position be filled, shall preside at all meetings of the shareholders and the board of directors and shall have such other duties and responsibilities as may be prescribed by the board of directors. If there shall be no chairman of the board, or in his or her absence or disability, the president also shall exercise the duties and responsibilities of that position.

Amended 1/1/85

Section 3. Compensation. Directors shall receive such reasonable compensation for their services as may be fixed from time to time by resolution of the board of directors, and shall be reimbursed for their expenses properly incurred in the performance of their duties as directors. No such payment shall preclude any director from serving the company in any other capacity and receiving such reasonable compensation for such services as may be fixed by resolution of the board.

Amended 5/17/84

ARTICLE IV.

MEETINGS OF THE BOARD OF DIRECTORS

Section 1. Regular Meetings. Regular meetings of the board of directors shall be held in the company's offices at two o'clock p.m., Pacific Time, on the fourth Thursday of February, April, May, July and September, and on the third Thursday of December, or on such other date or at such other hour and place as shall be specified in the notice of meeting. The date, time and place for holding regular meetings of the board of directors may be changed upon the giving of notice to all directors by or at the request of the chairman of the board or the president. The board may provide by resolution the time and place either within or without the State of Oregon for holding of meetings or may omit the holding of any meeting without other notice than such resolution.

Amended 5/26/88
Amended 5/23/91
Amended 12/16/93
Amended 7/25/96
Amended 5/28/98

Amended 1/1/85
Amended 2/24/95
Amended 5/23/02

Section 2. Special Meetings. Special meetings of the board of directors may be called by or at the request of the chairman of the board, the chairman of the governance committee, the president or any two directors. The person or persons authorized to call special meetings of the board may fix any place, either within or without the State of Oregon, as the place for holding any special meeting of the board called by them. Notice of the time and place of special meetings shall be given to each director at least one day in advance by the secretary or other officer performing his or her duties.

Section 3. Waiver of Notice. Any director may waive notice of any meeting. The attendance of a director at any meeting shall constitute a waiver of notice of such meeting, except where a director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened. Except as otherwise provided by law or the Restated Articles of Incorporation, neither the business to be transacted at, nor the purpose of, any regular or special meeting of the board of directors need be specified in the notice or waiver of notice of such meeting.

Amended 5/17/84

Section 4. Quorum. A majority of the number of directors at any time fixed by resolution adopted by the affirmative vote of a majority of the entire board of directors shall constitute a quorum for the transaction of business. If a quorum shall not be present at any meeting of directors, the directors present may adjourn the meeting from time to time without further notice until a quorum shall be present.

Section 5. Manner of Acting. Except as otherwise provided by law or the Restated Articles of Incorporation, the act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors.

Section 6. Action Without a Meeting. Any action required or permitted to be taken at a meeting of the board of directors may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the directors entitled to vote with respect to the subject matter thereof.

ARTICLE V.

COMMITTEES OF THE BOARD

Amended 5/17/84
Amended 1/1/85
Amended 11/21/91
Amended 2/24/95
Amended 5/23/96
Amended 5/23/02

Section 1. Governance Committee. The board of directors at any time, by resolution adopted by a majority of the board of directors, may appoint a governance committee composed of three or more independent directors. The board shall designate one member of the committee as chairman. The committee shall have and may exercise all of the authority of the board of directors in the management of the company, except with respect to matters upon which by law only the board of directors may act. The committee's responsibilities shall include serving as the nominating committee of the board; making recommendations to the board on board and board committee composition and structure, including recommendations with respect to committee and committee chairmanship assignments; and conducting periodic board self-assessments, peer reviews of individual directors and evaluations of committee effectiveness. The committee shall also perform such other functions as the board by resolution from time to time may direct.

Amended 2/24/95
Amended 5/23/02

Section 2. Audit Committee. The board of directors at any time, by resolution adopted by a majority of the board of directors, may appoint an audit committee composed of three or more independent directors. The board shall designate one member of the committee as chairman. The duties of the committee shall be to discuss and review with the company's independent auditors the annual audit of the company, including the scope of the audit, and report the results of this review to the board; to meet with the independent auditors at such other times as the committee shall deem to be advisable; and to perform such other functions as the board by resolution from time to time may direct.

Amended 2/22/90
Amended 2/24/95
Amended 5/23/02

Section 3. Organization and Executive Compensation Committee. The board of directors at any time, by resolution adopted by a majority of the board of directors, may appoint an organization and executive compensation committee composed of three or more independent directors. The board shall designate one member of the committee as chairman. The duties of the committee shall be to discuss and review the management of the affairs of the company relating to its organization and to executive personnel and their compensation, and to perform such other functions as the board by resolution from time to time may direct.

Section 4. Strategic Planning Committee. The board of directors at any time, by resolution adopted by a majority of the board of directors, may appoint from among its members a strategic planning committee composed of three or more directors, a majority of whom shall not be officers or retired officers of the company. The board shall designate one member of the committee who is not an officer or retired officer of the company as chairman. The duties of the committee shall be to review and make recommendations to the board with respect to the company's long-term strategic goals, objectives and plans. The committee shall also perform such other functions as the board by resolution from time to time may direct. Amended 7/24/03 Amended 9/25/03

Section 5. Finance Committee. The board of directors at any time, by resolution adopted by a majority of the board of directors, may appoint a finance committee composed of three or more directors, a majority of whom shall not be officers or retired officers of the company. The board shall designate one member of the committee who is not an officer or retired officer of the company as chairman. The duties of the committee shall be to discuss and review the management of the affairs of the company relating to financing, including the development of financial planning goals and financial policy, and to perform such other functions as the board by resolution from time to time may direct. Amended 2/24/95 Amended 2/25/99 Amended 9/25/03

Section 6. Public Affairs and Environmental Policy Committee. The board of directors at any time, by resolution adopted by a majority of the board of directors, may appoint from among its members a public affairs and environmental policy committee composed of three or more directors, a majority of whom shall not be officers or retired officers of the company. The board shall designate one member of the committee who is not an officer or retired officer of the company as chairman. The duties of the committee shall be (i) to consider, review and monitor significant matters of public interest and societal trends, and the company's community affairs, charitable contributions, diversity and equal employment opportunity compliance programs, and (ii) to monitor significant environmental issues affecting the company and to recommend to the board appropriate environmental policies. The committee shall also perform such other functions as the board by resolution from time to time may direct. Amended 5/22/03 Amended 9/25/03

Section 7. Other Committees. The board of directors at any time, by resolution adopted by a majority of the board of directors, may appoint from among its members such other committees and the chairmen thereof as it may deem to be advisable. Each such committee shall have such powers and authority as are set forth in the resolutions pertaining thereto from time to time adopted by the board. Amended 2/24/95

Section 8. Changes of Size and Function. Subject to the provisions of law, the board of directors shall have the power at any time to increase or decrease the number of members of any committee, to fill vacancies thereon, to change any members thereof and to change the functions and terminate the existence thereof.

Section 9. Conduct of Meetings. Each committee shall conduct its meetings in accordance with the applicable provisions of these bylaws relating to the conduct of meetings of the board of directors. Each committee shall adopt such further rules and regulations regarding its conduct, keep such minutes and other records and appoint such subcommittees and assistants as it shall deem to be appropriate.

Section 10. Compensation. Persons serving on any committee shall receive such reasonable compensation for their services on such committee as may be fixed by resolution of the board of directors, provided that no person shall receive compensation for his or her services on any committee while serving as an officer of the company.

ARTICLE VI.

NOTICES

Section 1. Form and Manner. Whenever, under the provisions of law or the Restated Articles of Incorporation, notice is required to be given to any director or shareholder, unless otherwise specified, it shall be given in writing by mail addressed to such director or shareholder at his or her address as it appears on the stock transfer books or other records of the company, with postage thereon prepaid, and such notice shall be deemed to be delivered when deposited in the United States Mail. Notice to directors also may be given by telephone or in any other manner which is reasonably calculated to give adequate notice.

Section 2. Waiver. Whenever any notice whatever is required to be given under the provisions of law, the Restated Articles of Incorporation or these bylaws, a waiver thereof in writing signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of such notice.

ARTICLE VII.

OFFICERS

Amended 1/1/85

Section 1. Election. The board of directors, at its first meeting following the annual meeting of shareholders each year, shall elect one of its members as president and shall elect a secretary. At such meeting, or at any other time it shall deem appropriate, the board may elect one or more vice presidents and a treasurer. The board also may elect or appoint such other officers and agents as it may deem necessary. Any two or more offices may be held by the same person, except the offices of president and secretary.

Section 2. Compensation. The officers of the company shall receive such reasonable compensation for their services as from time to time may be fixed by resolution of the board of directors.

Amended 5/17/84

Section 3. Term. The term of office of all officers shall commence upon their election or appointment and shall continue until the first meeting of the board of directors following the annual meeting of shareholders and thereafter until their successors shall be elected or until their resignation or removal. A vacancy occurring in any office of the company for whatever reason may be filled by the board.

Section 4. Removal. Any officer or agent elected or appointed by the board of directors may be removed by the board whenever in its judgment the best interests of the company will be served thereby but such removal shall be without prejudice to the contract rights, if any, of the officer or agent so removed.

Amended 10/18/84
Amended 3/1/96

Section 5. President. Unless otherwise determined by the board of directors, the president shall be the chief executive officer of the company and, subject to the control of the board of directors, shall be responsible for the general administration and operation of the company. He shall have such other duties and responsibilities as may pertain to such office or be prescribed by the board of directors. In the absence or disability of the president, an officer designated by the board shall exercise the duties and responsibilities of the president.

Section 6. Vice Presidents. Each vice president shall have such duties and responsibilities as may be prescribed by the board of directors and the president. The board or the president may confer a special title upon a vice president.

Section 7. Secretary. The secretary shall record and keep the minutes of the shareholders in one or more books provided for that purpose; see that all notices are duly given in accordance with the provisions of these bylaws or as required by law; and perform such other duties as may be prescribed by the board or the president. The secretary shall have custody of the corporate seal of the company and shall affix the seal to any instrument requiring it and attest the same by his or her signature.

The assistant secretaries shall have such duties as may be prescribed from time to time by the board, the president or the secretary. In the absence or disability of the secretary, his or her duties shall be performed by an assistant secretary.

Amended 1/1/85

Section 8. Treasurer. The treasurer shall have charge and custody and be responsible for all funds and securities of the company; deposit all moneys and other valuable effects in the name and to the credit of the company in such depositories as may be designated by the board of directors; and disburse the funds of the company as may be authorized by the board and take proper vouchers for such disbursements. The treasurer shall have such other duties as may be prescribed from time to time by the board or the president. In the absence or disability of the treasurer, his or her duties shall be performed by an assistant treasurer.

ARTICLE VIII.

CONTRACTS, LOANS, CHECKS AND DEPOSITS

Section 1. Contracts. The board of directors by resolution may authorize any officer or officers, agent or agents, to enter into any contract or execute and deliver any instrument in the name of and on behalf of the company, and such authority may be general or confined to specific instances.

Section 2. Loans. No loans shall be contracted on behalf of the company and no evidences of indebtedness shall be issued in its name unless authorized by a resolution of the board of directors. Such authority may be general or confined to specific instances.

Section 3. Checks and Drafts. All checks, drafts or other orders for the payment of money, notes or other evidences of indebtedness issued in the name of the company shall be signed by such officer or officers, agent or agents of the company and in such manner as shall from time to time be determined by resolution of the board of directors.

Section 4. Deposits. All funds of the company not otherwise employed shall be deposited from time to time to the credit of the company in such banks, trust companies or other depositories as the board of directors or officers of the company designated by the board may select, or be invested as authorized by the board.

ARTICLE IX.

CERTIFICATES FOR SHARES AND THEIR TRANSFER

Section 1. Certificates for Shares. The shares of the company shall be represented by certificates; provided, however, the board of directors may provide by resolution or resolutions that some or all of any or all classes or series of the company's shares shall be uncertificated shares. When shares are not represented by certificates then within a reasonable time after the issuance or transfer of such shares, the company shall send or cause to be sent to the shareholder to whom such shares have been issued or transferred a written statement of the information required by the laws of the State of Oregon to be on certificates. Amended 1/1/93 Amended 7/22/04

Certificates representing shares of the company shall be issued only for whole numbers of shares and shall be in such form as the board of directors may, from time to time, prescribe in accordance with the laws of the State of Oregon. Such certificates shall be signed by the president or a vice president and by the secretary or an assistant secretary and sealed with the corporate seal or a facsimile thereof. The signatures of such officers upon a certificate may be facsimiles thereof. In case of a lost, destroyed or mutilated certificate a new one may be issued therefor upon such terms and indemnity to the company as the board may authorize.

Section 2. Transfer. Shares of stock of the company shall be transferable on the books of the company by the holder of record thereof, or by his or her legal representative who shall furnish proper evidence of authority to transfer, or by his or her attorney thereunto authorized by duly executed power of attorney, and on surrender for cancellation of the certificates, if any, for such shares. The board of directors may appoint one or more transfer agents and registrars of stock of the company. Amended 7/22/04

Section 3. Owner of Record. The company shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends and to vote as such owner and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by law.

ARTICLE X.

INDEMNIFICATION AND INSURANCE

Section 1. Indemnification. The company shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she is or was a director, officer, employee or agent of the company, or is or was serving at the request of the company as a director, officer, employee, agent or fiduciary of another corporation, partnership, joint venture, trust or other enterprise or any employee benefit plan, against expenses (including attorney's fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him or her in connection with the defense or settlement of such action, suit or proceeding to the fullest extent permissible under the Oregon Business Corporation Act or the indemnification provisions of any successor Act. The foregoing rights of indemnification shall not be exclusive of any other rights to which any such person so indemnified may be entitled, under any agreement, vote of shareholders or disinterested directors or otherwise, both as to action in his or her official capacity and as to action in another capacity while holding such office; shall continue as to a person who has ceased to be a director, officer, employee or agent; and shall inure to the benefit of the heirs, executors and administrators of such a person.

Section 2. Insurance. The company may purchase and maintain insurance (and pay the entire premium therefor) on behalf of any person who is or was a director, officer, employee or agent of the company, or is or was serving at the request of the company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him or her and incurred by him or her in any such capacity or arising out of his or her status as such, whether or not the company would have the power to indemnify him or her against such liability under the provisions of the Oregon Business Corporation Act or any successor Act; and on behalf of any person who is or was a fiduciary under the Employee Retirement Income Security Act of 1974 with regard to an employee benefit plan of the company against any liability asserted against him or her and incurred by him or her in his or her fiduciary capacity.

ARTICLE XI.

SEAL

The corporate seal of the company shall be circular in form and shall bear an inscription containing the name of the company, the year of its organization, the state of its incorporation and the words "Corporate Seal."

ARTICLE XII.

AMENDMENTS

These bylaws, or any of them, may be altered, amended or repealed, or new bylaws adopted, by resolution of a majority of the board of directors, subject to repeal or change by action of the shareholders.

CERTIFICATE

I, C. J. Rue, Secretary of Northwest Natural Gas Company, a corporation organized and existing under the laws of the State of Oregon, HEREBY CERTIFY that the foregoing eight printed pages entitled "Bylaws of Northwest Natural Gas Company" constitute a full and true copy of the Bylaws of said corporation as of the date hereof.

WITNESS my hand and seal of said corporation this ____ day of ________________________________.

C. J. Rue
Secretary

EXHIBIT C

A certified copy of resolutions from the Board of Directors meeting held on April 27, 2006, relating to the proposed use of interest rate hedge transactions.

Executive Offices

NW Natural®

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800.422.4012
www.nwnatural.com

CERTIFIED COPY OF RESOLUTIONS

I, Richelle T. Luther, the duly elected and acting assistant secretary of Northwest Natural Gas Company, a corporation organized and existing under the laws of the State of Oregon, HEREBY CERTIFY that the following is a true and complete copy of resolutions adopted by the Board of Directors of said Corporation at a meeting thereof duly convened and held on the 27th day of April 2006, relating to authorizing applications for the regulatory approval of an interest rate hedging strategy; and that said resolutions are in full force and effect as of the date of this certificate, namely:

> WHEREAS, Northwest Natural Gas Company (the "Company") finds it to be desirable and in its best interests, based on a need to manage interest costs and financing risks, to negotiate and enter into interest rate hedging transactions from time to time for the purpose of fixing long-term debt rates for anticipated future debt issues over the next six to 18 months, and swapping from fixed-to-floating rates for debt issues maturing in three to five years ("Interest Rate Hedging Strategy"); and
>
> WHEREAS, implementation of an Interest Rate Hedging Strategy requires regulatory approval by the Public Utility Commission of Oregon ("OPUC") and the Washington Utilities and Transportation Commission ("WUTC");
>
> NOW THEREFORE BE IT RESOLVED, that the officers of the Company are authorized and directed, in its name and behalf, to prepare, execute and file with the OPUC and the WUTC appropriate applications, together with any and all necessary amendments, exhibits and other documents related thereto, for orders authorizing and approving the Company's Interest Rate Hedging Strategy; and further
>
> RESOLVED, that the officers of the Company are authorized and directed, in the Company's name and behalf, to execute and deliver such instruments and documents and to do or cause to be done any and all such acts and things as they may deem to be necessary or desirable in order to carry out the purposes of the foregoing resolutions with respect to the Company's Interest Rate Hedging Strategy.

WITNESS my hand and the seal of Northwest Natural Gas Company this 29th day of November 2006.

Richelle Luther
Assistant Secretary

(S E A L)

EXHIBIT D

Extract of presentation by JPMorgan defining and illustrating the use of interest rate swap and other interest rate hedge transactions.

SEPTEMBER 2006

NW Natural
We grew up here.

RISK MANAGEMENT DISCUSSION

JPMorgan

This presentation was prepared exclusively for the benefit and internal use of the JPMorgan client to whom it is directly addressed and delivered (including such client's subsidiaries, the "Company") in order to assist the Company in evaluating, on a preliminary basis, the feasibility of a possible transaction or transactions and does not carry any right of publication or disclosure, in whole or in part, to any other party. This presentation is for discussion purposes only and is incomplete without reference to, and should be viewed solely in conjunction with, the oral briefing provided by JPMorgan. Neither this presentation nor any of its contents may be disclosed or used for any other purpose without the prior written consent of JPMorgan.

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Notwithstanding anything herein to the contrary, the Company and each of its employees, representatives or other agents may disclose to any and all persons, without limitation of any kind, the U.S. federal and state income tax treatment and the U.S. federal and state income tax structure of the transactions contemplated hereby and all materials of any kind (including opinions or other tax analyses) that are provided to the Company relating to such tax treatment and tax structure insofar as such treatment and/or structure relates to a U.S. federal or state income tax strategy provided to the Company by JPMorgan.

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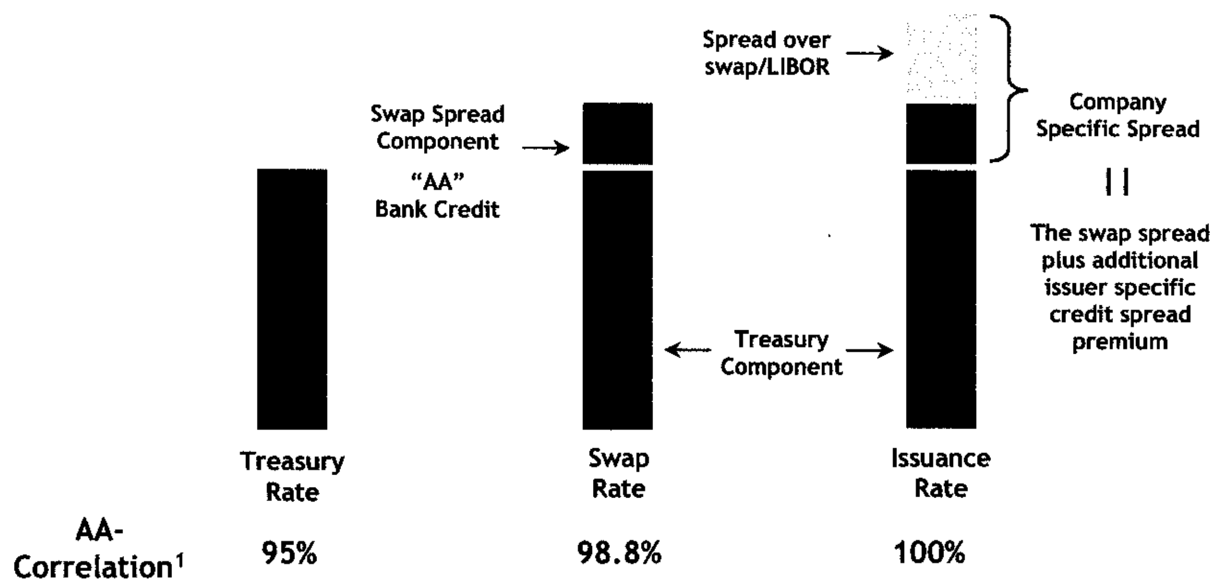
This presentation does not constitute a commitment by any JPMorgan entity to underwrite, subscribe for or place any securities or to extend or arrange credit or to provide any other services.

Agenda

Northwest Natural can choose between two types of issuance hedges: Treasury locks or forward-starting swaps

Corporate debt pricing is a function of Treasury yields, swap spreads and issuer-specific credit profile



- **Treasury rate**
  - The "risk-free" rate
- **Swap rate**
  - The "risk-free" rate plus the swap spread
  - Swap spread equals credit spread for generic "AA" bank
- **Corporate issuance rate**
  - The "risk-free" rate plus the company specific credit spread

Over 10 years, AA- issuance rates have demonstrated slightly better correlation with swap rates than with U.S. Treasury rates

- A **Treasury lock** fixes a forward yield on the underlying Treasury corresponding to a debt offering
- A **forward-starting swap** locks a forward rate for a pay-fixed swap with start date and tenor corresponding to the future debt offering
  - Forward-starting swap allows Northwest Natural to lock in the Treasury yield plus a portion of its credit spread
  - Swap rates are 98.8% correlated with AA- issuance rates versus 95% for Treasury yields[1]
- Typically, both T-locks and forward-starting swaps are cash-settled upon issuance

1 Correlation of weekly 10-year issuance rates for AA- industrials with 10-year UST and 10-year swap rates based on 10 years of historical data.

T-locks and Forward-Starting Swaps are simple and effective tools for hedging the coupon on a future debt issuance

Treasury Lock Overview

- T-lock effectively fixes the underlying benchmark rate for an anticipated bond issuance today:
  - We assume on Northwest Natural will issue a 10-year bullet
  - Therefore, Northwest Natural's coupon will equal the yield on the then-current 10-year UST note plus the Company's specific credit spread
- On the issuance date, if the market yield on the referenced UST exceeds (is less than) Northwest Natural's T-lock rate, Northwest Natural will receive (pay) the net present value of the rate differential
  - Hedge results will be amortized to interest expense over the life of the hedged item[1]

Forward-Starting Swap Overview

- Forward-starting swap locks a forward rate for a pay-fixed swap with start date and tenor corresponding to the future debt offering
- Forward-starting swap allows Northwest Natural to lock in the Treasury yield plus a portion of its credit spread
  - Credit spread component equals the swap spread (i.e., credit spread for generic "AA" bank)
- On the issuance date, if the then-prevailing swap rate exceeds (is less than) Northwest Natural's locked rate, Northwest Natural will receive (pay) the net present value of the rate differential
  - Hedge results will be amortized to interest expense over the life of the hedged item[1]

T-Lock Hedge Settlement on Pricing Date (Example then-current 10Y UST is locked until September 30, 2007)[1]

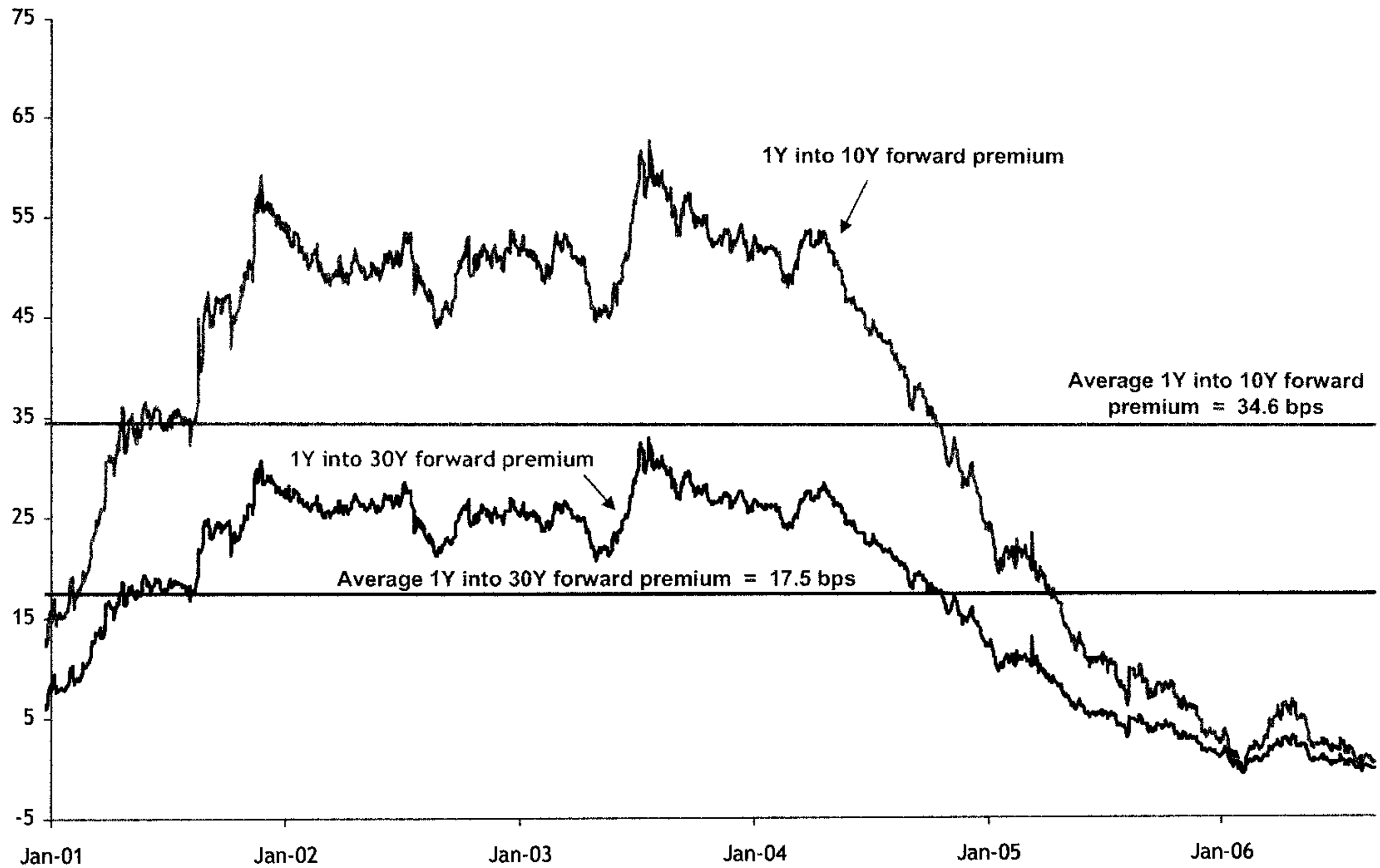
T-Lock Hedge Settlement		Bond Issuance		Effective Coupon (after hedge)	
10Y Hedge Rate (from 09/19/06)	4.745%	10Y UST Yield (on 9/30/07) [a]	5.25%	10Y Hedge Rate (from 09/19/06)	4.745%
10Y UST Yield (on 9/30/07) [a]	5.245%	Credit Spread [b]	0.60%	Credit Spread [b]	0.60%
Net Gain	0.50%	Bond Yield	5.85%	Effective Coupon	5.35%

a Hypothetical 10-year UST yield rate as of 9/30/07. In this example, Northwest Natural would amortize the gain of 50 basis points over the life of the issuance.
b Hypothetical credit spread over UST as of 9/30/07.

1 *JPMorgan does not offer accounting advice. Northwest Natural should confirm all accounting implications with its auditors before executing any trades.*

Longer-term rate locks are extremely cheap relative their historic average cost

Rate lock hedge cost is at its cheapest level in over 5 years



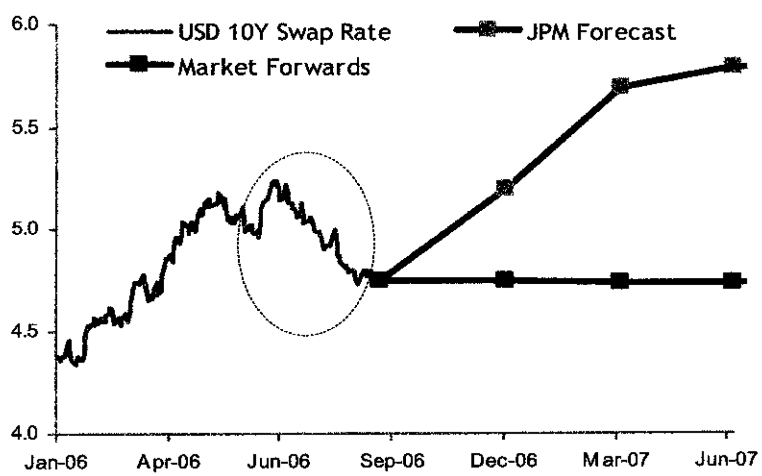
Recent rate declines combined with extremely low hedge cost make this an excellent time to hedge future debt issuance

Indicative Pricing for Issuance Hedging

	Treasury Lock		Forward-Starting Swap	
Hedge Benchmark	Then-Current 10Y UST	Then-Current 10Y UST	10-Year Swap	30-Year Swap
Spot Rate	4.73%	4.85%	5.28%	5.39%
Locked Until	30-Sep-07	30-Sep-07	30-Sep-07	30-Sep-07
Forward Premium	1.5 bps	1.5 bps	1.0 bps	1.0 bps
Locked Rate	4.745%	4.745%	5.290%	5.400%

- Longer-dated T-locks tend to be more expensive than swap locks due to uncertainty about the level of the actual coupon on the then-current UST against which the hedge will settle
  - Coupon uncertainty means uncertainty about the value of one basis point (DV01), which, in turn, forces traders to charge a risk premium for longer-dated T-locks

10Y UST rate has declined about 60 bps from late June highs



JPMorgan USD Interest Rate Forecast

	Current Sep-19-06	2006 Q4 Dec-31	2007 Q1 Mar-31	2007 Q2 Jun-30	2007 Q3 Sep-30
Fed Funds Target	5.25	5.25	5.50	6.00	6.00
3-month LIBOR	5.39	5.45	5.70	6.15	6.15
2-year T-note	4.80	4.95	5.15	5.65	5.70
5-year T-note	4.69	4.90	5.10	5.60	5.65
10-year T-note	4.73	5.00	5.20	5.65	5.70
30-year T-note	4.85	5.05	5.25	5.65	5.7

Accounting for Treasury Locks and Forward Starting Swaps[1]

Sample Documentation: Treasury/Swap lock hedges the variability of the 20 future semi-annual interest payments attributable to changes in benchmark interest rates (Treasury or LIBOR rates) related to Northwest Natural's probable debt issuance upcoming in December 2007

- Under FAS 133/138, Treasury rates and swap rates (LIBOR) are defined as "benchmark" rates for hedging corporate bond issuance
- Both Treasury locks and forward-starting swaps qualify as Cash Flow Hedges under paragraph 28 of FAS133
  - The Treasury lock hedges Treasury rate risk and the forward-starting swap hedges the LIBOR risk associated with an upcoming bond issuance
  - I.e., the hedge eliminates the benchmark variability in future semi-annual interest payments (Northwest Natural's coupons) that are expected to commence in September 2007 and occur over the next 10 and/or 30 years
- Under a Cash Flow Hedge, the the effective portion of the change in hedge value is posted to the Balance Sheet (OCI Account)
  - Hedge results are released/recognized in earnings over time when the forecasted transaction occurs
    - Following unwind of the rate lock, the gain or loss is amortized from OCI to earnings over the life of the issuance
  - If the critical terms of the hedge (notional amount, maturity date, etc.) match those of the forecasted debt issuance, then the hedge will qualify for "matched term method" (i.e., no ineffectiveness)
- Northwest Natural has up to a 60 day grace period to roll the hedges if the expected bond issuance date is delayed
  - Ineffectiveness could arise (P/L volatility could occur) if the issuance is delayed
  - Likewise, ineffectiveness could arise if Northwest Natural unwinds its rate locks early

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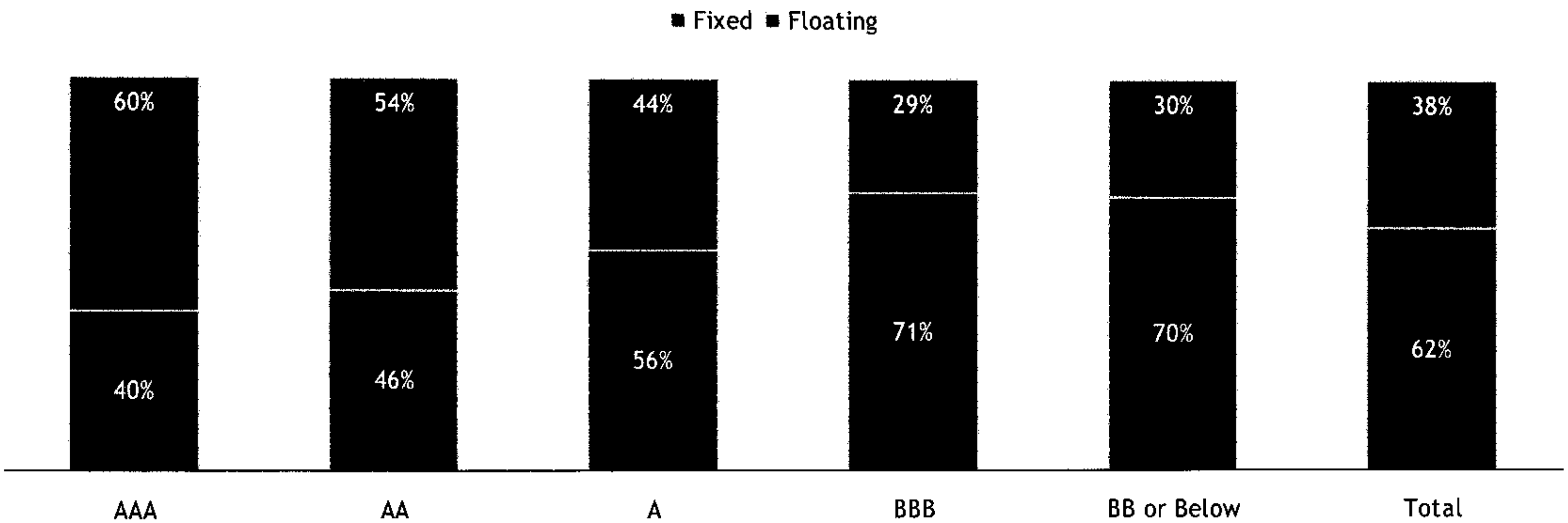
Agenda

On average across the S&P 500, companies hold 38% of their debt in floating-rate liabilities

Fixed-floating debt mix by ratings category (including swaps)[1]

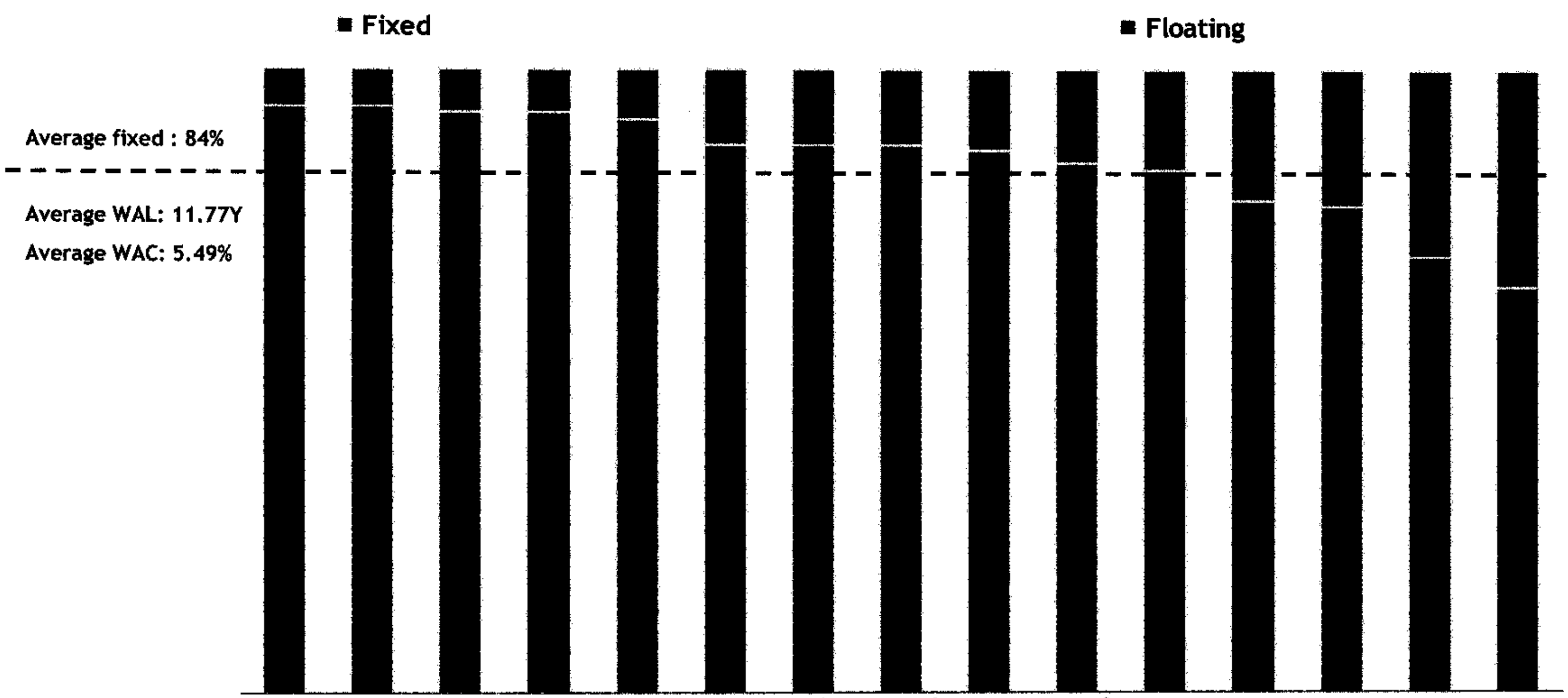


- On average, floating-rate debt comprises about 38% of total debt for the S&P 500
- In general, better rated companies are more likely to have higher floating-rate debt components

1 Data gathered from a sampling of 178 S&P 500 companies excluding financial institutions as of July 21, 2005.

In the power sector, fixed debt components tend to be higher due to long-lived fixed assets and legislated cost pass-through

Net fixed/floating mix (including debt, cash & swaps) for a variety of companies in the power sector[1]



	ED	AEP[2]	ETR	DTE[2]	EXC	PGN	D[2]	PSEG[2]	SO	PPL[2]	CIN	FPL	AEE	FE	TXU
WAL (yrs)	16.23	12.29	12.97	13.51	10.39	10.35	10.01	8.61	16.02	6.54	10.43	11.21	14.51	11.50	11.94
WAC (ex-swaps)	5.49%	5.23%	5.81%	5.74%	5.25%	6.04%	5.50%	5.92%	4.66%	5.44%	4.88%	5.33%	5.89%	5.80%	5.30%

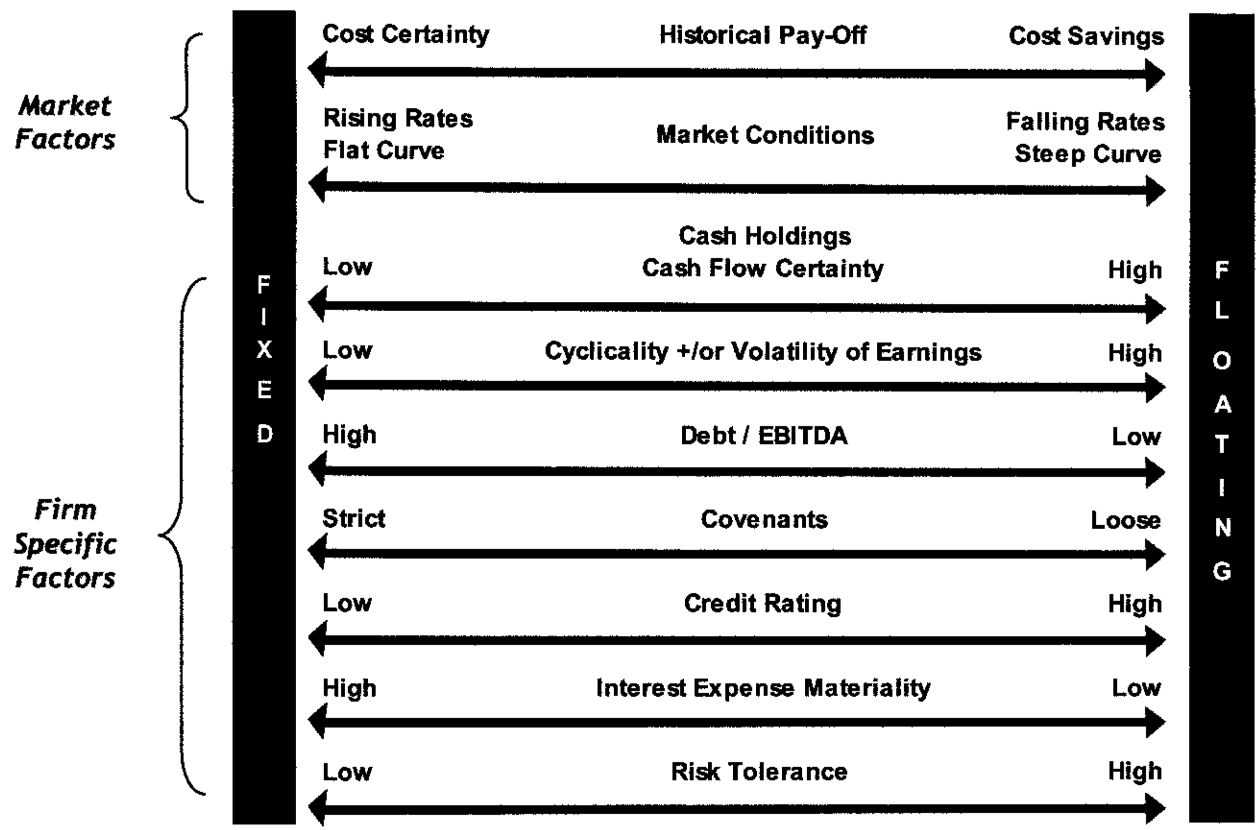
Source: Bloomberg and company filings

1 *Fixed/floating mix as of November 2005 based on most recent SEC filings*

2 *In this case, fixed/floating calculation excludes swaps, as company does not disclose interest rate swap details*

3 WAL = weighted average life. WAC = weighted average coupon

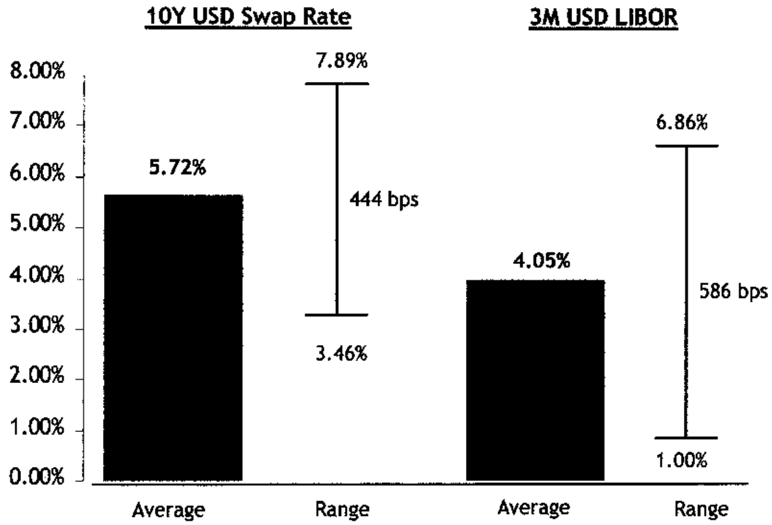
Market factors and firm specific factors drive decisions concerning a company's fixed-floating mix



- Historically, floating rate debt has resulted in lower total interest cost
- However, fixed rate debt provides interest cost certainty
- Companies must balance the benefits of lower-cost floating rates against firm-specific considerations
  - Cash holdings, earnings cyclicality, leverage, covenants, credit rating, interest expense materiality, and risk tolerance

Decision on fixed-floating mix is often characterized as a trade-off between interest cost and interest expense volatility

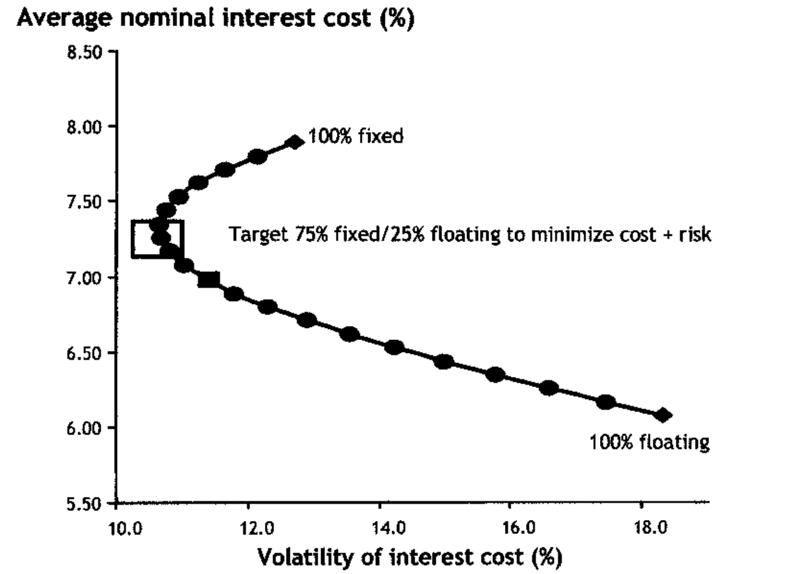
USD floating rates have been cheaper but more volatile



Source: Bloomberg (1996 - present)

- Historically, USD floating rates have averaged 167 basis points lower than USD fixed rates
  - In the typical upward-sloping yield curve environment, floating rates are lower in absolute terms than fixed rates
- However, USD floating rates have been more volatile than USD fixed rates

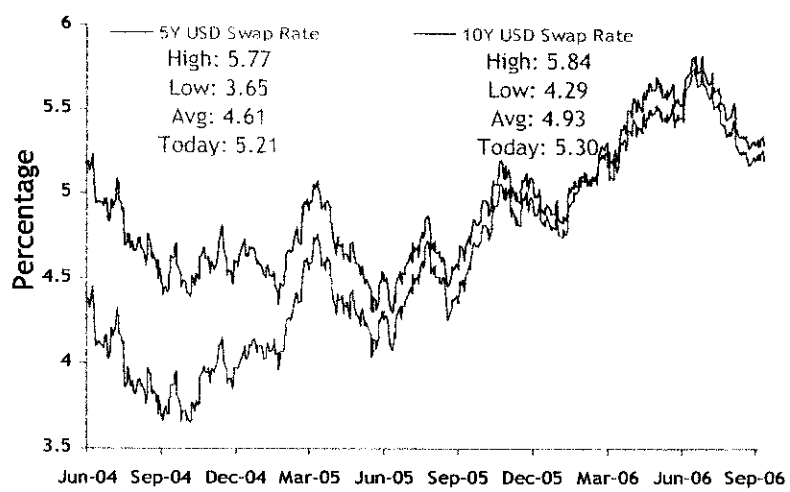
Imperfect rate correlation ==>"efficient frontier" for debt mix

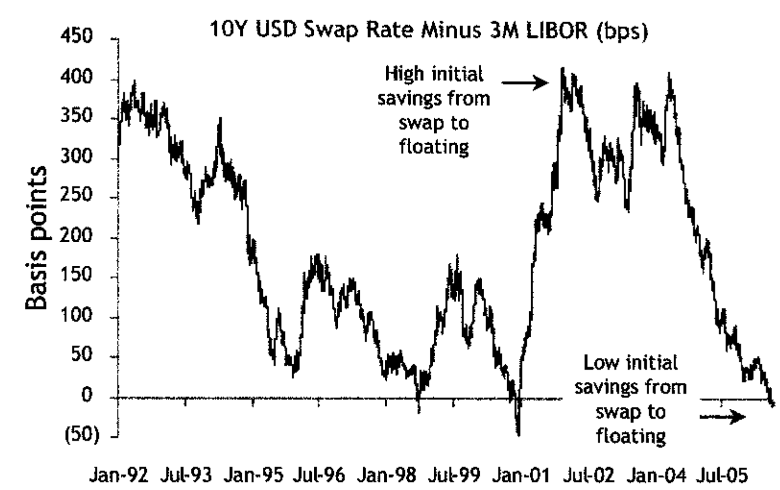


- The fixed-floating "efficient frontier" graphs the trade-off between the interest cost and interest expense volatility across variety of debt mixes
- A portfolio of 100% fixed-rate debt has the highest cost, while a portfolio of 100% floating-rate debt has the lowest cost
- From a long-run risk-reward perspective, mixed debt portfolios out-perform 100% fixed-rate liability profiles

Today's flat yield curves offer only minimal interest cost savings when converting fixed rate bonds to floating

Although long-term rates have risen substantially since 2004, the yield curve remains quite flat





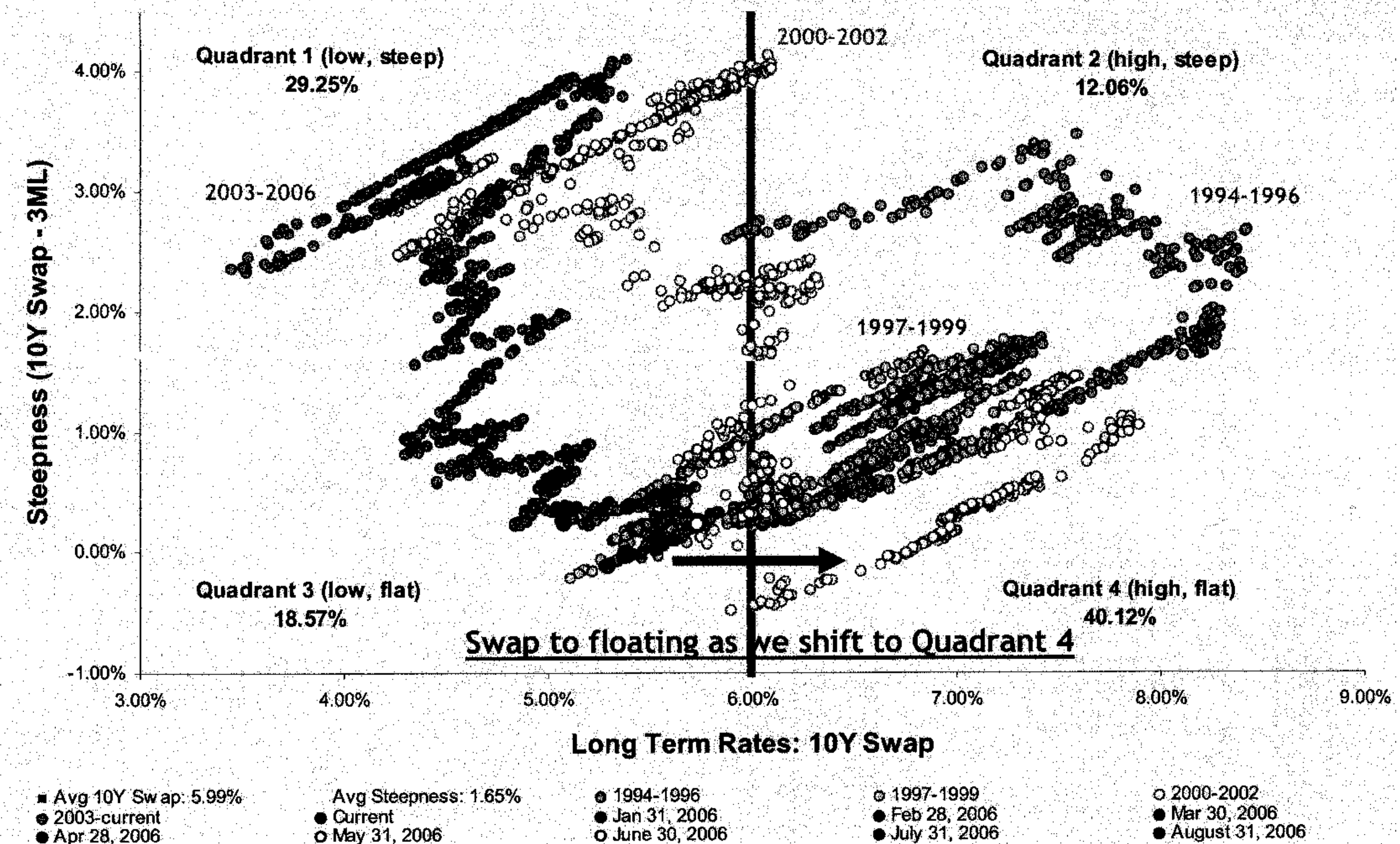
NWN should postpone pay-floating swap execution until long term rates return to the high end of recent trading ranges

USD Note Maturity	27-Jun-11	26-Mar-12	21-Sep-14	22-Jun-15	01-Aug-17	16-Mar-18
USD Notional	USD 10.0	USD 40.0	USD 10.0	USD 40.0	USD 40.0	USD 22.0
NWN receives Fixed Coupon (30/360)	6.665%	7.13%	8.260%	4.700%	7.000%	6.60%
NWN pays 3M LIBOR (Act/360) *plus*	1.55%	1.99%	3.08%	-0.45%	1.78%	1.38%
Current 3M LIBOR	5.39%	5.39%	5.39%	5.39%	5.39%	5.39%
Initial All-In Rate	6.94%	7.38%	8.47%	4.94%	7.17%	6.77%
Initial Savings vs. Fixed Coupon[1]	-0.37%	-0.35%	-0.32%	-0.30%	-0.27%	-0.26%

1 Adjusted for day count as follows: (coupon *360/365) - initial floating setting

Consider incremental swaps to floating as we move into a relatively high yield, flat curve environment

Curve Steepness Scatter Plot 1994-2006: 10Y USD Swap Rates versus 10Y Swap Rate minus 3M LIBOR

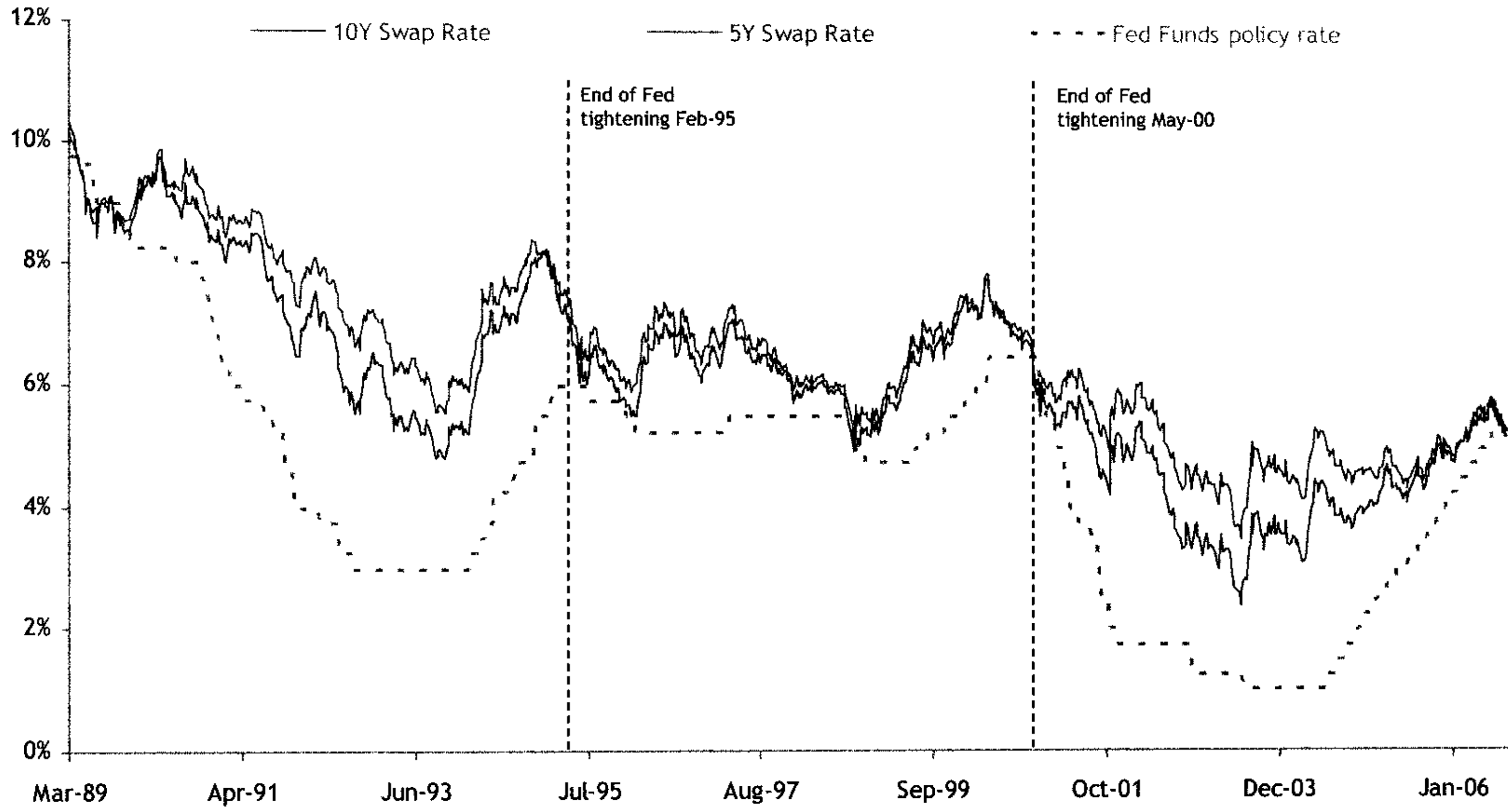


[1] Reflects daily closing market rates from January 3, 1994 to September 18, 2006

The relationship between yield curve and business cycles tends to move us counterclockwise on this diagram over time

Historically, long-term rates drop following the end of a Fed tightening cycle

Historical performance of 5Y and 10Y swaps versus the Fed Funds policy rate



Source: JPMorgan

NWN should swap to floating near the end of the Fed tightening cycle as long term rates peak, since a higher swap rate means higher interest cost savings versus a given bond coupon

Proposed pay-floating swap structure is FAS 133 friendly and should not cause earnings volatility[1]

Accounting Implications

- Critical terms of bonds and pay-floating swap match *and* meet the requirements of FAS 138 Paragraph 68, such that NWN qualifies for:
  - Fair Value Hedge accounting
  - The "short-cut" method
- Under the Fair Value Hedge model
  - Post change in fair market value of swap on Income Statement
    - I.e., post swap as Derivative Asset if mark-to-market value is positive or as "Derivative Liability" if mark-to-market value is negative
  - Likewise, adjust carrying value of fixed rate debt
    - I.e., post change in fair market value of bonds *due to interest rates only* on Income Statement
    - Do *not* reflect fair value changes in bonds due to changes in credit spreads
- "Short-cut method" allows assumption of 100% hedge effectiveness
  - Fair value change in bonds due to interest rates equals *exact opposite* of fair value change in swap
  - NWN experiences no earnings volatility

1 *JPMorgan does not offer accounting advice. NWN should confirm all accounting implications with its auditors before executing any trades.*

Agenda

Stock Repurchase Program

NW Natural's Board of Directors approved a stock repurchase program in 2000 to purchase up to 2 million shares, or up to $35 million in value, of NW Natural's common stock in the open market or through privately negotiated transactions. The repurchase program has been extended through May 2006. A total of 410,200 shares were repurchased under this program in 2005; however, no shares were repurchased in 2003 or 2004. Since the program's inception, the Company has repurchased 765,600 shares of common stock at a total cost of $23.1 million.

Restated Stock Option Plan

There are 2,400,000 shares authorized for option grants under the Restated Stock Option Plan. At Dec. 31, 2005, options on 1,229,800 shares were available for grant and options on 308,500 shares were outstanding.

Convertible Debentures

In August 2005, NW Natural called for redemption all of the Company's outstanding convertible debentures, 7-1/4% Series due 2012 at 100% of their principal amount plus accrued interest to the date of redemption. During 2005, debentures with an aggregate principal amount of $4.0 million were converted into shares of common stock on or prior to the redemption date at the rate of 50.25 shares for each $1,000 principal amount of debentures and $0.5 million of debentures were redeemed.

The following table shows the changes in the number of shares of NW Natural's capital stock and the premium on common stock for the years 2005, 2004 and 2003:

	------------Shares----------		
	Common stock	Redeemable preferred stock	Premium on common stock (thousands)
Balance, Dec. 31, 2002	25,586,313	82,500	$ 248,028
Sales to employees	14,175	–	425
Sales to stockholders	178,714	–	4,347
Exercise of stock options – net	127,357	–	2,545
Conversion of convertible debentures to common	31,443	–	526
Sinking fund purchases	–	(7,500)	–
Early redemption	–	(75,000)	–
Balance, Dec. 31, 2003	25,938,002	–	255,871
Sales to public	1,290,000	–	35,905
Sales to employees	27,541	–	605
Sales to stockholders	157,124	–	4,323
Exercise of stock options – net	73,649	–	2,285
Conversion of convertible debentures to common	64,904	–	1,086
Repurchase	(4,500)	–	(41)
Balance, Dec. 31, 2004	27,546,720	–	300,034
Sales to employees	30,896	–	741
Sales to stockholders	113,925	–	3,741
Exercise of stock options – net	97,068	–	2,241
Conversion of convertible debentures to common	200,887	–	3,360
Repurchase	(410,200)	–	(13,646)
Balance, Dec. 31, 2005	27,579,296	–	$ 296,471

4. STOCK–BASED COMPENSATION:

NW Natural has the following stock–based compensation plans: the Long–Term Incentive Plan (LTIP); the Restated Stock Option Plan (Restated SOP); the Employee Stock Purchase Plan (ESPP); and the Non–Employee Directors Stock Compensation Plan (NEDSCP). These plans are designed to promote stock ownership in NW Natural by employees and officers and, in the case of the NEDSCP, by non–employee directors.

Long–Term Incentive Plan. The LTIP is intended to provide a flexible, competitive compensation program for eligible officers and key employees. An aggregate of 500,000 shares of common stock was authorized for grants under the LTIP as stock bonus, restricted stock or performance–based stock awards. Shares awarded under the LTIP are purchased on the open market.

At year–end 2005, 433,000 shares of common stock were available for award under the LTIP, assuming that outstanding performance based grants are awarded at the target level. The LTIP stock awards are compensatory awards for which compensation expense is recognized based on the market value of performance shares earned, or a pro rata amortization over the vesting period for the outstanding restricted stock award.

Performance–based Stock Awards. Since the Plan's inception in 2001 through Dec. 31, 2005, performance–based stock awards have been granted annually based on three–year performance periods. At Dec. 31, 2005, all performance–based stock awards other than those covering the 2004–06 and 2005–07 periods had lapsed because the performance–based measures were not achieved. If the performance–based measures are achieved, at the end of the measurement period participants will receive shares of common stock and dividend equivalent cash payments equal to the number of shares of common stock received on the award payout multiplied by the aggregate cash dividends paid per share by the Company during the performance period.

No awards were paid for the three–year performance period that ended Dec. 31, 2005 because the performance measure was not achieved. For this performance period, a series of performance targets was established based on the Company's average annual return on equity (ROE) that was tied to the Company's authorized ROE.

At Dec. 31, 2005, the aggregate number of performance–based shares awarded and outstanding at the threshold, target and maximum levels were as follows:

Year Awarded	Performance Period	No. of Performance Shares Awarded		
		Threshold	Target	Maximum
2004	2004–06	6,750	27,000	54,000
2005	2005–07	8,750	35,000	70,000
	Total	15,500	62,000	124,000

For the 2004–06 and 2005–07 performance periods, awards will be based on total shareholder return relative to a peer group of gas distribution companies over the three–year performance period and on performance milestones relative to the Company's core and non–core strategies.

During the performance period, the Company will recognize compensation expense and liability for the LTIP awards based on performance levels achieved, and expected to be achieved, and the estimated market value of the common stock as of the distribution date. For the 12 months ended Dec. 31, 2005, $0.7 million and $0.5 million were accrued as compensation expense under the LTIP for the 2004–06 and 2005–07 performance periods, respectively.

Restricted Stock Awards. Restricted stock awards also have been granted under the LTIP. A restricted stock award consisting of 4,500 shares granted in 2001 lapsed in 2004, and a restricted stock award was granted in 2004 consisting of 5,000 shares that will vest ratably over the period 2005–09. In accordance with APB Opinion No. 25, compensation expense is recognized ratably over the vesting period.

Restated Stock Option Plan. The Restated SOP authorizes an aggregate of 2,400,000 shares of common stock for issuance as incentive or non–statutory stock options. These options may be granted only to officers and key employees designated by a committee of our Board of Directors. All options are granted at an option price not less than the market value at the date of grant and may be exercised for a period not exceeding 10 years from the date of grant. Option holders may exchange shares they have owned for at least six months, at the current market price, to purchase shares at the option price. Since inception in 1985, options on 1,312,721 shares of common stock have been granted at prices ranging from $11.75 to $38.30 per share, and options on 145,521 shares have expired.

Employee Stock Purchase Plan. The ESPP allows employees to purchase common stock at 85 percent of the closing price on the trading day immediately preceding the subscription date, which is set annually. Each eligible employee may purchase up to $24,000 worth of stock through payroll deductions over a six– to 12–month period.

In accordance with APB Opinion No. 25, no compensation expense was recognized for options granted under the Restated SOP or shares issued under the ESPP during 2005 or earlier years (see Note 1, "New Accounting Standards—Recent Accounting Pronouncements"). If compensation expense for awards under these two plans had been determined based on fair value at the grant dates using the method prescribed by SFAS No. 123R, "Accounting for Stock-Based Compensation," net income and earnings per share would have been reduced to the pro forma amounts shown below:

Thousands, except per share amounts	2005	2004	2003
Net income as reported	$ 58,149	$ 50,572	$ 45,983
Add: Stock based compensation expense included in reported net income – net of tax	613	96	–
Deduct: Pro forma stock-based compensation expense determined under the fair value based method – net of tax	(940)	(519)	(279)
Pro forma net income	57,822	50,149	45,704
Redeemable preferred and preference stock	–	–	(294)
Pro forma earnings applicable to common stock – basic	57,822	50,149	45,410
Debenture interest less taxes	–	200	257
Pro forma earnings applicable to common stock – diluted	$ 57,822	$ 50,349	$ 45,667
Basic earnings per share			
As reported	$ 2.11	$ 1.87	$ 1.77
Pro forma	$ 2.10	$ 1.86	$ 1.76
Diluted earnings per share			
As reported	$ 2.11	$ 1.86	$ 1.76
Pro forma	$ 2.09	$ 1.85	$ 1.75

The fair value of each stock option is estimated on the grant date (there were no stock option grants in 2003) using the Black-Scholes option pricing model with the following weighted average assumptions:

	2005	2004
Expected life in years	7.0	7.0
Risk-free interest rate	4.2%	3.6%
Expected volatility	24.6%	25.2%
Dividend yield	3.6%	4.1%
Present value of options granted	$ 27.87	$ 24.55

Information regarding the Restated SOP's activity for the three years ended Dec. 31, 2005 is summarized as follows:

	Option Shares	---------------Price per Share--------------- Range	Weighted–Average Exercise Price
Balance outstanding, Dec. 31, 2002	463,814	$20.25 – 27.875	$ 24.10
Exercised	(140,470)	20.25 – 27.875	21.14
Expired	(1,300)	20.25	20.25
Balance outstanding, Dec. 31, 2003	322,044	20.25 – 27.875	25.35
Granted	202,800	31.34 – 32.020	31.40
Exercised	(92,074)	20.25 – 27.875	24.39
Expired	(1,300)	26.30 – 31.340	30.18
Balance outstanding, Dec. 31, 2004	431,470	20.25 – 32.020	28.38
Granted	9,000	34.95 – 38.30	37.18
Exercised	(121,170)	20.25 – 31.34	26.59
Expired	(10,800)	27.60 – 31.34	30.79
Balance outstanding, Dec. 31, 2005	308,500	$20.25 – 38.30	$ 29.26
Shares available for grant Dec. 31, 2003	1,429,500		
Shares available for grant Dec. 31, 2004	1,228,000		
Shares available for grant Dec. 31, 2005	1,229,800		

The weighted average remaining life of outstanding stock options at Dec. 31, 2005 was 6.8 years.

The characteristics of exercisable stock options at Dec. 31, 2005 were as follows:

Range of Exercise Prices	Exercisable Stock Options	Weighted–Average Exercise Price
$20.25 – $32.02	189,500	$ 27.63

Non–Employee Directors Stock Compensation Plan. In February 2004, the NEDSCP was amended to permit non–employee directors to receive stock awards either in cash or in Company stock. As a result of modifications to the directors' compensation arrangements, the NEDSCP was further amended in September 2004 to eliminate any further awards, either in cash or stock, on and after Jan. 1, 2005.

Prior to the latter amendment to the NEDSCP, if non–employee directors elected to receive their awards in stock, approximately $100,000 worth of common stock was awarded upon joining the Board. These stock awards were subject to vesting and to restrictions on sale and transferability. The shares vested in monthly installments over the five calendar years following the award. On January 1 of each year following the initial award, non–employee directors who elected to receive their awards in Company stock were awarded an additional $20,000 worth of restricted Company stock, which vested in monthly installments in the fifth year following the award (after the previous award had fully vested). The Company holds the certificates for the restricted shares until the non–employee director ceases to be a director. Participants receive all dividends and have full voting rights on both vested and unvested shares. All awards vest immediately upon the death of a director or upon a change in control of the Company. Any unvested shares are considered to be unearned compensation, and thus are forfeited if the recipient ceases to be a director. The shares were purchased in the open market by the Company at the time of the award.

The following table presents the changes in unearned stock compensation for the years 2005 and 2004, which are reported as a reduction to total common equity in the consolidated balance sheets:

Thousands	2005	2004
Unearned stock compensation:		
Balance at beginning of year	$ 862	$ 729
Purchases of restricted stock	–	431
Restricted stock amortizations	(212)	(298)
Balance at end of year	$ 650	$ 862

Under a separate plan, prior to Jan. 1, 2005, non–employee directors could elect to invest their cash fees and retainers for board service in shares of our common stock. Under a new deferral plan effective Jan. 1, 2005, such fees and retainers will be deferred to a cash account. Cash account balances may be transferred to and invested in a Company stock account, at the election of the director, up to four times per year.

5. LONG–TERM DEBT:

The issuance of first mortgage debt, including secured medium–term notes, under the Mortgage and Deed of Trust (Mortgage), is limited by property additions, adjusted net earnings and other provisions of the Mortgage. The Mortgage constitutes a first mortgage lien on substantially all of our utility property.

The maturities on the long–term debt outstanding, for each of the 12–month periods through Dec. 31, 2010 amount to: $8 million in 2006; $29.5 million in 2007; $5 million in 2008, none in 2009; and $35 million in 2010. Holders of certain long–term debt have put options that, if exercised, would accelerate the maturities by $20 million in each of 2007, 2008 and 2009.

In June 2005, the Company issued and sold $50 million in principal amount of secured Medium Term Notes (MTNs), consisting of $40 million of the 4.70% Series B due 2015 and $10 million of the 5.25% Series B due 2035. Proceeds from these sales were used, in part, to redeem $15 million of maturing MTNs in July 2005, and the balance was applied to the Company's ongoing utility construction program and the repayment of short–term debt.

In July 2005, the Company redeemed three series of its maturing MTNs aggregating $15 million in principal amount. The series redeemed were the 6.34% Series B, the 6.38% Series B and the 6.45% Series B, each with a principal balance outstanding of $5 million due in July 2005. The MTNs were redeemed with proceeds from the sales of $50 million in principal amount of MTNs in June 2005.

6. NOTES PAYABLE AND LINES OF CREDIT:

The Company's primary source of short–term funds is from the sale of commercial paper notes payable. In addition to issuing commercial paper to meet seasonal working capital requirements, including the financing of gas purchases and accounts receivable, short–term debt is also used temporarily to fund capital requirements. Commercial paper is periodically refinanced through the sale of long–term debt or equity securities. NW Natural's commercial paper program is supported by committed bank lines of credit (see below). At December 31, 2005 and 2004, the amounts and average interest rates of commercial paper debt outstanding were $126.7 million and 4.3 percent and $102.5 million and 2.3 percent, respectively. NW Natural has not issued commercial paper in an aggregate amount outstanding in excess of its committed lines of credit.

In September 2005, NW Natural entered into an agreement for unsecured lines of credit totaling $200 million with five commercial banks, replacing the existing $150 million credit facilities. The new bank lines of credit (bank lines) are available and committed for a term of five years, beginning Oct. 1, 2005 and expiring on Sept. 30, 2010. NW Natural's bank lines are used primarily as back–up support for the notes payable under the Company's commercial paper borrowing program. Commercial paper borrowing provides the liquidity to meet the working capital and external financing requirements of NW Natural.

Under the terms of these bank lines, NW Natural pays upfront fees and annual commitment fees but is not required to maintain compensating bank balances. The interest rates on outstanding loans, if any, under these bank lines are based on then–current market interest rates. All principal and unpaid interest under the bank lines is due and payable on Sept. 30, 2010.

The bank lines require that NW Natural maintain credit ratings with Standard & Poor's and Moody's Investors Service and to notify the banks of any change in its senior unsecured debt ratings by such rating agencies. A change in NW Natural's credit rating is not an event of default, nor is the maintenance of a specific minimum level of credit rating a condition of drawing upon the bank lines. However, interest rates on any loans outstanding under these bank lines are tied to credit ratings, which would increase or decrease the cost of any loans under the bank lines when ratings are changed.

The bank lines also require the Company to maintain an indebtedness to total capitalization ratio of 65 percent or less. Failure to comply with this covenant would entitle the banks to terminate their lending commitments and to accelerate the maturity of all amounts outstanding. NW Natural was in compliance with this covenant at Dec. 31, 2005, with an indebtedness to total capitalization ratio of 53.5 percent.

7. PENSION AND OTHER POSTRETIREMENT BENEFITS:

NW Natural maintains two qualified non–contributory defined benefit pension plans covering all regular employees with more than one year of service, several non–qualified supplemental pension plans for eligible executive officers and certain key employees and other postretirement benefit plans for employees. Only the two qualified defined benefit pension plans have plan assets, which are held in a qualified trust to fund retirement benefits.

The following table provides a reconciliation of the changes in benefit obligations and fair value of assets, as applicable, for the pension plans and other postretirement benefit plans over the three-year period ended Dec. 31, 2005, and a statement of the funded status and amounts recognized in the consolidated balance sheets, using measurement dates of Dec. 31, 2005, 2004 and 2003:

	Post-Retirement Benefits					
	Pension Benefits			Other Postretirement Benefits		
Thousands	2005	2004	2003	2005	2004	2003
Change in benefit obligation:						
Benefit obligation at Jan. 1	$ 222,948	$ 205,352	$ 185,124	$ 22,729	$ 23,379	$ 18,457
Service cost	6,322	5,428	4,748	767	457	456
Interest cost	13,203	12,690	12,402	1,248	1,232	1,336
Special termination benefits	–	237	–	–	–	–
Expected benefits paid	(12,866)	(10,682)	(10,363)	(1,173)	(1,040)	(1,027)
Change in assumptions	31,642	–	–	2,215	–	–
Plan amendments	1,408	–	–	2,384	–	(111)
Net actuarial (gain) loss	5,197	9,923	13,441	(7,773)	(1,299)	4,268
Benefit obligation at Dec. 31	267,854	222,948	205,352	20,397	22,729	23,379
Change in plan assets:						
Fair value of plan assets at Jan. 1	186,787	168,324	143,164	–	–	–
Actual return on plan assets	12,558	19,835	34,520	–	–	–
Employer contributions	32,076	9,310	1,003	1,173	1,040	1,027
Benefits paid	(12,866)	(10,682)	(10,363)	(1,173)	(1,040)	(1,027)
Fair value of plan assets at Dec. 31	218,555	186,787	168,324	–	–	–
Funded status:						
Funded status at Dec. 31	(49,299)	(36,162)	(37,028)	(20,397)	(22,729)	(23,379)
Unrecognized transition obligation	–	–	–	2,880	3,292	3,703
Unrecognized prior service cost	6,492	5,146	6,240	2,243	–	–
Unrecognized net actuarial loss	69,766	33,897	32,156	988	6,717	8,304
Net amount recognized	$ 26,959	$ 2,881	$ 1,368	$ (14,286)	$ (12,720)	$ (11,372)
Amounts recognized in the consolidated balance sheets at Dec. 31:						
Prepaid benefit cost	$ 36,830	$ 12,745	$ 11,113	$ –	$ –	$ –
Accrued benefit liability	(12,910)	(12,919)	(11,319)	(14,286)	(12,720)	(11,372)
Intangible asset	–	–	–	–	–	–
Other comprehensive loss	3,039	3,055	1,574	–	–	–
Net amount recognized	$ 26,959	$ 2,881	$ 1,368	$ (14,286)	$ (12,720)	$ (11,372)

The Company's qualified defined benefit pension plans had a benefit obligation in excess of plan assets at Dec. 31, 2005. The plans' aggregate benefit obligation was $254 million, $209 million and $192 million at Dec. 31, 2005, 2004 and 2003, respectively, and the fair value of plan assets was $218.6 million, $186.8 million and $168.3 million, respectively. The benefit obligation at Dec. 31, 2005 increased $26.6 million from Dec. 31, 2004 due to the use of updated mortality rates and increased $8.1 million due to the 0.25 percent decrease in the discount rate. The fair value of plan assets increased from Dec. 31, 2004 to Dec. 31, 2005 due to $13.5 million in investment gains and employer contributions of $31 million, partially offset by $11.8 million in withdrawals to pay benefits and $0.9 million to pay eligible expenses of the plans. The combination of investment returns and future cash contributions is expected to provide sufficient funds to cover all benefit obligations of the plans.

The discount rate at Dec. 31, 2005 was determined by developing a spot rate yield curve using the pension plans' estimated future benefit payments applied to a portfolio of Moody's AA or better rated bonds.

The expected long–term rate of return was developed by averaging the expected earnings for the target asset portfolio. In developing the expected long–term rate of return assumption, consideration was given to the historical performance of the asset classes in which the plans' assets are invested and the target asset allocation for plan assets. The annualized returns for the past one, five and 10 years ended Dec. 31, 2005 were 7.4 percent, 5.9 percent and 10.1 percent, respectively.

The Company's Statement of Investment Policy and Performance Objectives for the qualified pension plan assets (plan assets) held in the Retirement Trust Fund was approved by the retirement committee which is composed of management employees. The policy sets forth the guidelines and objectives governing the investment of plan assets. Plan assets are invested for total return with appropriate consideration for liquidity and portfolio risk. All investments are expected to satisfy the requirements of the rule of prudent investments as set forth under the Employee Retirement Income Security Act of 1974. The approved asset classes are cash and short–term investments, fixed income, common stock and convertible securities, absolute and real return strategies, real estate and investments in Company securities, and may be invested in separately managed accounts or in commingled or mutual funds. Re–balancing will take place at least annually, or when significant cash flows occur, in order to maintain the allocation of assets within the stated target allocation ranges. The Retirement Trust Fund is not currently invested in any NW Natural securities.

The Company's pension plan asset allocation at Dec. 31, 2005 and 2004, and the target allocation and expected long–term rate of return by asset category for 2006, are as follows:

	Percentage of Plan Assets Dec. 31,		Target Allocation	Expected Long–term Rate of Return
Asset Category	2005	2004	2006	2006
US large cap equity	19.8%	36.3%	20%	8.50%
US small/mid cap equity	14.2%	9.2%	15%	9.50%
Non–US equity	19.7%	19.2%	20%	8.75%
Fixed income	19.3%	19.8%	15%	5.50%
Real estate	6.2%	3.6%	8%	7.75%
Absolute return strategies	14.2%	7.3%	15%	9.00%
Real return	6.6%	4.6%	7%	7.75%
Weighted average				8.25%

The Company's non–qualified supplemental pension plans' benefit obligations were $13.5 million, $13.6 million and $13.0 million at Dec. 31, 2005, 2004 and 2003, respectively. Although the plans are unfunded plans with no plan assets due to their nature as non–qualified plans, the Company indirectly funds its obligations with trust–owned life insurance.

The Company's plans for providing postretirement benefits other than pensions also are unfunded plans. The aggregate benefit obligation for those plans was $20.4 million, $22.7 million and $23.4 million at Dec. 31, 2005, 2004 and 2003, respectively.

Net periodic pension cost consists of service costs, interest costs, the amortization of actuarial gains and losses, the expected returns on plan assets and, in part, on a market–related valuation of assets. The market–related valuation reflects differences between expected returns and actual investment returns, which are recognized over a three–year period from the year in which they occur, thereby reducing year–to–year net periodic pension cost volatility.

The following tables provide the components of net periodic benefit cost for the qualified and non–qualified pension and other postretirement benefit plans for the years ended Dec. 31, 2005, 2004 and 2003 and the assumptions used in measuring these costs and benefit obligations:

	Pension Benefits			Other Postretirement Benefits		
Thousands	2005	2004	2003	2005	2004	2003
Service cost	$ 6,322	$ 5,428	$ 4,748	$ 767	$ 457	$ 456
Interest cost	13,203	12,689	12,402	1,248	1,232	1,336
Expected return on plan assets	(14,449)	(13,284)	(12,232)	–	–	–
Amortization of transition obligation	–	–	–	411	411	411
Amortization of prior service cost	1,077	1,094	1,132	142	–	–
Recognized actuarial loss	2,082	1,631	1,058	173	288	401
Net periodic cost	$ 8,235	$ 7,558	$ 7,108	$ 2,741	$ 2,388	$ 2,604
Assumptions:						
Discount rate for net periodic benefit cost (NPBC)	6.00%	6.25%	6.75%	6.00%	6.25%	6.75%
Rate of increase in compensation for NPBC	4.00–5.00%	4.00–5.00%	4.25–5.00%	n/a	n/a	n/a
Expected long–term rate of return for NPBC	8.25%	8.25%	8.00%	n/a	n/a	n/a
Discount rate for determination of funded status	5.75%	6.00%	6.25%	5.75%	6.00%	6.25%
Rate of increase in compensation for funded status	4.00–5.00%	4.00–5.00%	4.00–5.00%	n/a	n/a	n/a
Expected long–term rate of return for funded status	8.25%	8.25%	8.25%	n/a	n/a	n/a

The assumed annual increase in trend rates used in measuring postretirement benefits as of Dec. 31, 2005 were 10 percent for medical and 13 percent for prescription drugs. Medical costs were assumed to decrease gradually each year to a rate of 4.5 percent for 2013, while prescription drug costs were assumed to decrease gradually each year to a rate of 4.5 percent for 2013.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one–percentage point change in assumed health care cost trend rates would have the following effects:

Thousands	1% Increase	1% Decrease
Effect on the total service and interest cost components of net periodic postretirement health care benefit cost	$ 61	$ (60)
Effect on the health care component of the postretirement benefit obligation	$ 650	$ (665)

The following table provides information regarding employer contributions and benefit payments for the two qualified pension plans, the non–qualified pension plans and the other postretirement benefit plans for the years ended Dec. 31, 2005 and 2004, and estimated future payments:

Thousands	Pension Benefits	Other Benefits
Employer Contributions by Plan Year		
2004	$ 26,390	$ 1,040
2005	12,497	1,173
2006 (estimated)	1,598	1,433
Benefit Payments		
2003	$ 10,363	$ 1,027
2004	10,682	1,040
2005	12,866	1,173
Estimated Future Payments		
2006	$ 12,773	$ 1,433
2007	13,069	1,497
2008	14,017	1,571
2009	14,671	1,598
2010	15,731	1,689
2011–2015	89,931	9,034

NW Natural's Retirement K Savings Plan (RKSP) is a qualified defined contribution plan under Internal Revenue Code Section 401(k). NW Natural also has non–qualified deferred compensation plans for eligible officers and senior managers. These plans are designed to enhance the retirement program of employees and to assist them in strengthening their financial security by providing an incentive to save and invest regularly. NW Natural's matching contributions to these plans totaled $1.7 million in both 2005 and 2004, and $1.6 million in 2003. The RKSP includes an Employee Stock Ownership Plan.

In addition, in 2005 the Company began making contributions on behalf of each union employee to the Western States Office and Professional Employees Pension Fund.

8. INCOME TAXES:

A reconciliation between income taxes calculated at the statutory federal tax rate and the tax provision reflected in the financial statements is as follows:

Thousands	2005	2004	2003
Computed income taxes based on statutory federal income tax rate of 35%	$ 31,804	$ 26,986	$ 24,263
Increase (reduction) in taxes resulting from:			
Difference between book and tax depreciation	222	222	222
Current state income tax, net of federal tax benefit	2,913	2,554	2,310
Federal income tax credits	(210)	(210)	(357)
Amortization of investment tax credits	(956)	(920)	(879)
Gains on Company and trust–owned life insurance	(650)	(955)	(1,192)
Removal costs	(813)	(813)	(925)
Reversal of amounts provided in prior years	336	(392)	(226)
Other – net	74	59	124
Total provision for income taxes	$ 32,720	$ 26,531	$ 23,340
Total income taxes paid	$ 28,479	$ 2,500	$ 11,814

The provision for income taxes consists of the following:

Thousands, except percentages	2005	2004	2003
Income taxes currently payable (receivable):			
Federal	$ 21,429	$ (9,607)	$ 10,011
State	1,605	(1,111)	1,175
Total	23,034	(10,718)	11,186
Deferred taxes – net:			
Federal	7,502	33,602	10,747
State	3,140	4,567	2,286
Total	10,642	38,169	13,033
Investment and energy tax credits restored:			
From utility operations	(784)	(800)	(801)
From subsidiary operations	(172)	(120)	(78)
Total	(956)	(920)	(879)
Total provision for income taxes	$ 32,720	$ 26,531	$ 23,340
Percentage of pretax income	36.0%	34.4%	33.7%

Deferred tax assets and liabilities are comprised of the following:

Thousands	2005	2004
Deferred tax liabilities:		
Plant and property	$ 149,901	$ 146,657
Regulatory income tax assets	65,843	64,734
Regulatory liabilities	3,045	5,730
Other deferred liabilities	4,670	5,534
Total	223,459	222,655
Deferred tax assets:		
Minimum pension liability	1,128	1,068
Other deferred assets	–	7,330
Alternative minimum tax credit carryforward	–	1,631
Loss and credit carryforwards	–	1,546
Total	1,128	11,575
Net accumulated deferred income tax liability	$ 222,331	$ 211,080

The amount of income taxes paid in 2004 decreased significantly as compared to the total provision for income taxes, primarily due to the effects of the accelerated bonus depreciation provisions of the Job Creation and Worker Assistance Act of 2002 (the Assistance Act) and of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the Reconciliation Act). The Assistance Act provided for an additional depreciation deduction equal to 30 percent of an asset's adjusted basis. The Reconciliation Act increased this first–year additional depreciation deduction to 50 percent of an asset's adjusted basis. The additional first–year depreciation deduction is an acceleration of depreciation deductions that otherwise would have been taken in the later years of an asset's recovery period. The accelerated depreciation provisions in 2004 were the primary factors resulting in net operating losses (NOL) for tax purposes.

In 2005, the Company filed its 2004 federal and Oregon income tax returns, which reflected the federal NOL of $35.8 million and the Oregon NOL of $32.9 million. At Dec. 31, 2004, the Company estimated that the federal NOL would be $15.4 million and that the Oregon NOL would be $18.6 million. During 2005, an additional $20 million pension contribution was made to the Company's two qualified defined benefit pension plans for the 2004 Plan year (see Note 7). This additional pension contribution resulted in an increased tax deduction for both federal and Oregon purposes.

The increased federal NOL was carried back to 2002 and an application for refund was filed. A federal refund of $8.3 million was received in October 2005. In conjunction with recording the refund, the Company recorded an additional alternative minimum tax credit carryforward of $3.9 million and other federal tax credit carryforwards of $0.3 million. At Dec. 31, 2004, the Company recorded an estimated $1.6 million alternative minimum tax credit carryforward and other estimated federal tax credit carryforwards of $0.2 million. The Company applied all of its federal tax credit carryforwards totaling $6.0 million against its 2005 estimated federal current income tax liability. The Company partially offset its estimated 2005 Oregon taxable income by the NOL carryforward. The current income tax benefits recognized by the Oregon NOL and tax credit carryforwards reduced the estimated 2005 Oregon current income tax liability by approximately $2.7 million.

An Internal Revenue Service (IRS) examination of the Company's 2002 through 2004 consolidated federal income tax returns commenced during the third quarter of 2005. The IRS completed its examination of the 2003 federal tax return in January 2006, and completion of the examination of the 2002 and 2004 federal income tax returns is expected during 2006.

9. PROPERTY AND INVESTMENTS:

The following table sets forth the major classifications of the Company's utility plant and accumulated depreciation at Dec. 31:

	2005		2004	
Thousands, except percentages	Amount	Weighted Average Depreciation Rate	Amount	Weighted Average Depreciation Rate
Transmission and distribution systems	$1,575,545	3.2%	$1,509,475	3.2%
Utility storage	109,908	2.6%	109,613	2.6%
General	90,780	3.1%	91,229	3.4%
Intangible and other	66,354	8.4%	61,573	8.5%
Gas stored long–term	13,078	0.0%	13,434	0.0%
Utility plant in service	1,855,665	3.4%	1,785,324	3.4%
Assets held for future use	1,833		1,833	
Construction work in progress	17,946		7,815	
Total utility plant	1,875,444		1,794,972	
Accumulated depreciation	(536,867)		(505,286)	
Utility plant–net	$1,338,577		$1,289,686	

Accumulated depreciation does not include $169.9 million and $153.3 million at Dec. 31, 2005 and 2004, respectively, which represent accrued asset removal costs reflected on the balance sheets as regulatory liabilities (see Note 1).

The following table summarizes the Company's investments in non–utility plant at Dec. 31:

	2005		2004	
Thousands, except percentages	Amount	Weighted Average Depreciation Rate	Amount	Weighted Average Depreciation Rate
Non–utility storage	$34,486		$24,900	
Dock, land, oil station and other	4,953		4,728	
Non–utility plant in service	39,439	2.6%	29,628	2.3%
Construction work in progress	1,397		4,335	
Total non–utility plant	40,836		33,963	
Less accumulated depreciation	(5,990)		(5,244)	
Non–utility plant – net	$34,846		$28,719	

The following table summarizes the Company's other long–term investments, including financial investments in life insurance policies accounted for at fair value based on cash surrender values, equity investments in certain partnerships and joint ventures accounted for under the equity or cost methods, and a leveraged lease investment in an aircraft, at Dec. 31:

Thousands	2005	2004
Life insurance cash surrender value	$ 46,555	$ 45,011
Aircraft leveraged lease	6,884	6,621
Real estate partnership	1,502	1,500
Note receivable	1,237	1,240
Gas pipeline and other	1,434	1,619
Electric generation	839	4,627
Total other investments	$ 58,451	$ 60,618

Aircraft Leveraged Lease. In 1987, the Company invested in a Boeing 737–300 aircraft, which is leased to Continental Airlines for 20 years under a leveraged lease agreement.

Gas Pipeline. A wholly–owned subsidiary of Financial Corporation, KB Pipeline Company, owns a 10 percent interest in an 18–mile interstate natural gas pipeline.

Electric Generation. Financial Corporation held ownership interests ranging from 25 to 41 percent in wind power electric generation projects located near Livermore and Palm Springs, California at Dec. 31, 2005. The wind–generated power is sold to Pacific Gas and Electric Company and Southern California Edison Company under long–term contracts. In January 2005, Financial Corporation sold its limited partnership interests in three electric generating systems (see Note 2).

FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," provides guidance for determining whether consolidation is required for entities over which control is achieved through means other than voting rights, know as "variable interest entities." The Company does not have any significant interests in variable interest entities for which it is a primary beneficiary.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS:

The estimated fair value of NW Natural's financial instruments has been determined using available market information and appropriate valuation methodologies. The following are financial instruments whose carrying values are sensitive to market conditions:

	Dec. 31, 2005		Dec. 31, 2004	
Thousands	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long–term debt including amount due within one year	$ 529,500	$ 579,382	$ 499,027	$ 567,926

Fair value of the long–term debt was estimated using market prices in effect on the valuation date. Interest rates for debt with similar terms and remaining maturities were used to estimate fair value for long–term debt issues.

11. USE OF FINANCIAL DERIVATIVES:

NW Natural enters into forward contracts and other related financial transactions for the purchase of natural gas that qualify as derivative instruments under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 and SFAS No. 149 (collectively referred to as SFAS No. 133). NW Natural utilizes derivative financial instruments to manage commodity prices related to natural gas supply requirements.

In the normal course of business, NW Natural enters into forward natural gas commodity purchase (gas supply) contracts to meet the requirements of core utility customers. In 2005, NW Natural entered into a series of exchange transactions with an unaffiliated energy marketing company, which resulted in a change in the Company's accounting treatment for its forward gas supply contracts under SFAS No. 133. SFAS No. 133 requires that derivative instruments be recorded on the balance sheet at fair value. Prior to March 31, 2005, the Company's forward gas supply contracts were excluded from the fair value measurement requirement of SFAS No. 133 because these contracts were eligible for the normal purchase and normal sale exception. These physical supply contracts are now accounted for as derivative instruments and marked–to–market based on fair value pursuant to SFAS No. 133. These contracts include 25 index–based supply contracts, four fixed–price supply contracts and three physical option contracts. The mark–to–market adjustment for the forward gas supply contracts at Dec. 31, 2005 is an unrealized loss of $4.1 million, consisting of an unrealized loss of $5.5 million on index–based contracts, a $0.8 million unrealized gain on fixed–price contracts and a $0.6 million gain on physical option supply contracts. The net unrealized loss is recorded as a liability with an offsetting entry to a regulatory asset based on regulatory deferral accounting under SFAS No. 71, (see Note 1, "Industry Regulation").

Due to the forward gas supply contracts being classified as derivatives for accounting purposes, the corresponding derivative financial contracts originally designated as cash flow hedges no longer qualify for hedge accounting under SFAS No. 133, even though these contracts continue to hedge the financial risk exposure of the forward gas supply contracts. However, due to regulatory deferral accounting under SFAS No. 71, the accounting change had no impact on the Company's financial condition, results of operations or cash flows. The mark–to–market adjustment at Dec. 31, 2005 for the fixed–price financial swap contracts was an unrealized gain of $173.8 million.

Fixed–price financial call options are purchased to hedge the Company's forecasted purchases of winter swing supplies or spot gas. The mark–to–market adjustment at Dec. 31, 2005 was an unrealized gain of $1.9 million. These unrealized gains and losses were subject to regulatory deferral and, as such, were recorded as a non–trading derivative asset or liability which is offset by recording a corresponding amount to a deferred asset or liability account.

Certain natural gas purchases from Canadian suppliers are payable in Canadian dollars, including both commodity and demand charges, thereby exposing the Company to adverse changes in foreign currency rates. Foreign currency forward contracts are used to hedge the fluctuation in foreign currency exchange rates for NW Natural's commodity and commodity–related demand charges paid in Canadian dollars. Foreign currency contracts for commodity costs are purchased on a month–to–month basis because the Canadian cost is priced at the average noon–day exchange rate for each month. Foreign currency contracts for demand costs have terms ranging up to 12 months. The gains and losses on the shorter–term currency contracts for commodity costs are recognized immediately in cost of gas. The gains and losses on the currency contracts for demand charges are not recognized in current income but are subject to a regulatory deferral tariff and, as such, are recorded as a derivative asset or liability. These forward contracts qualify for cash flow hedge accounting treatment under SFAS No. 133. The mark–to–market adjustment at Dec. 31, 2005 was an unrealized gain of $0.2 million. These unrealized gains and losses were subject to regulatory deferral and, as such, were recorded as a derivative asset or liability which is offset by recording a corresponding amount to a regulatory asset or regulatory liability account. Certain contracts were in an over–hedged position at year–end due to a change in forecasted business requirements. The specific forward contracts involved were no longer designated as cash flow hedges, and the over–hedged position was immediately sold, resulting in a nominal gain which was deferred to a regulatory account.

NW Natural did not use any derivative instruments to hedge oil or propane prices or interest rates during 2005, 2004 or 2003.

At Dec. 31, 2005 and 2004, unrealized gains or losses from mark–to–market valuations of the Company's derivative instruments were not recognized in current income, but were reported as regulatory liabilities or regulatory assets because regulatory mechanisms provide for the realized gains or losses at settlement to be included in utility gas costs subject to regulatory deferral treatment. The estimated fair values (unrealized gains and losses) of derivative instruments outstanding were as follows:

	Fair Value Gains (Losses) Dec. 31,	
Thousands	2005	2004
Natural gas commodity–based derivative instruments:		
Fixed–price financial swaps	$ 173,790	$ 12,641
Fixed–price financial call options	1,871	(2,195)
Indexed–price physical supply	(5,454)	–
Fixed–price physical supply	820	–
Physical supply contracts with embedded options	567	24
Foreign currency forward purchases	183	442
Total	$ 171,777	$ 10,912

In 2005, 2004 and 2003, NW Natural realized net gains of $88.9 million, $42.4 million and $32.4 million, respectively, from the settlement of natural gas commodity swap and call option contracts, which were recorded as decreases to the cost of gas. The currency exchange rate in all foreign currency forward purchase contracts is included in our cost of gas at settlement; therefore, no gain or loss was recorded from the settlement of those contracts. Any change in value of cash flow hedge contracts that is not included in regulatory recovery is included in other comprehensive income.

The fair value of derivative instruments at Dec. 31, 2005 and 2004 (see table above) was determined using a discounted cash flow model for financial swaps and physical derivatives. A Black–Scholes model was used to value financial options.

As of Dec. 31, 2005, five of the natural gas commodity price swap contracts mature in 2007 and one contract matures in 2008. None of the natural gas commodity call option contracts extends beyond March 31, 2006.

12. COMMITMENTS AND CONTINGENCIES:

Lease Commitments

The Company leases land, buildings and equipment under agreements that expire in various years through 2045. Rental expense under operating leases was $4.1 million, $4.5 million and $4.9 million for the years ended Dec. 31, 2005, 2004 and 2003, respectively. The table below reflects the future minimum lease payments due under non–cancelable leases at Dec. 31, 2005. Such payments total $61.0 million for operating leases. The net present value of payments on capital leases less imputed interest was $0.3 million. These commitments principally relate to the lease of our office headquarters, underground gas storage facilities, vehicles and computer equipment.

Millions	2006	2007	2008	2009	2010	Later years
Operating leases	$ 4.4	$ 4.2	$ 4.1	$ 4.1	$ 4.1	$ 40.1
Capital leases	0.2	0.1	–	–	–	–
Minimum lease payments	$ 4.6	$ 4.3	$ 4.1	$ 4.1	$ 4.1	$ 40.1

Pipeline Capacity Purchase and Release Commitments

NW Natural has signed agreements providing for the reservation of firm pipeline capacity under which it must make fixed monthly payments for contracted capacity. The pricing component of the monthly payment is established, subject to change, by U.S. or Canadian regulatory bodies. In addition, NW Natural has entered into long–term sale agreements to release firm pipeline capacity. The aggregate amounts of these agreements were as follows at Dec. 31, 2005:

Thousands	Pipeline Capacity Purchase Agreements	Pipeline Capacity Release Agreements
2006	$ 69,482	$ 3,725
2007	64,831	3,725
2008	63,147	3,725
2009	56,970	3,725
2010	57,167	3,104
2011 through 2025	233,549	–
Total	545,146	18,004
Less: Amount representing interest	101,720	1,762
Total at present value	$ 443,426	$ 16,242

NW Natural's total payments of fixed charges under capacity purchase agreements in 2005, 2004 and 2003 were $83.1 million, $89.3 million and $86.7 million, respectively. Included in the amounts for 2005, 2004 and 2003 were reductions for capacity release sales of $3.7 million in each year. In addition, per–unit charges are required to be paid based on the actual quantities shipped under the agreements. In certain take–or–pay purchase commitments, annual deficiencies may be offset by prepayments subject to recovery over a longer term if future purchases exceed the minimum annual requirements.

Environmental Matters

NW Natural owns, or has previously owned, properties that may require environmental remediation or action. NW Natural accrues all material loss contingencies relating to these properties that it believes to be probable of assertion and reasonably estimable. The Company continues to study the extent of its potential environmental liabilities, but due to the numerous uncertainties surrounding the course of environmental remediation and the preliminary nature of several environmental site investigations, the range of potential loss beyond the amounts currently accrued, and the probabilities thereof, cannot be reasonably estimated. NW Natural regularly reviews its remediation liability for each site where it may be exposed to remediation responsibilities. The costs of environmental remediation are difficult to estimate. A number of steps are involved in each environmental remediation effort, including site investigations, remediation, operations and maintenance, monitoring and site closure. Each of these steps may, over time, involve a number of alternative actions, each of which can change the course of the effort. In certain cases, in addition to NW Natural, there are a number of other potentially responsible parties, each of which, in proceedings and negotiations with other potentially responsible parties and regulators, may influence the course of the remediation effort. The allocation of liabilities among the potentially responsible parties is often subject to dispute and highly uncertain. The events giving rise to environmental liabilities often occurred many decades ago, which complicates the determination of allocating liabilities among potentially responsible parties. Site investigations and remediation efforts often develop slowly over many years. To the extent reasonably estimable, NW Natural estimates the costs of environmental liabilities using current technology, enacted laws and regulations, industry experience gained at similar sites and an assessment of the probable level of involvement and financial condition of other potentially responsible parties. Unless there is a better estimate within this range of probable cost, NW Natural records the liability at the lower end of this range. It is likely that changes in these estimates will occur throughout the remediation process for each of these sites due to uncertainty concerning NW Natural's responsibility, the complexity of environmental laws and regulations and the selection of compliance alternatives. The status of each of the sites currently under investigation is provided below.

Gasco site. NW Natural owns property in Multnomah County, Oregon that is the site of a former gas manufacturing plant that was closed in 1956 (the Gasco site). The Gasco site has been under investigation by NW Natural for environmental contamination under the Oregon Department of Environmental Quality's (ODEQ) Voluntary Clean–Up Program. In June 2003, the Company filed a Feasibility Scoping Plan and an Ecological and Human Health Risk Assessment with the ODEQ, which outlined a range of remedial alternatives for the most contaminated portion of the Gasco site. NW Natural has accrued a liability of $1.4 million for the Gasco site, which is at the low end of the range because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

Siltronic (formerly Wacker) site. NW Natural previously owned property adjacent to the Gasco site that now is the location of a manufacturing plant owned by Siltronic Corporation (formerly Wacker Siltronic Corporation) (the Siltronic site). In 2005, the estimated liability for this site increased due to new information regarding required additional storm–water pollution work and indoor air quality studies, resulting in an additional accrual of less than $0.1 million. The amount of the additional accrual was deferred to a regulatory asset account pursuant to an order of the OPUC (see "Regulatory and Insurance Recovery for Environmental Matters," below).

Portland Harbor site. In 1998, the ODEQ and the U.S. Environmental Protection Agency (EPA) completed a study of sediments in a 5.5–mile segment of the Willamette River (the Portland Harbor) that includes the area adjacent to the Gasco site and the Siltronic site. The Portland Harbor was listed by the EPA as a Superfund site in 2000 and the Company was notified that it is a potentially responsible party. Subsequently, the EPA approved a Programmatic Work Plan, Field Sampling Plan and Quality Assurance Project Plan for the Portland Harbor Remedial Investigation/Feasibility Study (RI/FS). NW Natural's share of the original cost estimate for the RI/FS work, which was expected to be completed in 2007, was $1.6 million. However, as a result of the EPA's indication that further study will be required, an additional accrual of $2.3 million was recorded in 2005 for the additional studies, regulatory oversight and related legal costs. Current information is not sufficient to reasonably estimate additional liabilities, if any, or the range of potential liabilities, for environmental remediation and monitoring after the RI/FS work plan is completed, except for the early action removal of a tar deposit in the river sediments discussed below.

In April 2004 the Company entered into an Administrative Order on Consent providing for early action removal of a deposit of tar in the river sediments adjacent to the Gasco site. NW Natural completed the removal of the tar deposit in the Portland Harbor in October 2005 and on Nov. 5, 2005 the EPA approved the completed project. The estimated cost for the removal, including technical work, oversight, consultants, legal fees and ongoing monitoring is $10 million. To date NW Natural has spent $7.3 million on work related to the removal of the tar deposit with a remaining liability of $2.7 million.

Oregon Steel Mills site. See "Legal Proceedings," below.

Regulatory and Insurance Recovery for Environmental Matters. In May 2003, the OPUC approved NW Natural's request for deferral of environmental costs associated with specific sites, including the Gasco, Siltronic, and Portland Harbor sites. The authorization, which was extended through January 2006 and expanded to include the Oregon Steel Mills site, allows NW Natural to defer and seek recovery of unreimbursed environmental costs in a future general rate case. An application for extension of the regulatory approval to defer environmental costs is pending. As of Dec. 31, 2005, the Company has paid a cumulative total of $12.4 million relating to the named sites since the effective date of the deferral authorization.

On a cumulative basis, NW Natural has recognized a total of $23.7 million for environmental costs, including legal, investigation, monitoring and remediation costs. Of this total, $17.3 million has been spent to–date and $6.4 million is reported as an outstanding liability. At Dec. 31, 2005, the Company had a regulatory asset of $18.8 million which includes $12.4 million of total expenditures to date and accruals for an additional estimated cost of $6.4 million. The Company believes the recovery of these costs is probable through the regulatory process. The Company also has an insurance receivable of $1.1 million, which is not included in the regulatory asset amount. The Company intends to pursue recovery of these environmental costs from its general liability insurance policies, and the regulatory asset will be reduced by the amount of any corresponding insurance recoveries. The Company considers insurance recovery of some portion of its environmental costs probable based on a combination of factors, including a review of the terms of its insurance policies, the financial condition of the insurance companies providing coverage, a review of successful claims filed by other utilities with similar gas manufacturing facilities, and recent Oregon legislation that allows an insured party to seek recovery of "all sums" from one insurance company. The Company has not filed claims for insurance recovery nor have the insurance companies approved or denied coverage of these claims.

The following table summarizes the regulatory asset and accrued liabilities relating to environmental matters at Dec. 31, 2005 and 2004.

(Millions)	Regulatory Asset 2005	Regulatory Asset 2004	Accrued Liability 2005	Accrued Liability 2004
Gasco site	$ 3.2	$ 2.1	$ 1.4	$ 1.3
Siltronic site	0.3	0.2	–	0.1
Portland Harbor site	15.1	3.8	4.9	3.4
Oregon Steel Mills site	0.2	0.2	0.1	0.2
Total	$ 18.8	$ 6.3	$ 6.4	$ 5.0

Legal Proceedings

The Company is subject to claims and litigation arising in the ordinary course of business. Although the final outcome of any of these legal proceedings, including the matters described below, cannot be predicted with certainty, the Company does not expect that the ultimate disposition of these matters will have a materially adverse effect on the Company's financial condition, results of operations or cash flows.

Independent Backhoe Operator Action. Since May 2004 five lawsuits have been filed against NW Natural by 11 independent backhoe operators who performed backhoe services for the Company under contract. These five lawsuits have been consolidated into one consolidated case, Law and Zuehlke, et. al. v. Northwest Natural Gas Co., CV–04–728–KI. The consolidated case consolidates the following cases previously reported: *Kerry Law and Arnold Zuehlke, on behalf of themselves and all other similarly situated v. Northwest Natural Gas Company* (Filed May 28, 2004 U.S. Dist. Ct. D. Or. Case No. CV–04–728–KI), *Ike Whittlesey, C.G. Nick Courtney, Mark Parrish, John J. Shooter, Roger Whittlesey and Philip Courtney v. Northwest Natural* (Filed February 18, 2005 U.S. Dist. Ct. D. Or. Case No. CV–05–241–KI), *Phillip Courtney v. Northwest Natural* (Filed April 12, 2005 U.S. Dist. Ct. D. Or., Case No. CV–05–507–BR), and *Kenneth Holtmann et. al. v. Northwest Natural* (Filed May 20, 2005 U.S. Dist. Ct. D. Or. Case No. 05–CV–00724–BR). The consolidated case also includes a fifth lawsuit filed on January 23, 2006, *Larry L. Luethe v. Northwest Natural* (U.S. Dist. Ct. D. Or. Case No. CV–06–098–MO).

Plaintiffs in the consolidated case are or have been independent backhoe operators who performed services for the Company under contract. Plaintiffs allege violation of the Fair Labor Standards Act for failure to pay overtime and also assert state wage and hour claims. Plaintiffs claim that they should have been considered "employees," and seek overtime wages and interest in amounts to be determined, liquidated damages equal to the overtime award, civil penalties and attorneys' fees and costs. Additionally, with the exception of the plaintiff in *Larry L. Luethe v. Northwest Natural,* plaintiffs allege that the failure to classify them as employees constituted a breach of contract and a tort under and with respect to certain unspecified employee benefits plans, programs and agreements. With the exception of the plaintiff in *Larry L. Luethe v. Northwest Natural,* plaintiffs seek an unspecified amount of damages for the value of what they would have received under these employee benefit plans if they had been classified as employees. The Company expects that the plaintiff in *Larry L. Luethe v. Northwest Natural* will amend his complaint to include these breach of contract and tort claims for unspecified damages.

In October 2005, the court granted the Company's motion to stay plaintiffs' claims pending exhaustion of the administrative review process with regard to each of the plans under which plaintiffs allege that they would have been eligible to receive benefits. The litigation is still stayed pending plaintiffs' exhaustion of the administrative review process. There is insufficient information at this time to reasonably estimate the range of liability, if any, from these claims. NW Natural will vigorously contest these claims and does not expect the outcome of this litigation to have a material effect on its results of operations or financial condition.

Oregon Steel Mills site. In 2004, NW Natural was served with a third–party complaint by the Port of Portland (Port) in a Multnomah County Circuit Court case, *Oregon Steel Mills, Inc. v. The Port of Portland*. The Port alleges that in the 1940s and 1950s petroleum wastes generated by the Company's predecessor, Portland Gas & Coke Company, and ten other third–party defendants were disposed of in a waste oil disposal facility operated by the United States or Shaver Transportation Company on property then owned by the Port and now owned by Oregon Steel Mills. The Port's complaint seeks contribution for unspecified past remedial action costs incurred by the Port regarding the former waste oil disposal facility as well as a declaratory judgment allocating liability for future remedial action costs. In March 2005, motions to dismiss by the Company and other third–party defendants were denied on the basis that the failure of the Port to plead and prove that the Company was in violation of law was an affirmative defense that may be asserted at trial, but did not provide a sufficient basis for dismissal of the Port's claim. No date has been set for trial and discovery is ongoing. The Company has requested and received regulatory approval from the OPUC to defer and seek recovery of environmental costs related to the Oregon Steel Mills site, if any.

Industrial Customer Litigation. On Feb. 3, 2006, Georgia–Pacific Corporation filed suit against NW Natural (Georgia–Pacific Corporation v. Northwest Natural Gas Company, Case No. CV06–151–PK, United States District Court, District of Oregon), alleging that NW Natural offered to sell natural gas to Georgia–Pacific under the interruptible sales service provisions of the Company's Rate Schedule 32 at a commodity rate set at the Company's Weighted Average Cost of Gas (WACOG). Georgia–Pacific further alleged that it accepted this offer and that the Company failed to perform as promised when, in October 2005, NW Natural notified Georgia–Pacific that it would have to charge Georgia–Pacific the incremental costs of acquiring gas on the open market. Georgia–Pacific also alleges breach of contract, promissory estoppel, fraudulent misrepresentation and breach of the duty of good faith and fair dealing. As a result, Georgia–Pacific is seeking damages in an amount to be determined at trial but which they expect to be at least $235,000, plus consequential damages in an amount to be determined at trial. Georgia–Pacific further alleges that by failing to sell gas to Georgia–Pacific at the agreed upon price, NW Natural violated Oregon state laws that regulate utility operations, thereby entitling Georgia–Pacific to treble damages and attorney fees.

Prior to the Georgia–Pacific federal lawsuit being filed, on Jan. 5, 2006, NW Natural sought a declaratory judgment in the Circuit Court for the State of Oregon (NW Natural Gas Company v. Georgia–Pacific Corporation, Case No. 0601–00116, Multnomah County) declaring that, due to the rapid rise in the cost of natural gas after hurricanes Katrina and Rita, the Company acted in accordance with its tariffs and all applicable laws when it informed Georgia–Pacific that it would not sell Georgia–Pacific natural gas at its WACOG price. When Georgia–Pacific responded by filing the federal lawsuit described above, and removing the declaratory judgment action to the federal court on Feb. 2, 2006, NW Natural voluntarily dismissed its suit for declaratory relief, and now all matters between the parties are before the federal court. NW Natural will vigorously contest the claims of Georgia–Pacific.

EXHIBIT F

A list of all known contingent liabilities, other than minor items such as damages, claims and similar items involving relatively small amounts, as of the date of this Application. (See Exhibit E, Note 9, "Commitments and Contingencies," in the Notes to the Consolidated Financial Statements for the period ended September 30, 2006).

Thousands	Pension Benefits		Other Postretirement Benefits	
	Three Months Ended Sept. 30,			
	2006	2005	2006	2005
Service cost	$ 1,784	$ 1,564	$ 142	$ 114
Interest cost	3,761	3,377	322	308
Special termination benefits	—	63	—	—
Expected return on plan assets	(4,403)	(3,776)	—	—
Amortization of transition obligation	—	—	103	103
Amortization of prior service cost	245	361	48	—
Recognized actuarial loss	805	599	—	72
Net periodic benefit cost	$ 2,192	$ 2,188	$ 615	$ 597

Thousands	Pension Benefits		Other Postretirement Benefits	
	Nine Months Ended Sept. 30,			
	2006	2005	2006	2005
Service cost	$ 5,706	$ 4,741	$ 417	$ 342
Interest cost	11,277	9,903	888	924
Special termination benefits	—	189	—	—
Expected return on plan assets	(13,210)	(10,837)	—	—
Amortization of transition obligation	—	—	309	309
Amortization of prior service cost	735	807	146	—
Recognized actuarial loss	2,638	1,562	—	216
Net periodic benefit cost	$ 7,146	$ 6,365	$ 1,760	$ 1,791

Employer Contributions

We are not required to make cash contributions to our qualified non–contributory defined benefit plans in 2006, but cash contributions in the form of ongoing benefit payments will be required for the unfunded non–qualified supplemental pension plans and other postretirement benefit plans in 2006. See Part II, Item 8., Note 7, in the 2005 Form 10–K for a discussion of future payments.

9. Commitments and Contingencies

Environmental Matters

We own, or have previously owned, properties that may require environmental remediation or action. We accrue all material loss contingencies relating to these properties that we believe to be probable of assertion and reasonably estimable. We continue to study the extent of potential environmental liabilities, but due to the numerous uncertainties surrounding the course of environmental remediation and the preliminary nature of several environmental site investigations, the range of potential loss beyond the amounts currently accrued, and the probabilities thereof, cannot be reasonably estimated. We regularly review our remediation liability for each site where we may be exposed to remediation responsibilities. The costs of environmental remediation are difficult to estimate. A number of steps are involved in each environmental remediation effort, including site investigations, remediation, operations and maintenance, monitoring and site closure. Each of these steps may, over time, involve a number of alternative actions, each of which can change the course of the effort. In certain cases, in addition to NW Natural, there are a number of other potentially responsible parties, each of which, in proceedings and negotiations with other potentially responsible parties and regulators, may influence the course of the remediation effort and associated cost estimates. The allocation of liabilities among the potentially responsible parties is often subject to dispute and highly uncertain. The events giving rise to environmental liabilities often occurred many decades ago, which complicates the determination of allocating liabilities among potentially responsible parties. Site investigations and remediation efforts often develop slowly over many years. To the extent reasonably estimable, we estimate the costs of environmental liabilities using current technology, enacted laws and regulations, industry experience gained at similar sites and an assessment of the probable level of involvement and financial condition of other potentially responsible parties. Unless there is a more likely estimate within this range of probable cost, we record the liability at the lower end of this range. It is likely that changes in these estimates will occur throughout the remediation process for each of these sites due to uncertainty concerning our responsibility, the complexity of environmental laws and regulations, and the selection of compliance alternatives. The status of each of the sites currently under investigation is provided below. Also, see Part II, Item 8., Note 12, in the 2005 Form 10-K for a description of these properties and further discussion.

Gasco site. We own property in Multnomah County, Oregon that is the site of a former gas manufacturing plant that was closed in 1956 (the Gasco site). We have been investigating the Gasco site for environmental contamination under the Oregon Department of Environmental Quality's (ODEQ) Voluntary Clean-Up Program. In June 2003, we filed a Feasibility Scoping Plan and an Ecological and Human Health Risk Assessment with the ODEQ, which outlined a range of remedial alternatives for the most contaminated portion of the Gasco site. In the third quarter of 2006, we accrued an additional $0.3 million to be used for the upgrade of the water treatment system in conjunction with source control, replacement of a well, ongoing consultant and investigation fees for in-river groundwater and source control studies and to cover cost estimates of remedial alternatives identified in the Feasibility Scoping Plan and Ecological and Human Health Risk Assessment for the most contaminated portion of the site. The liability balance at Sept. 30, 2006 is $2.7 million, which is at the low end of the probable and reasonably estimable liability range. We are not able to estimate the high end of a liability range.

Siltronic site. We previously owned property adjacent to the Gasco site that now is the location of a manufacturing plant owned by Siltronic Corporation (the Siltronic site). We had previously agreed to an addendum to the Voluntary Clean-up Agreement with the ODEQ, which will require additional investigation of potential manufactured gas plant wastes on the Siltronic site. Since the scope of work is unknown, there is not enough information to reasonably estimate the additional liability. The additional amount accrued for this work in the third quarter of 2006 was negligible.

Portland Harbor site. In 1998, the ODEQ and the U.S. Environmental Protection Agency (EPA) completed a study of sediments in a 5.5-mile segment of the Willamette River (the Portland Harbor) that includes the area adjacent to the Gasco site and the Siltronic site. The Portland Harbor was listed by the EPA as a Superfund site in 2000 and we were notified that we are a potentially responsible party. Subsequently, the EPA approved a Programmatic Work Plan, Field Sampling Plan and Quality Assurance Project Plan for the Portland Harbor Remedial Investigation/Feasibility Study (RI/FS). In the third quarter of 2006, we accrued an additional $0.7 million to reflect our current estimate of liability of $1.9 million related to the RI/FS for consultant fees, technical work and other costs. Information is not sufficient to reasonably estimate additional liabilities, if any, or the range of potential liabilities for environmental remediation and monitoring after the RI/FS work plan is completed, except for the early action removal of a tar deposit in the river sediments discussed below.

In April 2004, we entered into an Administrative Order on Consent providing for early action removal of a deposit of tar in the Willamette River sediments adjacent to the Gasco site. The removal of the tar deposit in the Portland Harbor was completed in October 2005, and in November 2005, the EPA approved the completed project. In the third quarter of 2006, we accrued an additional $0.1 million to reflect our current estimate of liability of $0.9 million for costs related to the tar deposit, including oversight, consultant and legal fees, and ongoing monitoring. To date, $9.4 million has been spent for work related to the removal of the tar deposit.

Central Gas Storage Tanks. On Sept. 22, 2006, we received notice from the ODEQ that our Central Service Center has been assigned a high priority for further environmental investigation. Previously there were three manufactured gas storage tanks on the premises. The ODEQ believes there could be site contamination associated with releases of condensate from stored manufactured gas, or through historic gas handling practices. In the early 1990s, we excavated waste piles and much of the contaminated surface soils and removed accessible waste from some of the abandoned piping. A negligible accrual was recorded in September 2006 for the ODEQ site assessment and legal and technical costs to investigate and determine the appropriate action, if any. We intend to seek regulatory deferral of environmental costs related to this site (see "Regulatory and Insurance Recovery for Environmental Matters," below).

Oregon Steel Mills site. See "Legal Proceedings," below.

Regulatory and Insurance Recovery for Environmental Matters. In May 2003, the Oregon Public Utility Commission (OPUC) approved our request for deferral of environmental costs associated with specific sites. The authorization, which has been extended through January 2007, allows us to defer and seek recovery of unreimbursed environmental costs in a future general rate case. In April 2006, the OPUC authorized us to accrue interest on deferred balances effective Jan. 27, 2006, subject to an annual demonstration to the OPUC that we have maximized our insurance recovery or made substantial progress in securing insurance recovery for unrecovered environmental expenses. As of Sept. 30, 2006, we have paid a cumulative total of $17.1 million relating to the covered sites since the effective date of the deferral authorization.

On a cumulative basis, we have recognized a total of $27.7 million for environmental costs, including legal, investigation, monitoring and remediation costs. Of this total, $22.0 million has been spent to–date and $5.7 million is reported as an outstanding liability. During the third quarter of 2006, we increased regulatory assets by $1.1 million for additional environmental cost estimates related to sites authorized for deferral treatment, and at Sept. 30, 2006 we had a total environmental regulatory asset of $22.8 million, which includes $17.1 million of total expenditures to date and additional accruals of $5.7 million. We believe the recovery of these costs is probable through the regulatory process after first pursuing recovery of costs from insurance. We also have an insurance receivable of $1.1 million, which is not included in the regulatory asset amount. We intend to pursue recovery of these environmental costs from our general liability insurance policies, and the regulatory asset will be reduced by the amount of any corresponding insurance recoveries. We consider insurance recovery probable based on a combination of factors, including a review of the terms of our insurance policies, the financial condition of the insurance companies providing coverage, a review of successful claims filed by other utilities with similar gas manufacturing facilities and Oregon law, which allows an insured party to seek recovery of "all sums" from one insurance company. We have notified the insurance companies but have not yet filed claims for recovery, nor have the insurance companies approved or denied coverage of these claims.

Legal Proceedings

We are subject to claims and litigation arising in the ordinary course of business. Although the final outcome of any of these legal proceedings, including the matters described below and in Part II, Item 8., Note 12, in the 2005 Form 10–K, cannot be predicted with certainty, we do not expect that the ultimate disposition of these matters will have a material adverse effect on our financial condition, results of operations or cash flows.

Georgia–Pacific Corporation vs. Northwest Natural Gas Company. On Feb. 3, 2006, Georgia–Pacific Corporation filed suit against NW Natural (*Georgia–Pacific Corporation v. Northwest Natural Gas Company*, Case No. CV06–151–PK, United States District Court, District of Oregon), alleging that we offered to sell natural gas to Georgia–Pacific under the interruptible sales service provisions of Rate Schedule 32 at a commodity rate set at our Weighted Average Cost of Gas. Georgia–Pacific further alleged that it accepted this offer and that we failed to perform as promised when, in October 2005, we notified Georgia–Pacific that we would have to charge Georgia–Pacific the incremental costs of acquiring gas on the open market. Georgia–Pacific also alleged breach of contract, promissory estoppel, fraudulent misrepresentation and breach of the duty of good faith and fair dealing.

On Feb. 23, 2006, we filed a motion for summary judgment on all claims. On June 30, 2006, an order was issued by the U.S. District Court for the District of Oregon dismissing the lawsuit with prejudice and denying all pending motions, if any, as moot. On July 27, 2006, Georgia–Pacific appealed this ruling to the Ninth Circuit Court of Appeals. We do not expect the outcome of this appeal to have a material adverse effect on our financial condition, results of operations or cash flows.

Independent Backhoe Operator Action. Since May 2004, five lawsuits have been filed against NW Natural by 11 independent backhoe operators who performed backhoe services for NW Natural under contract. These five lawsuits have been consolidated into one case, *Law and Zuehlke, et. al. v. Northwest Natural Gas Co.*, CV–04–728–KI, United States District Court, District of Oregon). Plaintiffs allege violation of the Fair Labor Standards Act for failure to pay overtime and also assert state wage and hour claims. Plaintiffs claim that they should have been considered "employees," and seek overtime wages and interest in amounts to be determined, liquidated damages equal to the overtime award, civil penalties and attorneys' fees and costs. Additionally, with one exception, plaintiffs allege that the failure to classify them as employees constituted a breach of contract and a tort under and with respect to certain employee benefits plans, programs and agreements. With the one exception, plaintiffs seek an unspecified amount of damages for the value of what they would have received under these employee benefit plans if they had been classified as employees. We expect that the remaining plaintiff will amend his complaint to include breach of contract and tort claims for unspecified damages.

In October 2005, the court granted NW Natural's motion to stay plaintiffs' claims pending exhaustion of the administrative review process with regard to each of the plans under which plaintiffs allege that they would have been eligible to receive benefits. The litigation is still stayed pending plaintiffs' exhaustion of the administrative review process. There is insufficient information at this time to reasonably estimate the range of liability, if any, from these claims. We will continue to vigorously contest these claims and do not expect that the outcome of this litigation will have a material adverse effect on our financial condition, results of operations or cash flows.

Oregon Steel Mills site. In 2004, we were served with a third–party complaint by the Port of Portland (Port) in a Multnomah County Circuit Court case, *Oregon Steel Mills, Inc. v. The Port of Portland*. The Port alleges that in the 1940s and 1950s petroleum wastes generated by NW

Natural's predecessor, Portland Gas & Coke Company, and ten other third–party defendants disposed of waste oil in a disposal facility operated by the United States or Shaver Transportation Company on property then owned by the Port and now owned by Oregon Steel Mills. The Port's complaint seeks contribution for unspecified past remedial action costs incurred by the Port regarding the former waste oil disposal facility as well as a declaratory judgment allocating liability for future remedial action costs. In March 2005, motions to dismiss by NW Natural and other third–party defendants were denied on the basis that the failure of the Port to plead and prove that we were in violation of law was an affirmative defense that may be asserted at trial, but did not provide a sufficient basis for dismissal of the Port's claim. No date has been set for trial and discovery is ongoing. We do not expect that the ultimate disposition of this matter will have a material adverse effect on our financial condition, results of operations or cash flows.

Pipeline Safety Inspection. On Sept. 22, 2006, the Washington Utilities and Transportation Commission (WUTC) issued a Standard Natural Gas Pipeline Safety Inspection report on our facilities in Clark County, Washington. Based on the findings of the inspection report and regulatory action taken with other gas distribution companies, enforcement action is expected. We are in the process of taking corrective action and do not expect the impact of this action to have a material adverse effect on our financial condition, results of operations or cash flows.

10. Comprehensive Income

For the three and nine months ended Sept. 30, 2006 and 2005, reported net income was equivalent to total comprehensive income. Items that are excluded from net income and charged directly to common stock equity are included in accumulated other comprehensive income (loss), net of tax. The amount of accumulated other comprehensive loss in total common stock equity is $1.9 million at Sept. 30, 2006, which is related to our minimum pension liability (see "Consolidated Statements of Capitalization," above).

EXHIBIT G

Comparative Income Statements for the three and nine months ended September 30, 2006, and the 12 months ended December 31, 2005, as filed in the Company's reports to the SEC on Forms 10-Q and 10-K, respectively. (See Exhibit E for Notes to Financial Statements)

NORTHWEST NATURAL GAS COMPANY
PART I. FINANCIAL INFORMATION
Consolidated Statements of Income
(Unaudited)

Thousands, except per share amounts	Three Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Nine Months Ended Sept. 30, 2005
Operating revenues:				
Gross operating revenues	$114,914	$106,667	$676,284	$569,111
Less: Cost of sales	70,634	62,231	431,069	335,264
Revenue taxes	2,939	2,496	16,663	13,272
Net operating revenues	41,341	41,940	228,552	220,575
Operating expenses:				
Operations and maintenance	25,640	25,988	81,796	80,164
General taxes	5,595	5,915	19,234	17,895
Depreciation and amortization	16,196	15,452	47,988	45,959
Total operating expenses	47,431	47,355	149,018	144,018
Income (loss) from operations	(6,090)	(5,415)	79,534	76,557
Other income and expense – net	314	550	1,242	1,020
Interest charges – net of amounts capitalized	9,781	9,253	28,820	27,287
Income (loss) before income taxes	(15,557)	(14,118)	51,956	50,290
Income tax expense (benefit)	(5,833)	(5,447)	18,653	17,934
Net income (loss)	$ (9,724)	$ (8,671)	$ 33,303	$ 32,356
Average common shares outstanding:				
Basic	27,556	27,560	27,568	27,564
Diluted	27,669	27,630	27,686	27,626
Earnings (loss) per share of common stock:				
Basic	$ (0.35)	$ (0.31)	$ 1.21	$ 1.17
Diluted	$ (0.35)	$ (0.31)	$ 1.20	$ 1.17

See Notes to Consolidated Financial Statements

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF INCOME

Thousands, except per share amounts (year ended December 31)	2005	2004	2003
Operating revenues:			
Gross operating revenues	$ 910,486	$ 707,604	$ 611,256
Cost of sales	563,860	399,244	323,190
Revenue taxes	21,633	16,865	14,650
Net operating revenues	324,993	291,495	273,416
Operating expenses:			
Operations and maintenance	113,216	102,155	96,420
General taxes	23,185	21,943	20,475
Depreciation and amortization	61,645	57,371	54,249
Total operating expenses	198,046	181,469	171,144
Income from operations	126,947	110,026	102,272
Other income and expense – net	1,205	2,828	2,150
Interest charges – net of amounts capitalized	37,283	35,751	35,099
Income before income taxes	90,869	77,103	69,323
Income tax expense	32,720	26,531	23,340
Net income	58,149	50,572	45,983
Redeemable preferred stock dividend requirements	–	–	294
Earnings applicable to common stock	$ 58,149	$ 50,572	$ 45,689
Average common shares outstanding:			
Basic	27,564	27,016	25,741
Diluted	27,621	27,283	26,061
Earnings per share of common stock:			
Basic	$ 2.11	$ 1.87	$ 1.77
Diluted	$ 2.11	$ 1.86	$ 1.76

See Notes to Consolidated Financial Statements.

EXHIBIT H

Consolidated Statements of Shareholders' Equity and Comprehensive Income as of December 31, 2005 showing an analysis of surplus for that period. For the nine months ended September 30, 2006, see Exhibit E for the Balance Sheet showing the surplus invested in the business and for Note 10, "Comprehensive Income," in the Notes to the Consolidated Financial Statements)

NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

Thousands	Common Stock And Premium	Earnings Invested in the Business	Unearned Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity	Comprehensive Income
Balance at Dec. 31, 2002	$ 329,051	$ 157,136	$ (711)	$ (3,084)	$ 482,392	
Net Income	–	45,983	–	–	45,983	$ 45,983
Minimum pension liability adjustment – net of tax	–	–	–	2,068	2,068	2,068
Purchases of restricted stock	–	–	(328)	–	(328)	
Restricted stock amortizations	–	–	310	–	310	
Cash dividends paid:						
Redeemable preferred stock	–	(392)	–	–	(392)	
Common stock	–	(32,655)	–	–	(32,655)	
Tax benefits from employee stock option plan	401	–	–	–	401	
Issuance of common stock	7,930	–	–	–	7,930	
Convertible debentures	626	–	–	–	626	
Common stock expense	–	(19)	–	–	(19)	
Balance at Dec. 31, 2003	338,008	170,053	(729)	(1,016)	506,316	$ 48,051
Net Income	–	50,572	–	–	50,572	$ 50,572
Minimum pension liability adjustment – net of tax	–	–	–	(802)	(802)	(802)
Purchases of restricted stock	(55)	(51)	(431)	–	(537)	
Restricted stock amortizations	–	–	298	–	298	
Cash dividends paid:						
Common stock	–	(35,105)	–	–	(35,105)	
Tax benefits from employee stock option plan	872	–	–	–	872	
Issuance of common stock	47,148	–	–	–	47,148	
Convertible debentures	1,292	–	–	–	1,292	
Common stock expense	–	(1,537)	–	–	(1,537)	
Balance at Dec. 31, 2004	387,265	183,932	(862)	(1,818)	568,517	$ 49,770
Net Income	–	58,149	–	–	58,149	$ 58,149
Minimum pension liability adjustment – net of tax	–	–	–	(93)	(93)	(93)
Restricted stock amortizations	–	–	212	–	212	
Cash dividends paid:						
Common stock	–	(36,376)	–	–	(36,376)	
Tax benefits from employee stock option plan	220	–	–	–	220	
Issuance of common stock	7,266	–	–	–	7,266	
Common stock repurchased	(14,945)	–	–	–	(14,945)	
Convertible debentures	3,999	–	–	–	3,999	
Common stock expense	–	(18)	–	–	(18)	
Balance at Dec. 31, 2005	$ 383,805	$ 205,687	$ (650)	$ (1,911)	$ 586,931	$ 58,056

See Notes to Consolidated Financial Statements.

EXHIBIT I

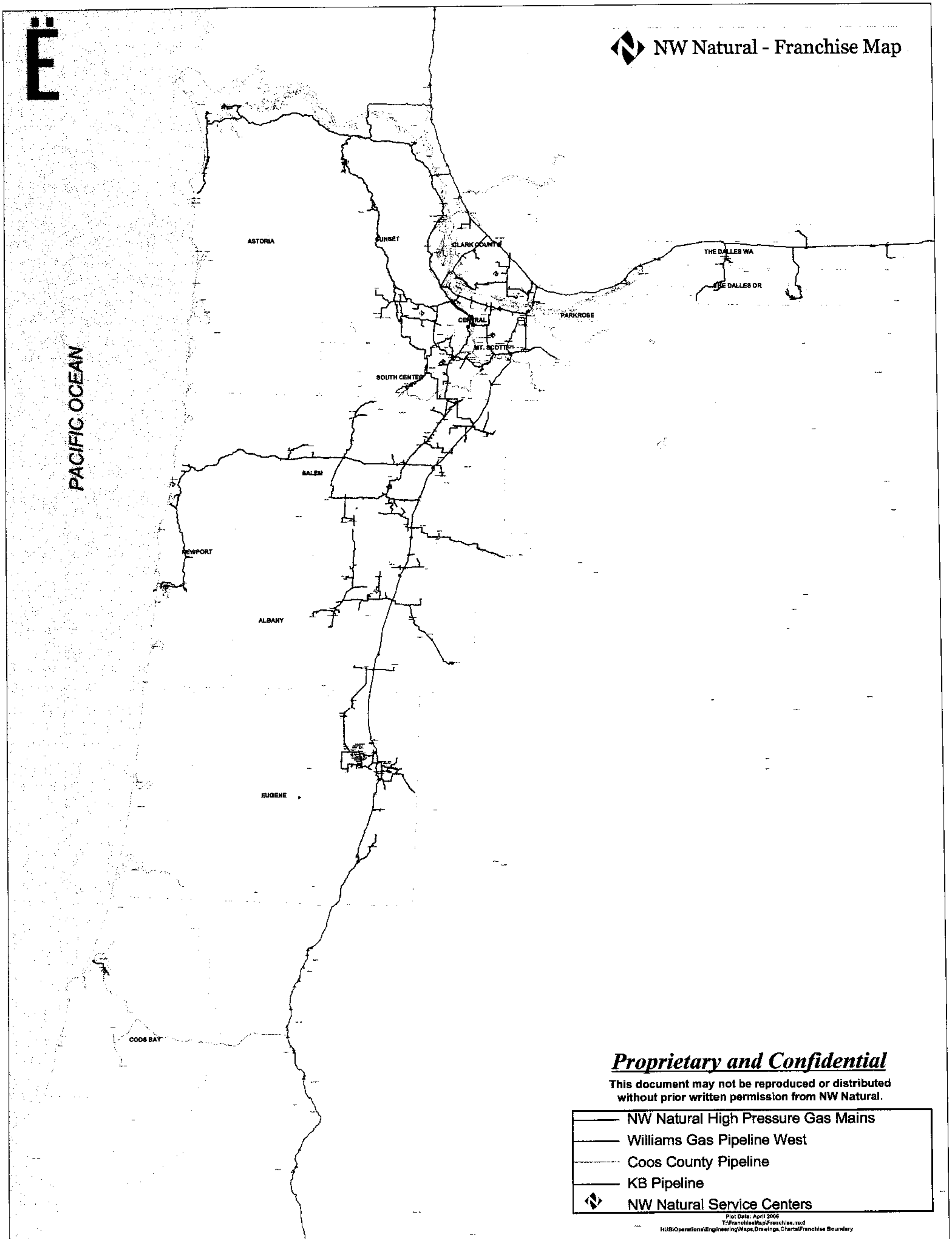
No Registration Statement for the Interest Rate Hedging Products is required to be filed with the Securities and Exchange Commission.

EXHIBIT J & K

There is no current agreement regarding the Interest Rate Hedge Products. See Exhibit D for an extract from a presentation by J.P. Morgan Securities, Inc. defining and illustrating the use of interest rate swap and other interest rate hedge transactions.

EXHIBIT AA

Map of the Company's Service Territories.



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NW Natural - Franchise Map
PACIFIC OCEAN
ASTORIA
SUNSET
CLARK COUNTY
THE DALLES WA
THE DALLES OR
PARKROSE
CENTRAL
MT. SCOTT
SOUTH CENTER
SALEM
NEWPORT
ALBANY
EUGENE
COOS BAY
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NW Natural High Pressure Gas Mains
Williams Gas Pipeline West
Coos County Pipeline
KB Pipeline
NW Natural Service Centers
Plot Date: April 2006
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HUS\Operations\Engineering\Maps,Drawings,Charts\Franchise Boundary

EXHIBIT BB

Company's Derivatives Policy-Financial Products

NORTHWEST NATURAL GAS COMPANY

DERIVATIVES POLICY
REVISED September 2005

Corporate Policy Statement on Financial Derivative Products

GENERAL OBJECTIVES

The use of selected financial derivative products provides Northwest Natural Gas Company and subsidiaries (the Company) with the ability to employ prudent risk management strategies within designated parameters for natural gas commodity prices, foreign currency exchange rates related to Company's natural gas purchase commitments, and interest rates on existing or forecasted debt balances. The objective is to use derivative products to structure hedging strategies as defined by this policy. Use of derivatives is permitted only after the purchase price, exchange rate, and interest rate exposures that have been identified are determined to exceed risk tolerance levels and are considered to be unavoidable because they are necessary or support normal business activities.

This policy is intended to allow the Company to reduce commodity price, exchange rate and interest rate risks (market risks) by using hedging strategies and derivative structures within certain limitations. Hedging strategies beyond the guidelines set forth in this policy must be reviewed and approved by the Finance Committee of the Board of Directors. This policy is intended to prevent speculative risk. Derivatives should decrease net exposures of the Company to market risk. Any increase in market risk created by the use of derivatives must be offset by the exposures they modify or specifically approved by the Management Finance Committee or the Gas Supply Strategy & Policies Committee (GASP) as appropriate.

The use of derivatives in connection with any of the Company's employee benefits plans, including medical and pension plans, are not governed by this policy, but rather are subject to separate statements of investment policy and guidelines applicable to such plans.

DEFINITIONS

Hedging means reducing risk. It includes activities that reduce risk or that convert one type of risk to another deemed more tolerable. To qualify as hedging, an activity should be expected to produce a measurable offset to risk relating to an asset, liability, committed transaction, or probable forecasted transaction.

Speculative risk means any risk that is engaged in for reasons other than to reduce market risk, including transactions engaged in solely for the purpose of profiting from market movements. Derivative activities are considered speculative if they increase the Company's exposure to market risk. Speculative risk also includes normal market making where the expectation is simply to profit from the bid-ask differences.

Financial exposure is defined in this policy as the amount of market risk for an individual transaction or the amount of credit risk for a specific counter-party. Financial exposure will be calculated using models approved by the Management Finance Committee.

Types of Derivative Instruments Authorized for Use

The Company may use derivative instruments provided their use is expected to result in a transaction that qualifies for hedge accounting as defined in this policy and Generally Accepted Accounting Principles (GAAP), and such use is not prohibited elsewhere by this policy, or is reasonably expected to qualify for regulatory deferral accounting based on approved practices by the OPUC and the WUTC. The following are considered derivative instruments for purposes of this policy and are specifically approved for use by the Company:

- Futures "exchange" contracts
- Forward "over-the-counter" contracts
- "Exchange" and "over-the-counter" basis contracts (see Operational Limitations, Item 4 below)
- Price and rate swap agreements
- Purchased Option contracts
- Sold ("written") option contracts related to "Extendible Swap" transactions or contracts to reverse an earlier purchased option
- Price and rate caps and collars (combination options)

Operating Procedures

Transaction authority will be delegated to responsible officers or managers of the Company, or their designees. Because the exposure to derivative contracts is directly related to their terms, the policy provides for decreasing authority based upon the declining financial exposure amount and term of the transactions.

Responsibility for the execution of the Derivatives Policy is assigned as follows:

1) Derivative instruments for hedging commodity prices related to natural gas purchase requirements will be the responsibility of the Company's gas purchasing and sales agent under the direction of the Director of Gas Supply.

2) Derivative instruments for hedging foreign currency exchange rates will be the responsibility of Cash Management personnel under the direction of the Manager of Treasury.

3) Derivative instruments for hedging interest rates will be the responsibility of the Treasurer.

4) All other derivative instruments, if applicable, will be the responsibility of the Treasurer.

Authorized Personnel and Transaction Limits:

	FINANCIAL EXPOSURE LIMITS			
TERM	**Derivative Instrument Limit**	**\$0-\$2.5 million**	**\$2.5 - \$5 million**	**Over \$5 million**
Up to 6 months	1)15,000 dth/day 2)\$5.0 million 3-4)\$50 million	1)Dir, Gas Supply 2) Mgr, Treasury 3-4) Treasurer	+ Treasurer + Treasurer + CFO	+ CFO + CFO (Same)
Over 6 mos, up to 1 year	1)15,000 dth/day 2)\$2.5 million 3-4)\$30 million	1)Dir, Gas Supply 2) Mgr, Treasury 3-4) Treasurer	+ Treasurer + Treasurer + CFO	+ CFO + CFO (Same)
Over 1 year, up to 3 years	1)10,000 dth/day 2)\$2.5 million 3-4)\$25 million	1)Dir, Gas Supply + Treasurer 2) Mgr, Treasury + Treasurer 3-4) Treasurer + CFO	+ CFO + CFO + CEO	+ CEO + CEO (Same)
Over 3 years, up to 5 years	1)10,000 dth/day 2)\$1 million 3-4)\$20million	1)Dir, Gas Supply + Treasurer + CFO 2) Mgr, Treasury + Treasurer + CFO 3-4) Treasurer +CFO	+ CEO + CEO + CEO	(Same) (Same) (Same)

Hedging activity is to be monitored by the Treasurer, and reviewed on a quarterly basis using summarized detail of individual derivative transactions and positions. As part of the Company's standard operating procedure with its derivatives dealers and counter-parties, the Company will request facsimile confirmation of all transactions be sent to and verified by an individual assigned to perform mid-office functions, which is segregated and independent of the individual or group executing the transaction except for foreign currency and interest rate transactions. With respect to foreign currency and interest rate transactions, confirmations must also be verified and approved by the immediate supervisor of the individual executing the derivative transaction.

Execution of a derivative transaction is typically performed verbally, with written confirmation following shortly thereafter. The authorized individuals listed above are empowered to enter into derivative transactions on a verbal basis in accordance with this policy, but complete and contemporaneous documentation is required and must be forwarded to the Company's Mid-Office on a timely basis. The Mid-Office is responsible for confirming transactions and monitoring compliance with this policy. If for any reason an executed transaction does not meet the limits or continuing requirements of this policy, the Mid-Office must immediately notify the authorized individuals and the Treasurer, CFO and CEO. The authorized individual shall be required to either: (1) obtain authorization from an individual with a higher level of authority who is authorized to transact at the higher level the transaction requires, or (2) receive a temporary waiver approved by the Chair of the GASP Committee. Temporary shall mean until submitted to the GASP Committee for approval at its next regularly scheduled meeting. If required, the individual shall obtain approval from the Treasurer, CFO or CEO to unwind the transaction, and then enter into a transaction to effectively unwind the position as soon as commercially possible. Any delay in unwinding a position shall immediately be approved by the GASP Committee. Additionally, written updates to the GASP Committee (including the Mid Office) are required on a weekly basis to report the status of any positions not unwound on a timely basis, except as noted below.

If a counterparty's credit rating remains unchanged and its financial exposure amount exceeds the approved credit limit by less than 10% due solely to changes in the spot and forward prices of natural gas, then the authorized individual may not be required to unwind the position. Prompt notification to the Treasurer and approval by the GASP Committee, as well as documentation by the Mid Office, are required for any positions not unwound on a timely basis.

<u>Operational Limitations</u>

The following operational limitations are imposed on the use of derivatives:

1) <u>Financial Derivative Positions for Current Hedge Strategies</u>: Derivatives are used to reduce exposure to natural gas commodity price, foreign currency exchange rate, ,and interest rate risk. Due to the limited number of personnel involved in the purchasing and liquidation of derivative instruments, the Company has

not developed individual employee limits. However, it is the responsibility of the managers of the respective groups to ensure that the transactions entered into by employees, individually and in aggregate, are reasonable and comply with appropriate delegation of authority and the specified procedures and limitations of this Policy.

a) Natural Gas Commodity Price. The policy allows a hedge position of commodity prices for projected or contracted volumes of natural gas purchase requirements:
- up to a 100 percent hedge position for the next 12-month gas contract period,
- up to a 50 percent hedge position for the second 12-month gas contract period,
- up to a 25 percent hedge position for the third gas contract period, and
- up to a 10 percent hedge position for the fourth and fifth gas contract period.

b) Foreign Currency Exchange Rate. The policy allows up to a 100 percent hedge position of Canadian currency purchase requirements related to the current month's estimated daily purchase requirements on commodity gas from Canada, and up to the following target ranges for monthly Canadian purchase requirements related to Canadian demand costs over the next 12 months:

Months	Position
0-3	75%-100%
3-6	50%-75%
6-9	25%-50%
9-12	0 -25%

c) Interest Rates. The policy allows up to a 100% position in interest rate derivatives to match specific outstanding debt instruments with maturities of less than five years, or with interest rates that are not fixed, in circumstances where current rates are considered favorable; where market conditions indicate a change in rates during a future period when the Company will need to issue additional debt; or when future financial results are significantly exposed to rate increases or decreases.

2) On a cumulative basis, derivative transactions for any single gas contract year will not exceed $500 million notional amount in aggregate, and will not

exceed $150 million notional amount with any single dealer or counter-party, without prior approval from the Board Finance Committee.

3) The use of derivatives must be limited such that the Company is not exposed to collateral calls cumulatively greater than 25 percent of annual working capital.

4) Combining derivative instruments/transactions to reduce the same exposure makes the net effect difficult to evaluate from economic and accounting perspectives and therefore should be used only when single derivative structures do not adequately minimize risk.

5) Forecasted business requirements more than one year into the future, and any transaction that will not commence its term within 15 months, requires approval from the Treasurer or CFO.

6) The policy allows for the unwinding or early extinguishment of established hedge positions if deemed appropriate by the Treasurer, CFO or CEO, as appropriate; however, frequent buying/selling/terminating of derivatives used in risk management activities without changing positions of matched items is discouraged.

7) The policy allows the Company to enter into derivative transactions with a dealer or counter-party subject to the following long-term credit ratings:

Contract Term	L-T Ratings	Credit Limit (Financial Exposure Amount[1])
Up to six months	BBB/BBB+	$7.5/$10 million
Up to one year	A-/A/A+	$15/$20/$25 million
Up to three years	AA-/AA/AA+	$30/$40/$50 million
Three to five years	AAA-/AAA	$75/$100 million

[1]Fin ancial exposure amount refers to market risk and counter-party credit risk, which is quantified using models selected and approved by the Management Finance Committee of NW Natural for purposes of this policy.

Exhibit E (attached) contains the approved list of dealers and counter-parties, and their respective credit ratings, as may be revised from time to time by the Management Finance Committee within the credit rating limits shown above.

Prohibited Uses

Derivatives cannot be used for activities that increase risk to the Company, such as trading, speculation or any other purpose in which there is no specific business objective other than to generate profits. The following are specifically prohibited by this policy:

1) The use of highly leveraged derivatives is inappropriate because they generally do not reduce risk, but rather expose the Company to loss in excess of gains expected to be generated by the positions/transactions they modify.

2) Use of any derivative is specifically prohibited if a market quotation cannot be obtained for it, or a price is not specified within the derivative contract.

3) Derivative transactions that are primarily motivated by accounting implications and do not reduce economic risk exposure are considered inappropriate and are prohibited by this policy.

4) Use of derivative instruments that do not qualify for hedge or regulatory deferral accounting under GAAP is prohibited, except for circumstances where the market risk exceeds tolerance levels and an effective hedge cannot otherwise qualify for hedge or deferral accounting.

5) Writing options, in general, is prohibited. Written options are only permitted for the purpose of unwinding or early extinguishing a purchased option, as allowed under Operational Limitations, Section 6 above, and for limited use of "extendable swaps."

REPORTING/OVERSIGHT

The Company will record, report and account for risk management and hedging activities in accordance with GAAP. To monitor management's compliance with this policy a quarterly report shall be submitted to the Finance Committee of the Board of Directors. At a minimum, this report shall include:

- Gains and losses realized by type of derivative transacted during the period, summarizing the specific items hedged, together with relevant data demonstrating the effectiveness of the hedge.

- Gains and losses realized on any derivatives that were terminated and any transaction costs associated with the hedging activity, as well as offsetting amounts on linked hedged items.

- Open positions of derivatives by type, by month and by counter-party, showing notional amounts and counter-party credit ratings.

- A mark-to-market valuation of the derivatives portfolio as of the most recent quarter, by counter-party.

- Security ratings of authorized brokers and counter-parties.

In addition, detailed information shall be made available to the Board Finance Committee upon request.

This policy shall be approved by the Management Finance Committee and the GASP Committee. Substantive changes to this policy shall also be approved by the Chair of the Finance Committee of the Board of Directors. The policy and any substantive changes will be reviewed on a regular basis with the Finance Committee of the Board of Directors.

EXHIBIT CC

Company's capital structure and weighted average cost of capital as authorized in Oregon Jurisdictional Rate Case UG-152.

NW Natural
Oregon Jurisdictional Rate Case - 2003-2004 Test Period - UG 152
Input Assumptions
Proforma Cost of Capital

Line No.		% of Total Capital	Average Cost	Average Weighted Cost
		(a)	(b)	(c)
1	Long Term Debt	49.82%	7.07%	3.52%
2	Preferred Stock	0.68%	7.16%	0.05%
3	Common Stock	49.50%	10.20%	5.05%
4	Total	100.00%		8.62%

ORDER NO. 03-507

ENTERED AUG 22 2003

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 152

In the Matter of NORTHWEST NATURAL GAS COMPANY Application For a General Rate Revision Advice No. 02-19.	)))))))	FINAL ORDER

DISPOSITION: STIPULATIONS ADOPTED; APPLICATION FOR GENERAL RATE REVISION APPROVED AS REVISED

I. BACKGROUND

On November 29, 2002, Northwest Natural Gas Company (NWN or Company) filed Advice No. 02-19, an application for revised tariff schedules. By Order No. 02-879, entered December 18, 2002, the tariff sheets were suspended and an investigation was ordered.

At the request of NWN, the Commission bifurcated this proceeding by considering the Company's investment in the construction of the Coos County Distribution System (CCDS) on an expedited schedule. After submission of numerous briefs and oral argument before the Commission, the parties entered into a Stipulation and, by Order No. 03-236, entered April 22, 2003, (CCDS Order) the Commission approved NWN's investment in the Coos County Distribution System for ratemaking purposes in accordance with the terms and conditions of the Stipulation.

The Commission adopted a procedural schedule to examine the remaining issues of revenue requirement and rate design (including the setting of rates to recover costs for the Commission-authorized CCDS investment), as well as numerous practical questions and policy issues arising out of various provisions of the Company's proposed tariffs. In addition to the Company, the parties who have been most actively involved in this second phase of the proceeding are the Commission staff (Staff), the Northwest Industrial Gas Users (NWIGU) and the Citizens' Utility Board (CUB).

Following a series of settlement discussions, the parties filed a total of four stipulations to resolve all remaining issues. The stipulations and supporting testimony were entered into the record of evidence pursuant to OAR 860-014-0085. We address each stipulation below.

II. THE PARTIAL REVENUE REQUIREMENT STIPULATION

Issues resolved by the Partial Revenue Requirement Stipulation. The Partial Revenue Requirement Stipulation executed by the Company, Staff, NWIGU and CUB and attached as Appendix A, relates to Staff issues S-2 through S-11, S-13 through S-18, and S-20 through S-23.[1] These changes constitute a series of adjustments to revenues, expenses, or rate base, because the revenue requirement impact of certain adjustments depends on the final cost of capital and capital structure. The revenue requirement effect of the adjustments is set forth in Apendix E. For some of the issues, the parties agreed to a general method or approach to resolution, rather than a numeric adjustment.[2] The parties also agreed that no change in the cost of preferred stock should be made to the filed case.

The issues resolved are summarized as follows:

Issue S-2: Miscellaneous Revenues. Revenues were increased by $612,000 to reflect Staff's calculation that greater revenues from late payment fees would be collected by the Company.[3]

Issue S-3: Uncollectible Expenses. Uncollectible expenses were reduced by $243,000, to account for the effect of the Company's low-income bill payment assistance program.[4]

Issue S-4: Call Center Staffing. Operations and maintenance (O & M) expenses were reduced by $57,000 to disallow one full-time equivalent employee (FTE) in the call center. The disallowance takes into account the use of additional call center FTEs who answer phones only part of the time.[5]

Issue S-5: Energy Efficiency Staffing. O & M expenses were reduced by $310,000 to disallow staffing costs as internal energy efficiency programs are transferred to the Energy Trust of Oregon.[6]

Issue S-6: Energy Assistance Staffing. One FTE was disallowed, reducing the Company's O & M expenses by $58,000. As a result, the Oregon Low Income Gas Assistance (OLGA) program remains staffed at a level comparable to that of the Low Income Energy Assistance Plan (LIEAP), the Company's other payment assistance program.[7]

[1] Partial Stipulation, Exhibit 100, p. 2.
[2] *Id.* pp. 1-2.
[3] *Id.* and Partial Stipulation, Exhibit 100, p. 2, Exhibit 109.
[4] *Id.*
[5] Partial Stipulation, Exhibit 100, p. 3, Exhibit 109.
[6] *Id.*
[7] Partial Stipulation, Exhibit 100, p. 3, Exhibit 109.

Issue S-7: Consumer Relations and Events. The Company agreed to Staff's adjustment, resulting in a $74,000 reduction in O & M expenses.[8]

Issue S-8: Safety Programs. O & M expenses were reduced by $335,000 to reflect a decrease of four FTEs intended to provide staffing to meet safety requirements imposed by new law. The Company will optimize use of fewer staff to meet the new requirements.[9]

Issue S-9: Corporate Governance. The Company agreed to Staff's adjustment to reflect a decrease of one FTE, resulting in a $147,000 reduction in O & M expenses.[10]

Issue S-10: Wage and Salary Expense. The Company accepted the Staff's final assessment of the appropriate wage level for the test period, resulting in a $1,265,000 reduction in O&M expense, a $477,000 reduction in Utility Plant in Service and a $161,000 reduction in other taxes.[11]

Issue S-11: Incentives and Bonus Pay. The adjustment included a decrease in both O & M expenses of $1,725,000 and Utility Plant in Service of $821,000 that correspond to a decreased estimate of the percentage of maximum potential payout, as well as a sharing of expenses between ratepayers and shareholders.[12]

Issue S-13: Pension Expense. The parties agreed that pension expense would remain at the level in the Company's filed case, but that deferred accounting will be implemented if actual expenses are lower. In addition, the parties agreed to consider implementation of deferred accounting if pension expenses increase.[13]

Issue S-14: Executive Retirement Benefits. The Company accepted the Staff's adjustment, resulting in a $787,000 reduction in O & M expenses.[14]

Issue S-15: Advertising. The adjustment agreed to among the parties reflects a disallowance of $576,000 in advertising expense. Approved Category A advertising expense is based on a calculated amount of $2.19 per customer. Category B expense levels allow for additional safety advertising requirements.[15]

Issue S-16: Marketing and Customer Relations. The parties agreed to adjustments reflecting disallowances in several areas of marketing and customer relations expense, resulting in an overall decrease in O & M expenses of $844,000.[16]

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[8] *Id.*
[9] *Id.*
[10] Partial Stipulation, Exhibit 100, p. 4 and Exhibit 109.
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] Partial Stipulation, Exhibit 100, p. 4 and 109.
[15] Partial Stipulation, Exhibit 100, pp. 4-5.
[16] Partial Stipulation, Exhibit 100, p. 5, Exhibit 109.

Issue S-17: Administrative and General Expenses. This adjustment reflected disallowances of certain costs in FERC Accounts 921, 923, 924, 930, 931 and 935, resulting in an overall decrease in O & M expenses of $1,226,000. The parties also agreed that Gas Technology Institute (GTI) costs booked to Account 930 would support GTI's Research and Deployment division. It was further agreed that GTI reports provided to the Company would be made available upon request to the parties, including members of NWIGU who are customers of the Company.[17]

Issue S-18: Capitalization Policy. The adjustments agreed upon by the parties included the following: a $3,163,000 decrease in O&M expense, a $115,000 increase in depreciation expense, a $3,202,000 increase in Utility Plant in Service, a $57,000 increase in Accumulated Depreciation and a $376,000 increase in deferred taxes (credit).[18]

Issue S-20: Income and Excise Taxes. The parties agreed that final income and excise tax amounts would be established after resolution of all issues affecting revenues, expenses, rate base, and cost of capital.[19]

Issue S-21: South Mist Pipeline Extension (SMPE). The parties agreed that SMPE expense will remain at the level in the Company's case as filed, but that the same true-ups and deferred accounting procedures would be followed for SMPE expense as previously applied to Mist III. The procedure provides for the use of an estimated final cost for purposes of initial ratemaking, with true-ups allowed for final cost variances using deferred accounting and revised rate determination.[20]

Issue S-22: Bare Steel. The Company agreed to Staff's proposed adjustment to decrease depreciation expense by $5,000, decrease Utility Plant in Service by $179,000, decrease Accumulated Depreciation by $13,000 and decrease deferred taxes (credit) by $20,000.[21]

Issue S-23: Miscellaneous Rate Base. The Company accepted Staff's adjustment, resulting in a $196,000 reduction to Utility Plant in Service.[22]

Issue S-24: Rate Design. The parties agreed with the Company's concept proposal to simplify and condense the industrial schedules.[23]

Discussion of the Partial Revenue Requirement Stipulation. The Commission encourages parties to resolve issues and narrow the scope of the proceedings to the extent that such actions further the public interest. In this instance, there has been participation and

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[17] *Id.*
[18] Partial Stipulation, Exhibit 100, p. 5, Exhibit 110.
[19] Partial Stipulation, Exhibit 100, p. 6, Exhibit 110.
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*

agreement by parties representing a broad range of interests and no persons have interposed any objections to the Partial Stipulation. Stipulations reduce the burdens of the parties and the Commission and facilitate the prompt completion of matters brought before the Commission for its consideration. We find the changes adopted by the Partial Revenue Requirement Stipulation to be in furtherance of our policies and objectives and approve the Partial Revenue Requirement Stipulation without modification.

III. THE MEDICAL BENEFITS STIPULATION

The Medical Benefits Stipulation, attached as Appendix B, was executed by the Company, Staff and NWIGU and relates to Staff issue S-12. In the Medical Benefits Stipulation, these parties agreed that the Company would reduce its O&M expense by $441,000 and Utility Plant in Service by $267,000. At paragraph 7 of the Medical Benefits Stipulation, the parties noted that "[b]ecause the rate of return and certain other issues have not been determined in this Docket, the amount by which this Stipulation will reduce the Company's revenue requirement may change pending the resolution of such issues."

Unlike the Partial Revenue Requirement Stipulation, CUB did not sign the Medical Benefits Stipulation. Nevertheless, as part of the overall settlement of this docket, discussed *infra*, CUB has withdrawn its objections to the Medical Benefits Stipulation that it voiced to the Commission in testimony filed April 24, 2003.[24] CUB originally opposed the Medical Benefits Stipulation on several grounds and we discuss them here because, while we disagreed with its formerly proposed remedy, now withdrawn, many of its concerns are, in our view, well-founded. CUB asserted that the Company's health insurance costs per employee are significantly greater than those of the typical American employer and are more than for most other utilities.[25] CUB found particular fault with the Medical Benefits Stipulation because it failed to offer the Company any incentive to control these costs or bring them into line with the competitive business world. While the Medical Benefits Stipulation assumed that the Company's negotiations with its bargaining unit are "arm's length" and will result in prudent costs (which customers will be required to pick up), there remains in place a "policy" that requires customers to pay for 100% of the costs regardless of how high or out of line with other companies' practices.

CUB faulted the Medical Benefits Stipulation for failing to get at the underlying problem:

> "The health insurance stipulation between the Company and the Staff fails to bring health insurance costs under control and does not represent a 'fair and reasonable' compromise of that issue. The Company's health

[24] UG152/CUB/300 and Exhibits 301-320. CUB has signed the Third Stipulation as part of the overall settlement; it includes the medical benefits adjustment in paragraph 10 which is identical to the language contained in the Medical Benefits Stipulation. *See* UG 152/NWN/2900, Johnson-Miller-Jenks-Schoenbeck/3.

[25] CUB cites a study performed for NWN by Hewitt Associates indicating that NWN pays 82% of employee health care costs compared to an industry average of 75%. NWN employees pay less out-of-pocket as well as making smaller contributions than their industry counterparts. UG 152/CUB/300, Jenks/6.

insurance costs are out of control, and are out of line when compared to other business. It is vital that this case provide an incentive to the Company to control these costs."[26]

In CUB's view, the Commission should determine whether there should be a cap on the amounts included in rates and whether Company employees should be required to make a greater contribution to their health insurance costs.[27]

In light of the Hewitt Associates study indicating that NWN was picking up 82% of the health insurance costs, CUB had recommended that the cost of health insurance picked up by customers should be capped at 82%. CUB asserted that this sharing percentage would reduce O&M costs by $1,309,572 and reduce rate base by $818,060.[28]

Discussion of the Medical Benefits Stipulation. Burgeoning health care costs have become a major issue for individuals and institutions alike. Adequate health care coverage is considered by many people to be one of the most important benefits of any job, sometimes eclipsing the importance of the wage or salary of the job itself. Efforts at containing such costs, either by imposing limitations on benefits or changing the balance of contributions, invariably cause conflicts among those providing healthcare services, those who receive them and those who pay the bills.

When health care benefits are being provided by a regulated utility to its employees, the prudently incurred costs for the provision of those benefits are usually considered to be "above the line," (i.e., part of the utility's revenue requirement). Such expenses are therefore subject to recovery through rates for the provision of service to the utility's customers. In essence, the utility's customers pay for the medical coverage provided to the utility's employees.

CUB has raised a legitimate concern: if, in the future, customers continue to carry the increasing burden of health costs, the Company does not have a strong incentive to contain those costs. Neither the Company's management nor its shareholders will be at risk for failing to exert their best efforts at healthcare cost containment. This lack of incentive may have already been manifest. According to the survey conducted for NWN by Hewitt and Associates, the Company picks up a significantly larger percentage of medical plan costs (82%) than the industry average (75%).[29] Thus, the Company is atypically generous with respect to the contribution it makes to meeting its employees' health care costs.

There is now an overall agreement among the parties that the costs and investments incurred by the Company during the test year with respect to medical benefits were legitimate. On that basis, and that basis only, we accept the Medical Benefits Stipulation language now contained in the Third Partial Stipulation and it is adopted as part of the overall

[26] UG 152/CUB/300, Jenks/1-2.
[27] UG 152/CUB/300, Jenks/3-4.
[28] UG 152/CUB/300, Jenks/6-7.
[29] UG 152/CUB/304, Jenks/3.

resolution of this case. In so doing, we do not in any way affirm or condone an open-ended policy of allowing the costs for providing medical benefits to inflate the Company's revenue requirement. Quite to the contrary, should the Company seek additional rate increases in the future based in whole or in part and the rising costs of providing medical benefits to its employees, it shall bear the burden to show that such costs were incurred only after extensive efforts at cost containment and burden sharing with employees were undertaken.

IV. THE FINAL SETTLEMENT STIPULATIONS

A hearing was held on August 5, 2003. Two Stipulations—the WARM Stipulation and the Third Partial Stipulation—and their supporting testimony were submitted at the hearing and each is discussed in turn below.

The WARM[30] Stipulation. This stipulation, attached as Appendix C, relates to Staff issue S-25. The parties to the stipulation—the Company, Staff, CUB, NWIGU and the Northwest Energy Coalition (NWEC)—agreed to the terms set forth in the Company's filed case, but subject to certain conditions and implementation details.

The WARM is a weather-normalization concept proposed by the Company in its initially filed case. The Company noted that fixed costs are recovered through volumetric (per therm) charges, which means that, while those costs remain fairly constant, the revenues to recover those costs vary widely; colder than normal winters boost Company revenues at the expense of customers grappling with higher bills, while milder winters reduce Company earnings. This exposes both customers and the Company to weather-related risks for fixed costs recovery; risks over which there is no control. The WARM mechanism seeks to modify the rate structure to recognize the need to separately identify and collect the revenues to cover the fixed costs from the revenues which cover the truly usage-related costs, and to do so in a way that immediately benefits both customers and the Company.[31] The parties to the WARM Stipulation agreed with the Company's proposal under the condition that there be provisions which allow a customer to opt-out of the program and that there is both a reporting requirement and a five-year sunset provision. With those additions, all parties believe that the WARM is beneficial to both ratepayers and the Company.

Discussion of the WARM Stipulation. We believe that the Company's WARM plan, with the agreed-upon conditions contained in the WARM Stipulation, reduces the weather-related financial risks for both customers and Company alike. We therefore approve the WARM Stipulation as being in the public interest.

The Third Partial Stipulation. The Third Partial Stipulation, attached as Appendix D, included settlement language of Staff issue S-12 Medical Benefits, (which we approve, as discussed above), to reflect CUB's acceptance of the settlement of the issue as part of the overall settlement of the case.

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[30] This is an acronym for "Weather Adjusted Rate Mechanism."
[31] UG 152/NWN/1607, Miller/2-10.

The revenue requirement issues, which constitute the balance of the Third Partial Stipulation, relate to Staff issues S-0, S-1, S-19 and S-24 and the overall settlement of the case. Specifically, these issues include rate of return, the sales revenue forecast, stock issuance costs, rate spread, rate design and ratemaking for the Coos County Distribution System (CCDS), whose construction we had authorized in Order No. 03-236, as noted above.

The parties filed several rounds of testimony on these issues, supporting a range of outcomes that were considered. Ultimately, they gave the following reasons for reaching the overall settlement:

> "The parties reached the agreements contained in the Third Stipulation based on their individual and collective evaluation of the positions expressed in testimony, the risk of decisions by the Commission adverse to their positions, and the advantages of a global settlement of the case.... [T]he overall terms of the Third Stipulation, when considered with the Previous Stipulations and the WARM Stipulation are acceptable. The parties also believe the stipulations taken together balance the interests of the utility investor and the consumer as required under the public utility statutes."[32]

Staff Issue S-0: Cost of Capital. Company and Staff both filed substantial testimony on this issue, with the Company seeking to raise the rate of return on equity by seventy-five basis points from the presently authorized 10.25 percent to 11.00 percent and the Staff arguing that it should be reduced seventy-five basis points to 9.50 percent. The parties agreed on a reduction of five basis points, providing a ROE of 10.20 percent. The parties also agreed upon a long-term debt cost of 7.066 percent and a preferred stock interest rate of 7.16 percent. The capital structure agreed upon had a ratio of 49.5 percent common equity, 49.82 percent long-term debt and 0.68 percent preferred stock.

Staff Issue S-1: Sales Revenues Forecast. The adjustment contained in this settlement increases the Company's forecast of residential, commercial and industrial sales revenues, with a corresponding increase in cost of gas.

Staff Issue S-19: Stock Issuance Costs. The parties agreed that the settled cost of common equity includes the Company's stock issuance expense.

Staff Issue S-24, Part 1: Rate Spread. The issue of rate spread arose in two distinct areas: First, how the proposed general rate increase would be spread across the customer base, and: Second, how the cost burden of the CCDS would be allocated among customer groups.[33] The Stipulation proposes the adoption of the Company's position with respect to the general rate increase and the Staff's proposal with respect to the CCDS.

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[32] *Id.*, p. 4.

[33] "The spreading of the burden among the ratepayers in a manner that is just, reasonable and nondiscriminatory, will be examined in the latter phase of this proceeding." CCDS Order, p. 5.

For the general rate spread, the Company proposed an equal percent of margin increase to Schedules 1, 2 and 3, where margin was defined as revenue less commodity and demand charges. The proposed adjustments were only applied to schedules with rates below the levels consistent with Long Run Incremental Cost (LRIC) estimates. The Company did not seek to further step up the pace toward LRIC levels, allowing that the phase in of increases could occur in future annual filings.[34]

With respect to the CCDS, the parties to the Stipulation adopted the Staff's rate spread proposal. In its testimony,[35] Staff took the position that the revenue requirement should be spread on an equal percentage of margin across all rate classes, including the industrial customers for whose benefit the 1999 Legislative Assembly determined the natural gas pipeline was necessary.

Discussion. We adopt the Stipulation's Rate Spread provisions. The Company's general rate spread proposals move rates in consumers' schedules closer to LRIC without undue rate shock. The Staff's CCDS proposal meets our requirements for just, reasonable and nondiscriminatory rates to recover the costs of the CCDS investment.

Staff Issue S-24, Part 2: Rate Design. Throughout this case, the parties continually sought to find common ground and this effort was often reflected in revisions to positions that were reflected in the rebuttal and surrebuttal testimony submissions. Thus, in its Rebuttal Testimony,[36] the Company proposed to replace Schedules 4, 5, 6, 10, 21, 23, 55, 90 and 91 with new Schedules 31, 32 and 33. The plan to implement the changeover from the previous schedules was described in the testimony of Tamy S. Linver.[37] According to the Company's direct testimony, the new rate structure will make it easier for customers to understand and choose the best schedule for their needs and to receive rational price signals to encourage efficient usage. As proposed by the Company, the changes would be revenue-neutral and not adversely affect any customer group.[38] However, as part of the overall settlement, the parties agreed that the introduction of New Rate Schedule 32 would yield total marginal revenues of $4 million less than the revenues generated on existing rate schedules and that this shortfall or margin shift would be applied to Rate Schedules 1, 2 and 3 on an equal percentage of margin basis. The Company agreed not to seek to recover from any customer class now or in the future, the $275,028 marginal revenue loss from the elimination of Rate Schedule 55.[39]

Although the rate redesign moves toward a simpler rate structure, the practical impact on the customers in transition is significant. The implementation plan requires internal revisions to Customer Information Systems, new and revised business rules and employee training and external requirements for customer communications, new equipment needs,

[34] UG152/NWN/1400, Ferguson-Linver-Henderson/1-3.
[35] UG152/Staff/100, Tatom/1-4.
[36] UG152/NWN/2301, Ferguson/1-9.
[37] UG152/NWN/2302, Linver.
[38] UG152/NWN/1402, Ferguson/1-2.
[39] Third Partial Stipulation, p. 4.

assistance with rate analysis and rate schedule transitions. For example, certain customers will require automated meter reading devices with active and continuous telephone service to the meter and it will be necessary for those customers to schedule their installation.[40]

Discussion. We find that the goals of the Company's proposed rate redesign serve the public interest. We adopt the new rate schedules and the rate transition implementation plan offered in the Company's Rebuttal Testimony and agreed upon by the parties. In adopting this significant redesign of the Company's rates, we also note that the conclusion of this proceeding ahead of schedule calls for a modification of the effective date of the schedules and activities related to their implementation. Accordingly, in making the new rates under this order effective on September 1, 2003, the implementation plan transferring industrial customers to the new rate schedules also becomes effective on September 1, 2003.

Miscellaneous Adjustments and Issues. As part of the overall settlement of the case, there were miscellaneous adjustments to the revenue requirement and decision on operational activities. Among the adjustments was the removal of both South Mist Pipeline Extension (SMPE) and CCDS investments in the test year to adjust for the delay in the in-service dates. The parties agreed not to oppose the Company in the event it applied for deferred accounting treatment to recover the revenue requirement associated with the SMPE and CCDS investments and that they would be placed in permanent rates when those facilities are used and useful, or at the next available filing.

NWIGU's issue with respect to geohazard risk mitigation was also settled in the Third Partial Stipulation, where it was agreed that the Company's geohazard cost tracking mechanism would continue in effect on its current terms through its expiration at the end of 2006, subject to the Commission's continuing jurisdiction. Consistent with that, the parties agreed to reserve the rights to raise issues in the future concerning the Company's cost tracking mechanism.

Discussion. We find the resolution of these miscellaneous items to be consistent with the public interest and adopt them as an integral part of our acceptance of the Third Partial Stipulation.

V. CONCLUSION

The stipulations submitted by NWN, CUB, NWIGU, NWEC and Staff produce a just and reasonable result and should be adopted in their entirety. In so doing, we note that the effect of our decision is to cause a rate increase of $6.2 million to go into effect September 1, 2003. After the SMPE and CCDS adjustments go into effect, the overall increase will rise to $13.9 million. An Issues Summary setting forth the adjustments to the Company's Filed Results on the Test Year Revenue Requirement is attached as Appendix E.

[40] *Id.*, pp. 2-3.

ORDER

IT IS ORDERED that:

1. The stipulations submitted by Northwest Natural Gas Company, Citizens' Utility Board, Northwest Industrial Gas Users, Northwest Energy Coalition and Commission Staff, attached as Appendices A, B, C and D are adopted in their entirety.

2. Advice No. 02-19, filed by Northwest Natural Gas Company on November 29, 2002, is permanently suspended.

3. Northwest Natural Gas Company shall file tariffs consistent with the findings and conclusions contained in this order by August 27, 2003, to be effective no later than September 1, 2003.

Made, entered, and effective ______________________________.

______________________	______________________
Roy Hemmingway Chairman	**Lee Beyer** Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order to a court pursuant to applicable law.