

NORTHWEST NATURAL GAS CO  
Form 10-Q  
May 02, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 1-15973

NORTHWEST NATURAL GAS COMPANY  
(Exact name of registrant as specified in its charter)

|   |   |
|---|---|
| Oregon<br>(State or other jurisdiction of<br>incorporation or organization) | 93-0256722<br>(I.R.S. Employer<br>Identification No.) |
|---|---|

220 N.W. Second Avenue, Portland, Oregon 97209  
(Address of principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: (503) 226-4211

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Edgar Filing: NORTHWEST NATURAL GAS CO - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

(Do not check if a Smaller Reporting Company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

At April 25, 2014, 27,137,366 shares of the registrant's Common Stock (the only class of Common Stock) were outstanding.

---

NORTHWEST NATURAL GAS COMPANY  
 For the Quarterly Period Ended March 31, 2014

TABLE OF CONTENTS

---

|   | Page      |
|---|-----------|
| PART 1. FINANCIAL INFORMATION   |           |
| <u>Forward-Looking Statements</u>   | <u>1</u>  |
| <u>Item 1.</u> Unaudited Consolidated Financial Statements:   |           |
| <u>Consolidated Statements of Comprehensive Income for the three months ended March 31, 2014 and 2013</u>   | <u>2</u>  |
| <u>Consolidated Balance Sheets at March 31, 2014 and 2013 and December 31, 2013</u>                         | <u>3</u>  |
| <u>Consolidated Statements of Cash Flows for the three months ended March 31, 2014 and 2013</u>             | <u>5</u>  |
| <u>Notes to Unaudited Consolidated Financial Statements</u>   | <u>6</u>  |
| <u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>21</u> |
| <u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | <u>36</u> |
| <u>Item 4.</u> <u>Controls and Procedures</u>   | <u>37</u> |
| PART II. OTHER INFORMATION  |           |
| <u>Item 1.</u> <u>Legal Proceedings</u>   | <u>38</u> |
| <u>Item 1A.</u> <u>Risk Factors</u>   | <u>38</u> |
| <u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | <u>38</u> |
| <u>Item 6.</u> <u>Exhibits</u>  | <u>38</u> |
| <u>Signature</u>  | <u>39</u> |

---

Table of Contents

FORWARD-LOOKING STATEMENTS

---

This report contains “forward-looking statements” within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as “anticipates,” “intends,” “plans,” “seeks,” “believes,” “estimates,” “expects” and similar references to future periods. Examples of forward-looking statements include, but are not limited to, statements regarding the following:

- plans;
- objectives;
- goals;
- strategies;
- assumptions and estimates;
- future events or performance;
- trends;
- timing and cyclicalities;
- earnings and dividends;
- growth;
- customer rates;
- commodity costs;
- gas reserves;
- operational performance and costs;
- efficacy of derivatives and hedges;
- liquidity and financial positions;
- project development and expansion;
- competition;
- procurement and development of gas supplies;
- estimated expenditures;
- costs of compliance;
- credit exposures;
- potential efficiencies;
- rate recovery and refunds;
- impacts of laws, rules and regulations;
- tax liabilities or refunds;
- levels and pricing of gas storage contracts;
- outcomes and effects of potential claims, litigation, regulatory actions, and other administrative matters;
- projected obligations under retirement plans;
- availability, adequacy, and shift in mix of gas supplies;
- approval and adequacy of regulatory deferrals;
- effects of regulatory mechanisms; and
- environmental, regulatory, litigation and insurance costs and recoveries.

Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks, and changes in circumstances that are difficult to predict. Our actual results may differ materially from those contemplated by the forward-looking statements. We therefore caution you against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future performance. Important factors that could cause actual results to differ materially from those in the forward-looking statements are discussed in our 2013 Annual Report on Form 10-K, Part I, Item 1A. “Risk Factors” and Part II, Item 7. and Item 7A., “Management’s Discussion and Analysis of Financial Condition and Results of Operations”

and “Quantitative and Qualitative Disclosures about Market Risk,” and in Part I, Items 2 and 3, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures About Market Risk,” and Part II, Item 1A, “Risk Factors,” herein.

Any forward-looking statement made by us in this report speaks only as of the date on which it is made. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

1

---

Table of Contents

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

NORTHWEST NATURAL GAS COMPANY  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

| In thousands, except per share data   | Three Months Ended |           |
|---|--------------------|-----------|
|   | March 31,<br>2014  | 2013      |
| Operating revenues  | \$293,386          | \$277,861 |
| Operating expenses:   |                    |           |
| Cost of gas   | 155,201            | 142,359   |
| Operations and maintenance  | 35,386             | 33,757    |
| General taxes   | 8,182              | 8,732     |
| Depreciation and amortization   | 19,589             | 18,807    |
| Total operating expenses  | 218,358            | 203,655   |
| Income from operations  | 75,028             | 74,206    |
| Other income and expense, net   | 1,383              | 520       |
| Interest expense, net   | 11,542             | 11,127    |
| Income before income taxes  | 64,869             | 63,599    |
| Income tax expense  | 26,985             | 25,960    |
| Net income  | 37,884             | 37,639    |
| Other comprehensive income:   |                    |           |
| Amortization of non-qualified employee benefit plan liability, net of taxes of \$109 and \$151 for the three months ended March 31, 2014 and 2013, respectively | 165                | 233       |
| Comprehensive income  | \$38,049           | \$37,872  |
| Average common shares outstanding:  |                    |           |
| Basic   | 27,094             | 26,929    |
| Diluted   | 27,126             | 26,973    |
| Earnings per share of common stock:   |                    |           |
| Basic   | \$1.40             | \$1.40    |
| Diluted   | 1.40               | 1.40      |
| Dividends declared per share of common stock  | 0.460              | 0.455     |

See Notes to Unaudited Consolidated Financial Statements.

Table of ContentsNORTHWEST NATURAL GAS COMPANY  
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| In thousands                              | March 31,<br>2014 | March 31,<br>2013 | December 31,<br>2013 |
|---|-------------------|-------------------|----------------------|
| Assets:                                   |                   |                   |                      |
| Current assets:                           |                   |                   |                      |
| Cash and cash equivalents                 | \$17,929          | \$8,337           | \$9,471              |
| Accounts receivable                       | 87,264            | 84,346            | 81,889               |
| Accrued unbilled revenue                  | 33,515            | 29,633            | 61,527               |
| Allowance for uncollectible accounts      | (2,235            | ) (2,116          | ) (1,656             |
| Regulatory assets                         | 27,834            | 39,001            | 22,635               |
| Derivative instruments                    | 15,846            | 8,200             | 5,311                |
| Inventories                               | 33,469            | 52,004            | 60,669               |
| Gas reserves                              | 21,990            | 14,286            | 20,646               |
| Income taxes receivable                   | —                 | 2,033             | 3,534                |
| Deferred tax assets                       | 4,915             | —                 | 45,241               |
| Other current assets                      | 13,595            | 12,441            | 21,181               |
| Total current assets                      | 254,122           | 248,165           | 330,448              |
| Non-current assets:                       |                   |                   |                      |
| Property, plant, and equipment            | 2,939,760         | 2,808,673         | 2,918,739            |
| Less: Accumulated depreciation            | 868,257           | 824,561           | 855,865              |
| Total property, plant, and equipment, net | 2,071,503         | 1,984,112         | 2,062,874            |
| Gas reserves                              | 134,894           | 100,169           | 121,998              |
| Regulatory assets                         | 285,046           | 384,453           | 369,603              |
| Derivative instruments                    | 1,078             | 2,836             | 1,880                |
| Other investments                         | 67,288            | 68,029            | 67,851               |
| Restricted cash                           | 4,000             | 4,000             | 4,000                |
| Other non-current assets                  | 12,453            | 14,735            | 12,257               |
| Total non-current assets                  | 2,576,262         | 2,558,334         | 2,640,463            |
| Total assets                              | \$2,830,384       | \$2,806,499       | \$2,970,911          |

See Notes to Unaudited Consolidated Financial Statements.





Table of ContentsNORTHWEST NATURAL GAS COMPANY  
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| In thousands   | March 31,<br>2014 | March 31,<br>2013 | December 31,<br>2013 |
|--|-------------------|-------------------|----------------------|
| Liabilities and equity:  |                   |                   |                      |
| Current liabilities:   |                   |                   |                      |
| Short-term debt  | \$ 32,600         | \$ 130,750        | \$ 188,200           |
| Current maturities of long-term debt   | 80,000            | —                 | 60,000               |
| Accounts payable   | 89,201            | 77,007            | 96,126               |
| Taxes accrued  | 34,146            | 10,262            | 10,856               |
| Interest accrued   | 11,144            | 10,952            | 7,103                |
| Regulatory liabilities   | 37,686            | 28,239            | 28,335               |
| Derivative instruments   | 1,191             | 3,450             | 1,891                |
| Other current liabilities  | 38,069            | 41,445            | 40,280               |
| Total current liabilities  | 324,037           | 302,105           | 432,791              |
| Long-term debt   | 661,700           | 691,700           | 681,700              |
| Deferred credits and other non-current liabilities:  |                   |                   |                      |
| Deferred tax liabilities   | 489,108           | 467,360           | 532,036              |
| Regulatory liabilities   | 308,858           | 293,135           | 303,485              |
| Pension and other postretirement benefit liabilities   | 147,733           | 215,808           | 149,354              |
| Derivative instruments   | 96                | 642               | 615                  |
| Other non-current liabilities  | 119,376           | 79,112            | 119,058              |
| Total deferred credits and other non-current liabilities   | 1,065,171         | 1,056,057         | 1,104,548            |
| Commitments and contingencies (see Note 13)  | —                 | —                 | —                    |
| Equity:  |                   |                   |                      |
| Common stock - no par value; authorized 100,000 shares;<br>issued and outstanding 27,132, 26,948, and 27,075 at March 31,<br>2014 and 2013 and December 31, 2013, respectively | 366,560           | 357,957           | 364,549              |
| Retained earnings  | 419,109           | 407,738           | 393,681              |
| Accumulated other comprehensive loss   | (6,193            | ) (9,058          | ) (6,358             |
| Total equity   | 779,476           | 756,637           | 751,872              |
| Total liabilities and equity   | \$ 2,830,384      | \$ 2,806,499      | \$ 2,970,911         |

See Notes to Unaudited Consolidated Financial Statements.

Table of ContentsNORTHWEST NATURAL GAS COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| In thousands   | Three Months Ended |          |
|--|--------------------|----------|
|  | March 31,<br>2014  | 2013     |
| Operating activities:  |                    |          |
| Net income   | \$37,884           | \$37,639 |
| Adjustments to reconcile net income to cash provided by operations:  |                    |          |
| Depreciation and amortization  | 19,589             | 18,807   |
| Regulatory amortization of gas reserves                              | 2,981              | 2,381    |
| Deferred tax liabilities, net  | 205                | 25,797   |
| Non-cash expenses related to qualified defined benefit pension plans | 1,278              | 1,476    |
| Contributions to qualified defined benefit pension plans             | (2,800)            | (1,400)  |
| Deferred environmental recoveries, net of (expenditures)             | 83,252             | (4,482)  |
| Other  | 603                | (545)    |
| Changes in assets and liabilities:                                   |                    |          |
| Receivables  | 23,216             | 5,281    |
| Inventories  | 27,200             | 15,598   |
| Taxes accrued  | 26,824             | 1,193    |
| Accounts payable   | (1,671)            | (13,781) |
| Interest accrued   | 4,041              | 4,999    |
| Deferred gas costs   | (14,049)           | 1,966    |
| Other, net   | 11,579             | 11,189   |
| Cash provided by operating activities                                | 220,132            | 106,118  |
| Investing activities:  |                    |          |
| Capital expenditures   | (25,588)           | (22,674) |
| Utility gas reserves   | (19,681)           | (12,257) |
| Other  | (191)              | (1,335)  |
| Cash used in investing activities                                    | (45,460)           | (36,266) |
| Financing activities:  |                    |          |
| Common stock issued, net   | 1,400              | 1,115    |
| Change in short-term debt  | (155,600)          | (59,500) |
| Cash dividend payments on common stock                               | (12,456)           | (12,248) |
| Other  | 442                | 195      |
| Cash used in financing activities                                    | (166,214)          | (70,438) |
| Increase (decrease) in cash and cash equivalents                     | 8,458              | (586)    |
| Cash and cash equivalents, beginning of period                       | 9,471              | 8,923    |
| Cash and cash equivalents, end of period                             | \$17,929           | \$8,337  |
| Supplemental disclosure of cash flow information:                    |                    |          |
| Interest paid  | \$7,502            | \$6,128  |
| Income taxes paid  | —                  | —        |

See Notes to Unaudited Consolidated Financial Statements.



Table of Contents

NORTHWEST NATURAL GAS COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. ORGANIZATION AND PRINCIPLES OF CONSOLIDATION

---

The accompanying consolidated financial statements represent the consolidation of Northwest Natural Gas Company (NW Natural or the Company) and all companies that we directly or indirectly control, either through majority ownership or otherwise. We have two core businesses: our regulated local gas distribution business, referred to as the utility segment, which serves residential, commercial, and industrial customers in Oregon and southwest Washington; and our gas storage businesses, referred to as the gas storage segment, which provides storage services for utilities, gas marketers, electric generators, and large industrial users from storage facilities located in Oregon and California. In addition, we have investments and other non-utility activities that we aggregate and report as other.

Our direct and indirect wholly-owned subsidiaries include NW Natural Energy, LLC (NWN Energy), NW Natural Gas Storage, LLC (NWN Gas Storage), Gill Ranch Storage, LLC (Gill Ranch), NNG Financial Corporation (NNG Financial), Northwest Energy Corporation (Energy Corp), and NW Natural Gas Reserves, LLC (NWN Gas Reserves). Investments in corporate joint ventures and partnerships that we do not directly or indirectly control, and for which we are not the primary beneficiary, are accounted for under the equity method, which includes NWN Energy's investment in Palomar Gas Holdings, LLC (PGH) and NNG Financial's investment in Kelso-Beaver (KB) Pipeline. NW Natural and its affiliated companies are collectively referred to herein as NW Natural. The consolidated unaudited financial statements are presented after elimination of all significant intercompany balances and transactions, except for amounts required to be included under regulatory accounting standards to reflect the effect of such regulation. In this report, the term "utility" is used to describe our regulated gas distribution business, and the term "non-utility" is used to describe our gas storage businesses and other non-utility investments and business activities.

Certain prior year balances in our unaudited consolidated financial statements and notes there to have been reclassified to conform with the current presentation. These reclassifications had no impact on our prior year's consolidated results of operations, financial condition or cash flows.

Information presented in these interim unaudited consolidated financial statements is unaudited, but includes all material adjustments that management considers necessary for a fair statement of the results for each period reported including normal recurring accruals. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our 2013 Annual Report on Form 10-K (2013 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.

2. SIGNIFICANT ACCOUNTING POLICIES

---

Our significant accounting policies are described in Note 2 of the 2013 Form 10-K. There were no material changes to those accounting policies during the three months ended March 31, 2014. The following are current updates to certain critical accounting policy estimates and accounting standards in general.

Table of Contents

## Regulatory Accounting

In applying regulatory accounting in accordance with generally accepted accounting principles in the United States of America (GAAP), we capitalize or defer certain costs and revenues as regulatory assets and liabilities. These deferrals were as follows:

| In thousands  | Regulatory Assets      |           | December 31,<br>2013 |
|---|------------------------|-----------|----------------------|
|   | March 31,<br>2014      | 2013      |                      |
| Current:  |                        |           |                      |
| Unrealized loss on derivatives <sup>(1)</sup>                       | \$1,191                | \$3,450   | \$1,891              |
| Other <sup>(2)</sup>  | 26,643                 | 35,551    | 20,744               |
| Total current   | \$27,834               | \$39,001  | \$22,635             |
| Non-current:  |                        |           |                      |
| Unrealized loss on derivatives <sup>(1)</sup>                       | \$96                   | \$642     | \$615                |
| Pension balancing <sup>(3)</sup>                                    | 27,328                 | 17,322    | 25,713               |
| Deferred income taxes   | 49,007                 | 53,065    | 51,814               |
| Pension and other postretirement benefit liabilities <sup>(3)</sup> | 123,399                | 178,377   | 125,855              |
| Environmental costs <sup>(4)</sup>                                  | 63,517                 | 125,671   | 148,389              |
| Other <sup>(2)</sup>  | 21,699                 | 9,376     | 17,217               |
| Total non-current   | \$285,046              | \$384,453 | \$369,603            |
|   | Regulatory Liabilities |           |                      |
|   | March 31,<br>2014      | 2013      | December 31,<br>2013 |
| In thousands  |                        |           |                      |
| Current:  |                        |           |                      |
| Gas costs   | \$9,137                | \$8,694   | \$7,510              |
| Unrealized gain on derivatives <sup>(1)</sup>                       | 15,788                 | 8,054     | 5,290                |
| Other <sup>(2)</sup>  | 12,761                 | 11,491    | 15,535               |
| Total current   | \$37,686               | \$28,239  | \$28,335             |
| Non-current:  |                        |           |                      |
| Gas costs   | \$2,602                | \$1,407   | \$2,172              |
| Unrealized gain on derivatives <sup>(1)</sup>                       | 1,078                  | 2,836     | 1,880                |
| Accrued asset removal costs   | 299,026                | 285,437   | 296,294              |
| Other <sup>(2)</sup>  | 6,152                  | 3,455     | 3,139                |
| Total non-current   | \$308,858              | \$293,135 | \$303,485            |

Unrealized gains or losses on derivatives are non-cash items and, therefore, do not earn a rate of return or a

(1) carrying charge. These amounts are recoverable through utility rates as part of the annual Purchased Gas Adjustment (PGA) mechanism when realized at settlement.

(2) Other primarily consists of deferrals and amortizations under other approved regulatory mechanisms. The accounts being amortized typically earn a rate of return or carrying charge.

Certain utility pension costs are approved for regulatory deferral, including amounts recorded to the pension balancing account, to mitigate the effects of higher and lower pension expenses. Pension costs that are deferred include an interest component when recognized in net periodic benefit costs. See Note 7.

Environmental costs relate to specific sites approved for regulatory deferral by the Public Utility Commission of Oregon (OPUC) and Washington Utilities and Transportation Commission (WUTC). In Oregon, we earn a

(4) carrying charge on cash amounts paid, whereas amounts accrued but not yet paid do not earn a carrying charge until expended. In Washington, a carrying charge related to deferred amounts will be determined in a future proceeding. For further information on environmental matters, see Note 13.



Table of Contents

## New Accounting Standards

## Recent Accounting Pronouncements

**OBLIGATIONS RESULTING FROM JOINT AND SEVERAL LIABILITY ARRANGEMENTS.** In February 2013, the Financial Accounting Standards Board (FASB) issued guidance regarding the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. Under the new guidance, an entity is required to measure fixed obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors plus any additional amount the reporting entity expects to pay on behalf of its co-obligors. In addition, an entity must disclose the nature and amount of the obligation as well as other information about the obligations. The adoption of this guidance during the first quarter of 2014 did not have a material impact on our financial position, results of operations, or disclosures.

**PRESENTATION OF UNRECOGNIZED TAX BENEFIT.** In July 2013, the FASB issued guidance that requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except under certain circumstances. The adoption of this guidance during the first quarter of 2014 did not have a material impact on our financial position, results of operations, or disclosures.

## Subsequent Events

See Note 14 for information regarding the amendment to the Gill Ranch loan agreement.

**3. EARNINGS PER SHARE**

Basic earnings per share are computed using net income and the weighted-average number of common shares outstanding for each period presented. Diluted earnings per share are computed in the same manner, except it uses the weighted-average number of common shares outstanding plus the effects of the assumed exercise of stock options, and payment of estimated stock awards from other stock-based compensation plans that are outstanding at the end of each period presented. Diluted earnings per share are calculated as follows:

| In thousands, except per share data   | Three Months Ended<br>March 31, |          |
|---|---------------------------------|----------|
|   | 2014                            | 2013     |
| Net income  | \$37,884                        | \$37,639 |
| Average common shares outstanding - basic   | 27,094                          | 26,929   |
| Additional shares for stock-based compensation plans outstanding                  | 32                              | 44       |
| Average common shares outstanding - diluted                                       | 27,126                          | 26,973   |
| Earnings per share of common stock - basic  | \$1.40                          | \$1.40   |
| Earnings per share of common stock - diluted                                      | \$1.40                          | \$1.40   |
| Additional information:   |                                 |          |
| Antidilutive shares excluded from net income per diluted common share calculation | 44                              | 32       |

Table of Contents

## 4. SEGMENT INFORMATION

We operate in two primary reportable business segments, local gas distribution and gas storage. We also have other investments and business activities not specifically related to one of these two reporting segments, which we aggregate and report as other. We refer to our local gas distribution business as the utility, and our gas storage segment and other as non-utility. Our utility segment also includes NWN Gas Reserves, which is a wholly-owned subsidiary of Energy Corp, and the utility portion of our Mist underground storage facility in Oregon (Mist). Our gas storage segment includes NWN Gas Storage, which is a wholly-owned subsidiary of NWN Energy, Gill Ranch, which is a wholly-owned subsidiary of NWN Gas Storage, the non-utility portion of Mist, and all third-party asset management services. Other includes NNG Financial and NWN Energy's equity investment in PGH, which is pursuing development of a cross-Cascades pipeline project. See Note 4 in our 2013 Form 10-K for further discussion of our segments.

The following table presents summary financial information concerning the reportable segments. Inter-segment transactions are insignificant:

| In thousands                      | Three Months Ended March 31, |             |          | Total       |
|-----------------------------------|------------------------------|-------------|----------|-------------|
|                                   | Utility                      | Gas Storage | Other    |             |
| 2014                              |                              |             |          |             |
| Operating revenues                | \$285,495                    | \$7,835     | \$56     | \$293,386   |
| Depreciation and amortization     | 17,967                       | 1,622       | —        | 19,589      |
| Income from operations            | 71,457                       | 3,553       | 18       | 75,028      |
| Net income                        | 36,019                       | 1,627       | 238      | 37,884      |
| Capital expenditures              | 25,350                       | 238         | —        | 25,588      |
| Total assets at March 31, 2014    | 2,506,930                    | 307,055     | 16,399   | 2,830,384   |
| 2013                              |                              |             |          |             |
| Operating revenues                | \$269,659                    | \$8,146     | \$56     | \$277,861   |
| Depreciation and amortization     | 17,188                       | 1,619       | —        | 18,807      |
| Income from operations            | 70,228                       | 3,957       | 21       | 74,206      |
| Net income                        | 36,031                       | 1,636       | (28 )    | 37,639      |
| Capital expenditures              | 22,388                       | 286         | —        | 22,674      |
| Total assets at March 31, 2013    | 2,501,724                    | 288,795     | 15,980   | 2,806,499   |
| Total assets at December 31, 2013 | \$2,644,367                  | \$310,097   | \$16,447 | \$2,970,911 |



Table of Contents

## Utility Margin

Utility margin is a financial measure consisting of utility operating revenues less revenue taxes and the associated cost of gas. Cost of gas purchased for utility customers is generally a pass-through cost in the amount of revenues billed to regulated utility customers. By netting costs of gas from utility operating revenues, utility margin provides a key metric used by our chief operating decision maker in assessing the performance of the utility segment. The following table presents additional segment information concerning utility margin. The gas storage and other segments emphasize growth in operating revenues and net income as opposed to margin because these segments do not incur commodity cost of sales like the utility and, therefore, use operating revenues and net income to assess performance.

| In thousands                | Three Months Ended March 31, |            |
|-----------------------------|------------------------------|------------|
|                             | 2014                         | 2013       |
| Utility margin calculation: |                              |            |
| Utility operating revenues  | \$285,495                    | \$269,659  |
| Less: Utility cost of gas   | 155,201                      | 142,359    |
| Utility margin              | \$ 130,294                   | \$ 127,300 |

**5. STOCK-BASED COMPENSATION**

Our stock-based compensation plans include a Long-Term Incentive Plan (LTIP) under which various types of equity awards may be granted, an Employee Stock Purchase Plan, and a Restated Stock Option Plan (Restated SOP). The Restated SOP was terminated for new stock option grants in 2012. These plans are designed to promote stock ownership in NW Natural by employees and officers. For additional information on our stock-based compensation plans, see Note 6 in the 2013 Form 10-K and updates provided below.

## Long-Term Incentive Plan

## Performance-Based Stock Awards

LTIP performance shares incorporate a combination of market, performance, and service-based factors. During the first quarter of 2014, 43,625 performance-based shares were granted under the LTIP based on target-level awards and a weighted-average grant date fair value of \$42.43 per share. Fair value for the market based portion of the LTIP was estimated as of the date of grant using a Monte-Carlo option pricing model based on the following assumptions:

|                                    |         |   |
|------------------------------------|---------|---|
| Stock price on valuation date      | \$41.78 |   |
| Performance term (in years)        | 3.0     |   |
| Quarterly dividends paid per share | \$0.460 |   |
| Expected dividend yield            | 4.3     | % |
| Dividend discount factor           | 0.8845  |   |

## Performance-Based Restricted Stock Units (RSUs)

During the first quarter of 2014, 31,113 performance-based RSUs were granted under the LTIP with a weighted-average grant date fair value of \$42.03 per share. As of March 31, 2014, there was \$2.6 million of unrecognized compensation cost from grants of RSUs, which is expected to be recognized over a period extending through 2019. Generally, the RSUs awarded include a performance-based threshold and a vesting period of four years from the grant date. An RSU obligates the Company upon vesting to issue the RSU holder one share of common stock plus a cash payment equal to the total amount of dividends paid per share between the grant date and vesting date of that portion of the RSU. The fair value of the RSU is equal to the closing market price of the Company's common stock on the grant date.



Table of Contents

## Restated Stock Option Plan

As of March 31, 2014, there was \$0.2 million of unrecognized compensation cost from grants of stock options issued in prior years, which is expected to be recognized in 2014. The Restated SOP was terminated for new option grants in 2012; however, options that had been granted before the Restated SOP was terminated will remain outstanding until the earlier of their expiration, forfeiture, or exercise. Any new grants of stock options would be made under the LTIP. No stock options were granted under the LTIP in the three months ended March 31, 2014.

## 6. DEBT

## Short-Term Debt

At March 31, 2014, our short-term debt consisted of commercial paper notes payable with a maximum and an average maturity of less than 30 days, and an outstanding balance of \$32.6 million. The carrying cost of our commercial paper approximates fair value using Level 2 inputs due to the short-term nature of the notes. See Note 2 in our 2013 Form 10-K for a description of the fair value hierarchy.

## Current Maturities of Long-Term Debt

The utility has first mortgage bonds (FMBs) with maturity dates in the 12-month period ending March 31, 2015 totaling \$60 million, which consists of \$50 million of FMBs with a coupon rate of 3.95% and maturity in July 2014 and \$10 million of FMBs with a coupon rate of 8.26% and maturity in September 2014.

In addition, in April 2014, Gill Ranch amended its loan agreement with Prudential. The amendment requires Gill Ranch to pay back \$20 million of variable-rate outstanding debt during the second quarter of 2014, with the remaining \$20 million of fixed-rate debt scheduled to mature on November 30, 2016. The \$20 million of debt to be prepaid had an interest rate of 7.00% as of March 31, 2014. As part of the amended agreement, the EBITDA covenant requirement is suspended through March 31, 2015 with lower EBITDA hurdles thereafter. The amendment also fixes the debt service reserve at \$3 million. At March 31, 2014, we were in compliance with all covenants and restrictions under the debt agreement.

## Long-Term Debt

Our utility's long-term debt, including current maturities, consisted of \$701.7 million of first mortgage bonds (FMBs) as of March 31, 2014, with maturity dates ranging from 2014 through 2042, interest rates ranging from 3.176% to 9.05%, and a weighted-average coupon rate of 5.55%. We did not redeem any FMBs during the three months ended March 31, 2014.

At March 31, 2014, our gas storage segment's long-term debt consisted of \$20 million of senior secured debt with a maturity date of November 30, 2016 and an interest rate of 7.75%. The \$20 million variable interest rate portion of this debt has been classified with current maturities as it is expected to be paid during the second quarter of 2014. The debt is secured by all of the membership interests in Gill Ranch and is nonrecourse to NW Natural.

Our outstanding debt does not trade in active markets. We estimate the fair value of our debt using utility companies with similar credit ratings, terms, and remaining maturities to our debt that actively trade in public markets. These valuations are based on Level 2 inputs as defined in the fair value hierarchy. See Note 2 in our 2013 Form 10-K.

The following table provides an estimate of the fair value of our long-term debt, including current maturities of long-term debt, using market prices in effect on the valuation date:

| In thousands    | March 31,<br>2014 | 2013      | December 31,<br>2013 |
|-----------------|-------------------|-----------|----------------------|
| Carrying amount | \$741,700         | \$691,700 | \$741,700            |

|                      |         |         |         |
|----------------------|---------|---------|---------|
| Estimated fair value | 820,458 | 825,038 | 806,359 |
|----------------------|---------|---------|---------|

See Note 7 in our 2013 Form 10-K for more detail on our long-term debt.

11

---

Table of Contents

## 7. PENSION AND OTHER POSTRETIREMENT BENEFIT COSTS

The following table provides the components of net periodic benefit cost for the Company's pension and other postretirement benefit plans:

| In thousands   | Three Months Ended March 31, |          |                               |        |
|--|------------------------------|----------|-------------------------------|--------|
|  | Pension Benefits             |          | Other Postretirement Benefits |        |
|  | 2014                         | 2013     | 2014                          | 2013   |
| Service cost   | \$1,918                      | \$2,341  | \$136                         | \$179  |
| Interest cost  | 4,512                        | 4,103    | 309                           | 286    |
| Expected return on plan assets                                 | (4,886 )                     | (4,678 ) | —                             | —      |
| Amortization of net actuarial loss                             | 2,580                        | 4,421    | 46                            | 169    |
| Amortization of prior service costs                            | 56                           | 56       | 49                            | 49     |
| Net periodic benefit cost                                      | 4,180                        | 6,243    | 540                           | 683    |
| Amount allocated to construction                               | (1,201 )                     | (1,855 ) | (171 )                        | (219 ) |
| Amount deferred to regulatory balancing account <sup>(1)</sup> | (1,101 )                     | (2,349 ) | —                             | —      |
| Net amount charged to expense                                  | \$1,878                      | \$2,039  | \$369                         | \$464  |

<sup>(1)</sup> The deferral of certain pension expenses above or below the amount set in rates was approved by the OPUC, with recovery of these deferred amounts through the implementation of a balancing account, which includes the expectation of lower net periodic benefit costs in future years. Deferred pension expense balances include accrued interest at the utility's actual cost of long-term debt.

The following table presents amounts recognized in accumulated other comprehensive loss (AOCL) and the changes in AOCL related to our non-qualified employee benefit plans:

| In thousands                           | Three Months Ended March 31, |            |
|--|------------------------------|------------|
|  | 2014                         | 2013       |
| Beginning balance                      | \$(6,358                     | \$(9,291 ) |
| Amounts reclassified from AOCL:        |                              |            |
| Amortization of prior service costs    | (2 )                         | (2 )       |
| Amortization of actuarial losses       | 276                          | 386        |
| Total reclassifications before tax     | 274                          | 384        |
| Tax expense                            | (109 )                       | (151 )     |
| Total reclassifications for the period | 165                          | 233        |
| Ending balance                         | \$(6,193                     | \$(9,058 ) |

**Employer Contributions to Company-Sponsored Defined Benefit Pension Plan**

In the three months ended March 31, 2014, we made cash contributions totaling \$2.8 million to our qualified defined benefit pension plan. In 2012, Congress passed the "Moving Ahead for Progress in the 21st Century Act" (MAP-21), which among other things, includes provisions that reduce the level of minimum required contributions in the near-term but generally increase contributions in the long-run as well as increase the operational costs of running a pension plan. We expect to contribute up to \$15 million to the pension plan during 2014.

**Multiemployer Pension Plan**

In addition to the Company-sponsored defined benefit pension plan described above, the Company also contributed to a multiemployer pension plan for our utility's union employees known as the Western States Office and Professional Employees International Union Pension Fund (plan's EIN is 94-6076144) prior to December 2013. Effective December 22, 2013, the Company withdrew from the plan as allowed under the terms of its current collective bargaining agreement. Vested participants will receive all benefits accrued through the date of the withdrawal. As the

plan was underfunded at the time of withdrawal, the Company was assessed a withdrawal liability of \$8.3 million, which requires NW Natural to pay \$0.6 million each year to the plan for the next 20 years. The cost of withdrawal liability was deferred to a regulatory account on the balance sheet.

12

---

Table of Contents

## Defined Contribution Plan

The Retirement K Savings Plan provided to our employees is a qualified defined contribution plan under Internal Revenue Code Section 401(k). Company contributions to this plan totaled \$0.5 million for both the three months ended March 31, 2014 and 2013.

See Note 8 in the 2013 Form 10-K for more information concerning these retirement and other postretirement benefit plans.

**8. INCOME TAX**

An estimate of annual income tax expense (or benefit) is made each interim period using estimates for annual pre-tax income, regulatory flow-through adjustments, tax credits and other items. The estimated annual effective tax rates do not include discrete events, such as tax law changes, which are recorded in the interim period in which they occur. The estimated annual effective tax rate is applied to year-to-date, pre-tax income to determine income tax expense (or benefit) for the interim period consistent with the annual estimate.

The effective income tax rate varied from the combined federal and state statutory tax rates due to the following:

| Dollars in thousands  | Three Months Ended March 31, |          |
|---|------------------------------|----------|
|   | 2014                         | 2013     |
| Income tax at statutory rates (federal and state)                   | \$25,721                     | \$25,239 |
| Increase (decrease):  |                              |          |
| Differences required to be flowed-through by regulatory commissions | 1,433                        | 1,512    |
| Other, net  | (169)                        | (791)    |
| Income tax expense  | \$26,985                     | \$25,960 |
| Effective income tax rate   | 41.6                         | % 40.8   |

The change in income tax expense for the three months ended March 31, 2014, compared to the same period in 2013, is primarily due to an increase in pre-tax earnings in 2014 and a \$0.6 million income tax charge related to a higher effective tax rate in Oregon, which required the revaluation of deferred tax balances. See Note 9 in the 2013 Form 10-K for more detail on income taxes and effective tax rates.

The Company's examination by the Internal Revenue Service (IRS) for tax years 2009 through 2011 was completed during the three months ended March 31, 2014. The examination did not result in a material change to the returns as originally filed or previously adjusted for net operating loss carrybacks. The 2012 tax year is subject to examination and the 2013 and 2014 tax years are subject to review under the Compliance Assurance Process (CAP) with the IRS.

## 9. PROPERTY, PLANT, AND EQUIPMENT

The following table sets forth the major classifications of our property, plant, and equipment and related accumulated depreciation:

| In thousands   | March 31,<br>2014 | 2013        | December 31,<br>2013 |
|--|-------------------|-------------|----------------------|
| Utility plant in service                               | \$2,605,018       | \$2,452,419 | \$2,585,901          |
| Utility construction work in progress                  | 30,699            | 53,474      | 28,855               |
| Less: Accumulated depreciation                         | 838,285           | 799,864     | 827,380              |
| Utility plant, net                                     | 1,797,432         | 1,706,029   | 1,787,376            |
| Non-utility plant in service                           | 297,352           | 296,228     | 297,330              |
| Non-utility construction work in progress              | 6,691             | 6,552       | 6,653                |
| Less: Accumulated depreciation                         | 29,972            | 24,697      | 28,485               |
| Non-utility plant, net                                 | 274,071           | 278,083     | 275,498              |
| Total property, plant, and equipment                   | \$2,071,503       | \$1,984,112 | \$2,062,874          |
| Capital expenditures acquired with accrued liabilities | \$7,769           | \$7,621     | \$10,456             |

## 10. GAS RESERVES

We entered into agreements with Encana Oil & Gas (USA) Inc. (Encana) in 2011 to develop and produce physical gas reserves and provide long-term gas price protection for utility customers. Encana began drilling in 2011 under these agreements. Gas produced from working interests in these gas fields is sold at prevailing market prices, with revenues from such sales, less associated production costs, credited to the utility's cost of gas. The cost of gas, including a carrying cost for the net rate base investment, is part of NW Natural's annual Oregon PGA filing, which allows us to recover our costs through customer rates.

On March 28, 2014, we amended the original gas reserve agreements in order to facilitate Encana's proposed sale of its interest in the Jonah field. Under the amendment, we ended the drilling program with Encana, but increased our assigned ownership interests in certain sections of the Jonah field. Our investment to-date will continue to earn a rate of return and provide long-term gas price protection for our utility customers. Although we retained the right to drill additional wells, we have not determined at this time whether we will seek to do so. Recovery of drilling costs through customer rates for these additional wells would require regulatory approval.

Gas reserves acted to hedge the cost of gas for approximately 4% and 3% of our utility's gas supplies for the three months ended March 31, 2014 and 2013, respectively. Our utility gas reserves are stated at cost, net of regulatory amortization, with the associated deferred tax benefits recorded as liabilities on the balance sheet. The following table outlines our net investment in gas reserves:

| In thousands                                   | March 31,<br>2014 | 2013     | December 31,<br>2013 |
|--|-------------------|----------|----------------------|
| Gas reserves, current                          | \$21,990          | \$14,286 | \$20,646             |
| Gas reserves, non-current                      | 156,450           | 110,033  | 140,573              |
| Less: Accumulated amortization                 | 21,556            | 9,864    | 18,575               |
| Total gas reserves                             | 156,884           | 114,455  | 142,644              |
| Less: Deferred tax liabilities on gas reserves | 30,704            | 32,907   | 42,117               |
| Net investment in gas reserves                 | \$126,180         | \$81,548 | \$100,527            |





Table of Contents

## 11. INVESTMENTS

## Equity Method Investments

Palomar Gas Transmission, LLC (Palomar), a wholly-owned subsidiary of PGH, is pursuing the development of a new gas transmission pipeline that would provide an interconnection with our utility distribution system. PGH is owned 50% by NWN Energy, a wholly-owned subsidiary of NW Natural, and 50% by TransCanada American Investments Ltd., an indirect wholly-owned subsidiary of TransCanada Corporation. PGH is a development stage Variable Interest Entity, with our investment in Palomar reported under equity method accounting based on the determination that we are not the primary beneficiary of PGH's activities, as defined by the authoritative guidance related to consolidations, as we have only a 50% share and there are no stipulations that allow us a disproportionate influence over the entity. Our investment in PGH and Palomar are included in other investments on our balance sheet. Our maximum loss exposure related to PGH is limited to our equity investment balance, less our share of any cash or other assets available to us as a 50% owner. Our investment balance in PGH was \$13.4 million at both March 31, 2014 and 2013 and December 31, 2013. See Note 12 in our 2013 Form 10-K.

## Other Investments

Other investments include financial investments in life insurance policies, which are accounted for at fair value. See Note 12 in the 2013 Form 10-K.

## 12. DERIVATIVE INSTRUMENTS

We enter into financial derivative contracts to meet our utility's natural gas sales requirements. These contracts include swaps, options, and combinations of option contracts. We primarily use these derivative financial instruments to manage commodity price variability. A small portion of our derivative hedging strategy involves foreign currency exchange contracts. The financial derivatives used in order to meet our utility's natural gas requirements qualify for regulatory deferral accounting.

We enter into these financial derivatives, up to prescribed limits, primarily to hedge price variability related to our physical gas supply contracts as well as to hedge spot purchases of natural gas. The foreign currency forward contracts are used to hedge the fluctuation in foreign currency exchange rates for pipeline demand charges paid in Canadian dollars.

In the normal course of business, we also enter into indexed-price physical forward natural gas commodity purchase contracts and options to meet the requirements of utility customers. These contracts qualify for regulatory deferral accounting treatment. We also enter into exchange contracts related to the asset management of our gas portfolio, which are derivatives that do not qualify for hedge accounting or regulatory deferral, but are subject to our regulatory sharing agreement.

## Notional Amounts

The following table presents the absolute notional amounts related to open positions on our derivative instruments:

| In thousands             | March 31,<br>2014 | 2013     | December 31,<br>2013 |
|--------------------------|-------------------|----------|----------------------|
| Natural gas (in therms): |                   |          |                      |
| Financial                | 295,125           | 302,020  | 389,225              |
| Physical                 | 875,150           | 671,000  | 552,500              |
| Foreign exchange         | \$5,590           | \$16,322 | \$15,002             |

Purchased Gas Adjustment

Derivatives entered into by the utility for the procurement or hedging of natural gas for future gas years and prior to our annual PGA filing receive regulatory deferred accounting treatment. Derivative contracts entered into after the annual PGA rate is set for the current gas contract year are subject to our PGA incentive sharing mechanism, which provides for either an 80% or 90% deferral of any gains and losses as regulatory assets or liabilities, with the remaining 10% or 20% recognized in current income. For the current gas year we have selected the 90% deferral option. In general, our commodity hedging for the current gas year is completed prior to the start of the upcoming gas year, and hedge prices are included in the Company's weighted-average cost of gas in the PGA filing. As of

15

---

Table of Contents

November 1, 2013, we reached our target hedge percentage of approximately 75% for the 2013-14 gas year, and these hedge prices were included in the PGA filing and qualified for regulatory deferral.

## Unrealized and Realized Gain/Loss

The following table reflects the income statement presentation for the unrealized gains and losses from our derivative instruments. Outstanding derivative instruments related to regulated utility operations are deferred in accordance with regulatory accounting standards.

| In thousands   | Three months ended March 31, |                  |                       |                  |
|--|------------------------------|------------------|-----------------------|------------------|
|  | 2014                         |                  | 2013                  |                  |
|  | Natural gas commodity        | Foreign currency | Natural gas commodity | Foreign currency |
| Benefit (expense) to cost of gas                             | \$ 15,912                    | \$(275 )         | \$ 7,183              | \$(239 )         |
| Less:  |                              |                  |                       |                  |
| Amounts deferred to regulatory accounts on the balance sheet | (15,875 )                    | 275              | (7,037 )              | 239              |
| Total gain in pre-tax earnings                               | \$ 37                        | \$—              | \$ 146                | \$—              |

The cost of foreign currency forward contracts and natural gas derivative contracts are recognized immediately in the cost of gas; however, costs above or below the amount embedded in the current year PGA are subject to a regulatory deferral tariff and therefore, are recorded as a regulatory asset or liability.

We realized a net gain of \$8.5 million and a net loss of \$5.4 million for the three months ended March 31, 2014 and 2013, respectively, from the settlement of natural gas financial derivative contracts. Realized gains are recorded as a reduction to the cost of gas, while realized losses were recorded as increases to the cost of gas.

## Credit Risk Management of Financial Derivatives Instruments

No collateral was posted with or by our counterparties as of March 31, 2014 or 2013. We attempt to minimize the potential exposure to collateral calls by counterparties to manage our liquidity risk. Counterparties generally allow a certain credit limit threshold before requiring us to post collateral against loss positions. Given our counterparty credit limits and portfolio diversification, we have not been subject to collateral calls in 2013 or 2014. Our collateral call exposure is set forth under credit support agreements, which generally contain credit limits. We could also be subject to collateral call exposure where we have agreed to provide adequate assurance, which is not specific as to the amount of credit limit allowed, but could potentially require additional collateral in the event of a material adverse change. Based upon current financial derivative contracts outstanding, which reflect unrealized gains of \$16.5 million at March 31, 2014, we do not have any collateral demand exposure.

Our financial derivative instruments are subject to master netting arrangements; however, they are presented on a gross basis on the face of our statement of financial position. The Company and its counterparties have the ability to set-off their obligations to each other under specified circumstances. Such circumstances may include when there is a defaulting party or in the event of a credit change due to a merger that affects either party or any other termination event. If netted by counterparty, our derivative position would result in an asset of \$16.6 million and a liability of \$1.0 million as of March 31, 2014. As of March 31, 2013, our derivative position would have resulted in an asset of \$8.3 million and a liability of \$1.4 million.

We are exposed to derivative credit and liquidity risk primarily through securing fixed price natural gas commodity swaps to hedge the risk of price increases for our natural gas purchases made on behalf of customers. See Note 13 in our 2013 Form 10-K.

## Fair Value

In accordance with fair value accounting, we include nonperformance risk in calculating fair value adjustments. This includes a credit risk adjustment based on the credit spreads of our counterparties when we are in an unrealized gain position, or on our own credit spread when we are in an unrealized loss position. The inputs in our valuation techniques include natural gas futures, volatility, credit default swap spreads and interest rates. Additionally, our assessment of non-performance risk is generally derived from the credit default swap market and from bond market credit spreads. The impact of the credit risk adjustments for all outstanding derivatives was immaterial to the fair value calculation at March 31, 2014. As of March 31, 2014 and 2013 and December 31, 2013, the net fair value was

16

---

Table of Contents

an asset of \$15.6 million, \$6.9 million, and \$4.7 million, respectively, using significant other observable, or Level 2 inputs. We have used no Level 3 inputs in our derivative valuations. We did not have any transfers between Level 1 or Level 2 during the three months ended March 31, 2014 and 2013.

13. ENVIRONMENTAL MATTERS

---

We own, or previously owned, properties that may require environmental remediation or action. We estimate the range of loss for environmental liabilities based on current remediation 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. Due to the numerous uncertainties surrounding the course of environmental remediation and the preliminary nature of several site investigations, in some cases, we may not be able to reasonably estimate the high end of the range of possible loss. In those cases, we have disclosed the nature of the possible loss and the fact that the high end of the range cannot be reasonably estimated. Unless there is an estimate within a range of possible losses that is more likely than other cost estimates within that range, we record the liability at the low end of this range. It is likely that changes in these estimates and ranges will occur throughout the remediation process for each of these sites due to our continued evaluation and clarification concerning our responsibility, the complexity of environmental laws and regulations, and the determination by regulators of remediation alternatives.

In the 2012 Oregon general rate case, the new SRRM mechanism was approved to recover the Company's deferred environmental costs. The Commission ordered a separate docket to determine the prudence of deferred costs, the allocation of insurance proceeds, and an earnings test that would be applied to past and future deferred costs. We have established a schedule with parties for 2014 and are working toward resolution of this matter.

In Washington, cost recovery and carrying charges on amounts deferred for costs associated with services provided to Washington customers will be determined in a future proceeding. We annually review all regulatory assets for recoverability and more often if circumstances warrant. If we should determine that all or a portion of these regulatory assets no longer meet the criteria for continued application of regulatory accounting, then we would be required to write off the net unrecoverable balances against earnings in the period such determination is made.

In December 2010, NW Natural commenced litigation against certain of its historical liability insurers in Multnomah County Circuit Court, State of Oregon (see Part I, Item 3. Legal Proceedings in our 2013 Form 10-K). In the complaint, NW Natural sought damages in excess of the \$50 million in losses it had incurred through the date of the complaint, as well as declaratory relief for additional losses it expected to incur in the future. In February 2014, we settled with all defendant insurance companies in this litigation with the Company to receive additional payments aggregating approximately \$102 million in 2014. During the first quarter of 2014, we received \$91 million of settlement payments with an additional \$11 million expected in the second quarter of 2014. We expect the litigation to be dismissed in the second quarter of 2014 after the remaining settlement payments are made. The settlements are recognized in regulatory accounts with the treatment to be determined through the SRRM.

Table of Contents

## Environmental Sites

The following table summarizes information regarding liabilities related to environmental sites, which are recorded in other current liabilities and other non-current liabilities on the balance sheet:

| In thousands                | Current Liabilities |          | Non-Current Liabilities |                   |          |                      |
|-----------------------------|---------------------|----------|-------------------------|-------------------|----------|----------------------|
|                             | March 31,<br>2014   | 2013     | December 31,<br>2013    | March 31,<br>2014 | 2013     | December 31,<br>2013 |
| Portland Harbor site:       |                     |          |                         |                   |          |                      |
| Gasco/Siltronic Sediments   | \$776               | \$389    | \$1,278                 | \$38,584          | \$38,050 | \$37,954             |
| Other Portland Harbor       | 1,408               | 1,678    | 1,766                   | 3,283             | 2,793    | 3,478                |
| Gasco Uplands site          | 8,766               | 15,411   | 11,010                  | 39,482            | 8,365    | 39,508               |
| Siltronic Uplands site      | 872                 | 556      | 763                     | 394               | 414      | 406                  |
| Central Service Center site | 70                  | 80       | 85                      | 224               | 386      | 248                  |
| Front Street site           | 1,176               | 760      | 1,274                   | 115               | 199      | 122                  |
| Oregon Steel Mills          | —                   | —        | —                       | 179               | 179      | 179                  |
| Total                       | \$13,068            | \$18,874 | \$16,176                | \$82,261          | \$50,386 | \$81,895             |

The following table presents information regarding the total amount of cash paid for environmental sites and the total regulatory asset deferred:

| In thousands                                   | March 31,<br>2014 | 2013     | December 31,<br>2013 |
|--|-------------------|----------|----------------------|
| Cash paid <sup>(1)</sup>                       | \$106,105         | \$75,620 | \$98,817             |
| Total regulatory asset deferral <sup>(2)</sup> | 63,517            | 125,671  | 148,389              |

<sup>(1)</sup> Includes \$20.1 million reclassified to utility plant in 2013 associated with the water treatment station of which a portion was paid in 2012.

<sup>(2)</sup> Includes cash paid, remaining liability, and interest, net of insurance reimbursement and amounts reclassified to utility plant for the water treatment station.

**PORTLAND HARBOR SITE.** The Portland Harbor is an EPA listed Superfund site that is approximately 11 miles long on the Willamette River and is adjacent to NW Natural's Gasco uplands and Siltronic uplands sites. We have been notified that we are a potentially responsible party to the Superfund site and we have joined with other potentially responsible parties (the Lower Willamette Group or LWG) to develop a Portland Harbor Remedial Investigation/Feasibility Study (RI/FS). The LWG submitted a draft Feasibility Study (FS) to the EPA in March 2012 that provides a range of remedial costs for the entire Portland Harbor Superfund Site, which includes the Gasco/Siltronic Sediment site, discussed below. The range of costs estimated for various remedial alternatives for the entire Portland Harbor, as provided in the draft FS, is \$169 million to \$1.8 billion. NW Natural's potential liability is a portion of the costs of the remedy the EPA will select for the entire Portland Harbor Superfund site. The cost of that remedy is expected to be allocated among more than 100 potentially responsible parties. NW Natural is participating in a non-binding allocation process in an effort to settle this potential liability. We manage our liability related to the Superfund site as two distinct remediation projects, the Gasco/Siltronic Sediments and Other Portland Harbor projects.

**GASCO/SILTRONIC SEDIMENTS.** In 2009, NW Natural and Siltronic Corporation entered into a separate Administrative Order on Consent with the EPA to evaluate and design specific remedies for sediments adjacent to the Gasco uplands and Siltronic uplands sites. NW Natural submitted a draft Engineering Evaluation/Cost Analysis (EE/CA) to the EPA in May 2012 to provide the estimated cost of potential remedial alternatives for this site. At this time, the estimated costs for the various sediment remedy alternatives in the draft EE/CA range from \$39.4 million to \$350 million. We have recorded a liability of \$39.4 million for the sediment clean-up, which reflects the low end of

the EE/CA range as well as costs for the additional studies and design work needed before the clean-up can occur, and for regulatory oversight throughout the clean-up. At this time, we believe sediments at this site represent the largest portion of our liability related to the Portland Harbor site, discussed above.

18

---



Table of Contents

OTHER PORTLAND HARBOR. NW Natural incurs costs related to its membership in the LWG, which is performing the RI/FS for the EPA. NW Natural also incurs costs related to natural resource damages from these sites. The Company and other parties have signed a cooperative agreement with the Portland Harbor Natural Resource Trustee council to participate in a phased natural resource damage assessment to estimate liabilities to support an early restoration-based settlement of natural resource damage claims. Natural resource damage claims may arise only after a remedy for clean-up has been settled. We have accrued a liability for these claims which is at the low end of the range of the potential liability; the high end of the range cannot be reasonably estimated. This liability is not included in the range of costs provided in the draft FS for the Portland Harbor.

GASCO UPLANDS SITE. NW Natural owns a former gas manufacturing plant that was closed in 1958 (Gasco site) and is adjacent to the Portland Harbor site described above. The Gasco site has been under investigation by us for environmental contamination under the ODEQ Voluntary Clean-Up Program. It is not included in the range of remedial costs for the Portland Harbor site. We manage the Gasco site in two parts, the uplands portion and the groundwater source control action.

In May 2007, we completed a revised Remedial Investigation Report for the uplands portion and submitted it to ODEQ for review. We have recognized a liability for the remediation of the uplands portion of the site which is at the low end of the range of potential liability; the high end of the range cannot be reasonably estimated at this time.

In September 2013, we completed construction of a groundwater source control system, including a water treatment station, at the Gasco site. We are working with ODEQ on monitoring the effectiveness of the system and at this time it is unclear what, if any, additional actions ODEQ may require subsequent to the initial testing of the system or as part of the final remedy for the uplands portion of the Gasco site. We have estimated the cost associated with the ongoing operation of the system and have recognized a liability which is at the low end of the range of potential cost. We cannot estimate the high end of the range due to the uncertainty associated with the duration of running the water treatment station, which will be highly dependent upon the remedy determined for both the upland portion as well as the final remedy for our Gasco sediment exposure.

Beginning November 1, 2013, capital asset costs of \$19.0 million for the Gasco water treatment station were placed into rates with OPUC approval. During the first quarter of 2014, the OPUC deemed these costs prudent and approved the application of \$2.5 million from insurance proceeds plus interest to reduce the total amount of Gasco costs to be recovered in rates beginning November 1, 2014.

OTHER SITES. In addition to those sites above, we have environmental exposures at four other sites: Siltronic, Central Service Center, Front Street, and Oregon Steel Mills. Due to the uncertainty of the design of remediation, regulation, timing of the liabilities, and in the case of the Oregon Steel Mills site, pending litigation, liabilities for each of these sites have been recognized at their respective low end of the range of potential liability; the high end of the range could not be reasonably estimated as of March 31, 2014.

Siltronic Upland site. Siltronic is the location of a manufactured gas plant formerly owned by NW Natural. We are currently conducting an investigation of manufactured gas plant wastes on the uplands at this site for the ODEQ.

Central Service Center site. We are currently performing an environmental investigation of the property under the ODEQ's Independent Cleanup Pathway. This site is on ODEQ's list of sites with confirmed releases of hazardous substances, and cleanup is necessary.

Front Street site. The Front Street site was the former location of a gas manufacturing plant we operated. Studies for source control investigation have been presented to ODEQ and a final sampling plan required by ODEQ is currently being developed.

Oregon Steel Mills site. See “Legal Proceedings,” below.

19

---

Table of Contents

Legal Proceedings

NW Natural is subject to claims and litigation arising in the ordinary course of business. Although the final outcome of any of these legal proceedings cannot be predicted with certainty, including the matter described below, NW Natural does not expect the ultimate disposition of any of these matters will have a material effect on our financial condition, results of operations or cash flows. See also Part II, Item 1, "Legal Proceedings."

OREGON STEEL MILLS SITE. In 2004, NW Natural was served with a third-party complaint by the Port of Portland (the 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 our predecessor, Portland Gas & Coke Company, and 10 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 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. No date has been set for trial. Although the final outcome of this proceeding cannot be predicted with certainty, we do not expect that the ultimate disposition of this matter will have a material effect on our financial condition, results of operations or cash flows.

14. SUBSEQUENT EVENTS

---

In April 2014, Gill Ranch amended its loan agreement with Prudential. Under the amended agreement, Gill Ranch is required to pay off \$20 million of variable-rate outstanding debt during the second quarter of 2014 and the EBITDA covenant requirement is suspended through March 31, 2015 with lower EBITDA hurdles thereafter. The amendment also fixes the debt service reserve at \$3 million. See also Note 6.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's assessment of Northwest Natural Gas Company's (NW Natural or the Company) financial condition, including the principal factors that affect results of operations. The disclosures contained in this report refer to our consolidated activities for the three months ended March 31, 2014 and 2013. References to "Notes" are to the Notes to Unaudited Consolidated Financial Statements in this report. A significant portion of our business results are seasonal in nature, and as such the results of operations for these three month periods are not necessarily indicative of expected fiscal year results. Therefore, this discussion should be read in conjunction with our 2013 Annual Report on Form 10-K (2013 Form 10-K).

The consolidated financial statements include NW Natural, the parent company, and its direct and indirect wholly-owned subsidiaries. Selected subsidiaries are depicted and organized as follows:

We operate in two primary reportable business segments, local gas distribution and gas storage. We also have other investments and business activities not specifically related to one of these two reporting segments, which we aggregate and report as other. We refer to our local gas distribution business as the utility, and our gas storage segment and other as non-utility. Our utility segment includes our NW Natural local gas distribution business, NWN Gas Reserves, which is a wholly-owned subsidiary of Energy Corp, and the utility portion of our Mist underground storage facility in Oregon (Mist). Our gas storage segment includes NWN Gas Storage, which is a wholly-owned subsidiary of NWN Energy, Gill Ranch, which is a wholly-owned subsidiary of NWN Gas Storage, the non-utility portion of Mist, and asset management services. Other includes NWN Energy's equity investment in Palomar Gas Holdings, LLC (PGH), which is pursuing the development of a proposed natural gas pipeline through its wholly-owned subsidiary, Palomar Gas Transmission, LLC (Palomar), and NNG Financial's equity investment in Kelso-Beaver Pipeline (KB Pipeline). Our equity investments, PGH and KB Pipeline, are not depicted in the chart above. For a further discussion of our business segments and other, see Note 4.

In addition to presenting results of operations and earnings amounts in total, certain financial measures are expressed in cents per share, which are non-GAAP financial measures. These amounts reflect factors that directly impact earnings. In calculating these financial disclosures, we allocate income tax expense based on the effective tax rate, where applicable. All references in this section to earnings per share (EPS) are on the basis of diluted shares (see Part II, Item 8., Note 3, "Earnings Per Share," in our 2013 Form 10-K). We use such non-GAAP measures in analyzing our financial performance because we believe they provide useful information to our investors and creditors in evaluating our financial condition and results of operations.

Table of Contents

## EXECUTIVE SUMMARY

Key financial highlights include:

| In thousands, except per share data | Three Months Ended March 31, |          |        |
|-------------------------------------|------------------------------|----------|--------|
|                                     | 2014                         | 2013     | Change |
| Consolidated net income             | \$37,884                     | \$37,639 | \$245  |
| Consolidated EPS                    | 1.40                         | 1.40     | —      |
| Utility margin                      | 130,294                      | 127,300  | 2,994  |
| Gas storage income from operations  | 3,553                        | 3,957    | (404 ) |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The primary factors contributing to changes in first quarter financial results were as follows:

- consolidated net income was slightly higher than last year with the increase due to higher utility margin, largely offset by increased utility operations and maintenance expense and a slightly higher state income tax rate;
- utility margin was higher driven by customer growth and rate-base return on our gas reserve and other investments, partially offset by losses from gas cost incentive sharing; and
- gas storage income from operations was lower reflecting decreased revenues.

We continued to make progress on several key initiatives. Highlights for the quarter included:

- receipt of \$91 million related to environmental insurance settlements;
- annual customer growth rate increased to 1.3% at March 31, 2014, compared to 1.1% at March 31, 2013; and
- a new daily volume sendout record of 9.0 million therms on February 6, 2014.

Our progress on, and commitment to, our 2014 initiatives are a part of our core business objectives and long-term strategic plan. See Part II, Item 7, “2014 Outlook” in our 2013 Form 10-K.

## ISSUES AND CHALLENGES

**ECONOMY.** The local, national, and global economies continued to show signs of improvements during the first quarter of 2014 as evidenced by increased utility customer growth and business demand for natural gas. Our utility’s annual customer growth rate was 1.3% at March 31, 2014, compared to 1.1% at March 31, 2013. The unemployment rate in our region remained below 7% during the first quarter of 2014, a decline of over 1% from the same period in 2013. We believe our utility is well positioned for customer additions and increasing industrial demand as the economy continues to improve, regional business projects move forward, and proposed legislation favoring lower carbon emissions develop.

**GAS PRICES AND SUPPLIES.** Our gas acquisition strategy is designed to secure sufficient supplies of natural gas to meet the needs of our utility customers and to hedge gas prices, so we can effectively manage costs, reduce price volatility, and maintain a competitive advantage. Our utility’s annual Purchased Gas Adjustment (PGA) mechanisms in Oregon and Washington, combined with our gas price hedging strategies, enable us to reduce earnings exposure for the Company and secure lower and more stable gas costs for customers. We typically hedge gas prices on 75% of our utility’s annual sales requirement based on normal weather, including both physical and financial hedges. We entered the 2013-14 gas year (November 1, 2013 – October 31, 2014) hedged at 75% of our forecasted sales volumes, including 31% in financial swap and option contracts and 44% in physical gas supplies. For further discussion see “Results of Operations—Regulatory Matters—Rate Mechanisms—Purchased Gas Adjustment” below.

In addition to the amount hedged for the current gas contract year, we were hedged at approximately 35% as of March 31, 2014 for the upcoming 2014-15 gas year and between 7% and 21% hedged for annual requirements for the

following five gas years. Our hedge levels are subject to change based on actual load volumes, which depend, to a certain extent, on weather and economic conditions, and estimated gas reserve production. Also, our storage inventory levels may increase or decrease based on storage expansion, storage contracts with third parties, or storage recall by the utility.

While currently low forward gas price curves provide opportunities to manage costs for our utility customers, they also present challenges for our gas storage businesses by lowering the price of, and reducing the demand for,

22

---

Table of Contents

storage services. Consequently, our ability to sign storage contracts with customers at favorable prices directly impacts our financial results. Increases in demand for natural gas or a decrease in supply can cause upward pressure on gas prices and gas price volatility. Current storage prices remain very low relative to prior years due to a flat forward price curve; as a result, in the short-term we are focused on lowering operating costs and finding opportunities in the market to increase revenues through enhanced or alternative services for storage customers.

**ENVIRONMENTAL COSTS.** We accrue estimates for environmental loss contingencies related to environmental sites for which we are responsible. Due to numerous uncertainties surrounding the nature of environmental investigations and the development of remediation solutions approved by regulatory agencies, actual costs could vary significantly from our loss estimates. As a regulated utility, we have been allowed to defer certain costs pursuant to regulatory orders. In our 2012 general rate case, the Public Utility Commission of Oregon (OPUC) approved the recovery of our environmental costs for investigation and site remediation from customers subject to certain conditions as noted in "Results of Operations—Regulatory Matters—Rate Mechanisms" below.

We also recover some of our environmental costs from insurance policies and only seek recovery from customers for amounts not covered by insurance. Ultimate recovery of environmental costs from regulated utility rates will depend on our ability to effectively manage these costs and demonstrate that costs were prudently incurred, and the impact of the annual earnings test in Oregon. Environmental cost recovery and carrying charges on amounts charged to Washington customers will be determined in a future proceeding.

**CONSOLIDATED EARNINGS AND DIVIDENDS**

## Consolidated Earnings

Consolidated highlights include:

| In thousands, except per share data | Three Months Ended March 31, |           | Change   |
|-------------------------------------|------------------------------|-----------|----------|
|                                     | 2014                         | 2013      |          |
| Consolidated operating revenues     | \$293,386                    | \$277,861 | \$15,525 |
| Consolidated operating expenses     | 218,358                      | 203,655   | 14,703   |
| Consolidated net income             | 37,884                       | 37,639    | 245      |
| Consolidated EPS                    | 1.40                         | 1.40      | —        |

**THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013.** The primary factors contributing to higher consolidated net income were a \$3.0 million net increase in utility margin primarily due to customer growth and rate-base return on our gas reserve and other investments, partially offset by losses from gas cost incentive sharing due to higher gas prices than prices embedded in customer rates. This utility margin increase was partially offset by a \$1.6 million increase in operations and maintenance expense and a \$0.6 million income tax charge related to a higher effective tax rate in Oregon.

## Dividends

Dividend highlights include:

| Per common share | Three Months Ended March 31, |         | Change  |
|------------------|------------------------------|---------|---------|
|                  | 2014                         | 2013    |         |
| Dividends paid   | \$0.460                      | \$0.455 | \$0.005 |

The Board of Directors declared a quarterly dividend on our common stock of 46.0 cents per share, payable on May 15, 2014, to shareholders of record on April 30, 2014, reflecting an indicated annual dividend rate of \$1.84 per share.





Table of Contents

RESULTS OF OPERATIONS

---

Regulatory Matters

Regulation and Rates

UTILITY. Our utility business is subject to regulation by the OPUC, the Washington Utilities and Transportation Commission (WUTC), and Federal Energy Regulatory Commission (FERC) with respect to, among other matters, rates and terms of service. The OPUC and WUTC also regulate the system of accounts and issuance of securities by our utility. Approximately 90% of our utility gas volumes and revenues are derived from Oregon customers, with the remaining 10% from Washington customers. Earnings and cash flows from utility operations are largely determined by rates set in general rate cases and other proceedings in Oregon and Washington, but are also affected by the local economies in Oregon and Washington, the pace of customer growth in the residential, commercial, and industrial markets, and our ability to remain price competitive, control expenses, and obtain reasonable and timely regulatory recovery of our utility-related costs, including operating expenses and investment costs in utility plant and other regulatory assets. See "Current Regulatory Activities" below.

GAS STORAGE. Our gas storage businesses are subject to regulation by the OPUC, California Public Utilities Commission (CPUC), and FERC with respect to, among other matters, rates and terms of service. The OPUC and CPUC also regulate the issuance of securities and system of accounts. The OPUC and CPUC regulate intrastate storage services, and the FERC regulates interstate storage services. The OPUC and FERC use a maximum cost of service model which allows for gas storage prices to be set at or below the cost of service as approved by each agency in the last regulatory filing. The CPUC regulates Gill Ranch under a market-based rate model which allows for the price of storage services to be set by the marketplace. In 2013, approximately 56% of our storage revenues were derived from operations regulated by OPUC and FERC and approximately 44% was derived from operations regulated by CPUC.

Current Regulatory Activities

The following list provides the status of open regulatory dockets and the status of other regulatory activities during the first quarter of 2014:

Gasco Water Treatment Station - Beginning November 1, 2013, capital asset costs of \$19.0 million for the Gasco water treatment station were placed into rates with OPUC approval. During the first quarter of 2014, the OPUC deemed these costs prudent and approved the allocation of \$2.5 million from insurance proceeds plus interest to reduce the total amount of Gasco costs to be recovered in rates beginning November 1, 2014.

Site Remediation and Recovery Mechanism (SRRM) - We established a schedule to resolve this docket in 2014, which is expected to include a review of deferred environmental costs for prudence, the allocation of insurance proceeds, including the proceeds from the recent insurance litigation settlements, and policy decisions regarding the application of an earnings test.

Interstate Storage Sharing - This docket was opened to review the current revenue sharing arrangement that allocates a portion of the net revenues generated from non-utility Mist storage services and third-party asset management services to utility customers. We anticipate resolution of this docket in 2014.

Prepaid Pension Asset - We anticipate resolution of this docket in 2014 with a decision by the OPUC on rate-base treatment of pension on a general, non-utility-specific basis. The Company has requested that the prepaid pension asset on the balance sheet be included in rate base and allowed a return on the investment.

Integrated Resource Plan (IRP) - We anticipate filing our 2014 Oregon and Washington IRPs in the second half of 2014, including analyses of different growth scenarios and corresponding resource acquisition strategies in an effort to develop supply and demand resource requirements, consider uncertainties in the planning process and the need for flexibility to respond to changes, and establish a plan for providing reliable service at the least cost.

Compressed Natural Gas (CNG) - In January 2014, we received approval from the OPUC to install, own, and maintain gas compression equipment and offer business customers a service to fuel their vehicle fleets using our

equipment. Costs associated with providing this service will be directly paid by business customers using the service. The OPUC will review the tariff in two years to assess the market for CNG at that time.

Table of Contents

Rate Mechanisms

**PURCHASED GAS ADJUSTMENT.** Rate changes are established for the utility each year under PGA mechanisms in Oregon and Washington to reflect changes in the expected cost of natural gas commodity purchases. This includes gas prices under spot purchases as well as contract supplies, gas prices hedged with financial derivatives, gas prices from the withdrawal of storage inventories, the production of gas reserves, interstate pipeline demand costs, a permanent rate adjustment for our SIP program, temporary rate adjustments, which amortize balances of deferred regulatory accounts, and the removal of temporary rate adjustments effective for the previous year.

Under the current PGA mechanism in Oregon, there is an incentive sharing provision whereby we are required to select each year either an 80% deferral or a 90% deferral of higher or lower actual gas costs compared to estimated PGA prices, such that the impact on current earnings from the incentive sharing is either 20% or 10% of the difference between actual and estimated gas costs, respectively. Under the Washington PGA mechanism, we defer 100% of the higher or lower actual gas costs, and those gas cost differences are passed on to customers through the annual PGA rate adjustment.

**EARNINGS REVIEW.** We are subject to an annual earnings review in Oregon to determine if the utility is earning above its authorized ROE threshold. If utility earnings exceed a specific ROE level, then 33% of the amount above that level is required to be deferred for refund to customers. Under this provision, if we select the 80% deferral option, then we retain all of our earnings up to 150 basis points above the currently authorized ROE. If we select the 90% deferral option, then we retain all of our earnings up to 100 basis points above the currently authorized ROE. We selected the 90% deferral option for the 2013-2014 PGA year. The ROE threshold is subject to adjustment annually based on movements in long-term interest rates. For the 2013 calendar year, the ROE threshold was 10.58%. We do not expect to be subject to a refund for the 2013 or 2014 test years.

**SYSTEM INTEGRITY PROGRAM (SIP).** The OPUC approved specific accounting treatment and cost recovery for our transmission pipeline integrity management program, our SIP, and for related pipeline safety rules adopted by the U.S. Department of Transportation's PHMSA. In addition, the OPUC has provided a two-year extension beginning in November 2012 of our capital expenditure tracking mechanism to recover capital costs related to SIP. We record the costs related to the integrity management program as either capital expenditures or regulatory assets, accumulate the costs over each 12-month period, and recover the revenue requirement associated with these costs, subject to audit, through rate changes effective with the Oregon annual PGA. Our SIP costs are tracked into rates annually, with rate base recovery after the first \$4 million of capital costs. An annual cap for expenditures has been set at \$12 million, but extraordinary costs above the cap may be approved with written consent of the OPUC staff and other interested parties and approval of the OPUC. During 2013, the Commission approved a temporary increase to the annual cap, authorizing an additional \$13.7 million of expenditures above the cap over the next two years to be tracked into rates. With the increased cap, we plan to substantially complete our bare steel replacement by the end of 2015, and as a result this stipulation precludes us from tracking any additional bare steel replacement costs into rates after 2015. We do not have any special accounting or rate treatment for our SIP costs incurred in the state of Washington.

**ENVIRONMENTAL COST DEFERRAL.** The OPUC has authorized the deferral of environmental costs associated with certain named sites and the accrual of a carrying cost on amounts deferred, subject to an annual demonstration that we have maximized our insurance recovery or made substantial progress in securing insurance recovery for unrecovered environmental expenses. Through a series of extensions, the authorized cost deferral and accrual of carrying costs was extended through January 2015. The WUTC also authorized the deferral of environmental costs, if any, that are appropriately allocated to Washington customers. This order was effective January 26, 2011 with cost recovery and a carrying charge to be determined in a future proceeding. See also Note 13 and "Current Regulatory Activities" above for information regarding SRRM.

PENSION DEFERRAL. In Oregon, we are allowed to defer annual pension expenses related to the qualified employee defined benefit pension plan. The amount deferred each period represents the difference between annual expense and the amount set in rates. Recovery of these deferred amounts are through the implementation of a balancing account, which includes the expectation of higher and lower pension expenses in future years. Our recovery of these deferred balances includes accrued interest. Future years' deferrals will depend on changes in plan assets and projected benefit liabilities based on a number of key assumptions, and our pension contributions. Pension expense deferrals were \$1.1 million and \$2.3 million for the three months ended March 31, 2014 and 2013, respectively.

Table of Contents

**CUSTOMER CREDITS FOR GAS STORAGE SHARING.** In April 2014, the Company requested regulatory approval to provide its Oregon utility customers with an \$11.4 million interstate storage credit to be included in their June bills. These customer credits were part of our regulatory incentive sharing mechanism related to non-utility Mist storage services and asset management services. The OPUC approved an \$8.8 million interstate storage credit to Oregon customers in June of 2013.

For a discussion of other rate mechanisms, see Part II, Item 7, “Results of Operations—Regulatory Matters—Rate Mechanisms” in our 2013 Form 10-K.

**Business Segments - Local Gas Distribution Utility Operations**

Our utility margin results are largely affected by customer growth and, to a certain extent, by changes in volume due to weather and customers’ gas usage patterns because a significant portion of our utility margin is derived from natural gas sales to residential and commercial customers. In Oregon, we have a conservation tariff (also called the decoupling mechanism), which adjusts utility margin up or down each month through a deferred accounting adjustment to offset changes resulting from increases or decreases in average use by residential and commercial customers. We also have a weather normalization tariff in Oregon, which adjusts customer bills up or down to offset changes in utility margin resulting from above- or below-average temperatures during the winter heating season. Both mechanisms are designed to reduce the volatility of our utility’s earnings and customer charges. See “Results of Operations—Regulatory Matters—Rate Mechanisms” in our 2013 Form 10-K for more information on our decoupling and weather normalization mechanisms.

Utility segment highlights include:

| In thousands, except per share data | Three Months Ended March |           | Change    |
|-------------------------------------|--------------------------|-----------|-----------|
|                                     | 31, 2014                 | 2013      |           |
| Utility net income                  | \$36,019                 | \$36,031  | \$(12 )   |
| EPS - utility segment               | \$1.33                   | \$1.34    | \$(0.01 ) |
| Gas sold and delivered (therms)     | 406,217                  | 400,190   | 6,027     |
| Utility margin <sup>(1)</sup>       | \$130,294                | \$127,300 | \$2,994   |

<sup>(1)</sup> See Utility Margin Table below for a reconciliation and additional detail.

**THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013.** The primary factors contributing to the increase in net income were as follows:

• a \$3.0 million increase in utility margin primarily due to:

• a \$5.4 million increase from customer growth and the rate-base return on our gas reserve investment, and other investments, such as our pipeline integrity tracker; partially offset by

• a \$2.4 million decrease due to losses from gas cost incentive sharing resulting from actual gas prices and volumes that were higher than those estimated in the PGA for the current gas year as compared to the prior year.

• a \$1.4 million increase in other income and expense, net primarily due to additional regulatory interest income from deferred gas cost balances and other rate-base investments.

• Partially offsetting the above factors were:

• a \$2.1 million increase in tax expense due to higher pre-tax utility income and an increase in the Oregon state income tax rate; and

• a \$1.4 million increase in operations and maintenance expense primarily due to an adjustment to our allowance for uncollectible accounts in the first quarter of 2013.

Total utility volumes sold and delivered increased 2% over last year primarily due to customer growth and the impact of colder weather in February. Weather overall for the first quarter of 2014 was 2% colder than average and 1%

warmer than the first quarter of 2013.

26

---

Table of Contents

UTILITY MARGIN TABLE. The following table summarizes the composition of utility gas volumes, revenues, and costs of sales:

| In thousands, except degree day and customer data           | Three Months Ended |           | Favorable/(Unfavorable)<br>Change |
|---|--------------------|-----------|-----------------------------------|
|   | March 31,<br>2014  | 2013      |                                   |
| Utility volumes (therms):                                   |                    |           |                                   |
| Residential and commercial sales                            | 274,156            | 268,664   | 5,492                             |
| Industrial sales and transportation                         | 132,061            | 131,526   | 535                               |
| Total utility volumes sold and delivered                    | 406,217            | 400,190   | 6,027                             |
| Utility operating revenues:                                 |                    |           |                                   |
| Residential and commercial sales                            | \$270,002          | \$256,366 | \$ 13,636                         |
| Industrial sales and transportation                         | 21,512             | 19,025    | 2,487                             |
| Other revenues  | 1,477              | 1,529     | (52 )                             |
| Less: Revenue taxes   | 7,496              | 7,261     | 235                               |
| Total utility operating revenues                            | 285,495            | 269,659   | 15,836                            |
| Less: Cost of gas   | 155,201            | 142,359   | 12,842                            |
| Utility margin  | \$130,294          | \$127,300 | \$ 2,994                          |
| Utility margin: <sup>(1)</sup>                              |                    |           |                                   |
| Residential and commercial sales                            | \$122,104          | \$117,363 | \$ 4,741                          |
| Industrial sales and transportation                         | 8,484              | 7,718     | 766                               |
| Miscellaneous revenues                                      | 1,587              | 1,529     | 58                                |
| Gain (loss) from gas cost incentive sharing                 | (1,831 )           | 542       | (2,373 )                          |
| Other margin adjustments                                    | (50 )              | 148       | (198 )                            |
| Utility margin  | \$130,294          | \$127,300 | \$ 2,994                          |
| Degree days:  |                    |           |                                   |
| Average <sup>(2)</sup>                                      | 1,855              | 1,855     | —                                 |
| Actual degree days  | 1,890              | 1,904     | (14 )                             |
| Percent colder (warmer) than average weather <sup>(2)</sup> | 2                  | %3        | % (1 )%                           |
|   | As of March 31,    |           |                                   |
| Customers - end of period:                                  | 2014               | 2013      |                                   |
| Residential customers                                       | 631,557            | 623,609   | 7,948                             |
| Commercial customers  | 65,883             | 64,649    | 1,234                             |
| Industrial customers  | 932                | 941       | (9 )                              |
| Total number of customers                                   | 698,372            | 689,199   | 9,173                             |

<sup>(1)</sup> Amounts reported as margin for each category of customer are operating revenues, which are net of revenue taxes, less cost of gas.

<sup>(2)</sup> Average weather represents the 25-year average degree days, as determined in our 2012 Oregon general rate case.

Table of Contents

## Residential and Commercial Sales

Residential and commercial sales highlights include:

| In thousands                      | Three Months Ended March 31, |           | Change   |
|-----------------------------------|------------------------------|-----------|----------|
|                                   | 2014                         | 2013      |          |
| Volumes (therms):                 |                              |           |          |
| Residential sales                 | 173,177                      | 169,950   | 3,227    |
| Commercial sales                  | 100,979                      | 98,714    | 2,265    |
| Total volumes                     | 274,156                      | 268,664   | 5,492    |
| Operating revenues:               |                              |           |          |
| Residential sales                 | \$179,982                    | \$172,168 | \$7,814  |
| Commercial sales                  | 90,020                       | 84,198    | 5,822    |
| Total operating revenues          | \$270,002                    | \$256,366 | \$13,636 |
| Utility margin:                   |                              |           |          |
| Residential:                      |                              |           |          |
| Sales                             | \$88,508                     | \$84,601  | \$3,907  |
| Weather normalization adjustments | (1,174)                      | (3,660)   | 2,486    |
| Decoupling adjustments            | (1,135)                      | 2,817     | (3,952)  |
| Total residential utility margin  | 86,199                       | 83,758    | 2,441    |
| Commercial:                       |                              |           |          |
| Sales                             | 34,948                       | 33,647    | 1,301    |
| Weather normalization adjustments | (456)                        | (1,638)   | 1,182    |
| Decoupling adjustments            | 1,413                        | 1,596     | (183)    |
| Total commercial utility margin   | 35,905                       | 33,605    | 2,300    |
| Total utility margin              | \$122,104                    | \$117,363 | \$4,741  |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The primary factors contributing to changes in residential and commercial sales were as follows:

- sales volumes increased 2% primarily driven by customer growth and a record February cold weather event;
- operating revenues increased \$13.6 million due to a 2% increase in sales volumes and a 2% increase in average gas prices collected through rates; and
- utility margin increased \$4.7 million, primarily due to increases from customer growth and the rate-base return on our gas reserve and other investments.

## Industrial Sales and Transportation

Industrial sales and transportation highlights include:

| In thousands                                       | Three Months Ended March |         | Change  |
|--|--------------------------|---------|---------|
|  | 31,                      | 2013    |         |
|  | 2014                     |         |         |
| Volumes (therms):                                  |                          |         |         |
| Industrial - firm sales                            | 10,138                   | 9,480   | 658     |
| Industrial - firm transportation                   | 44,160                   | 39,753  | 4,407   |
| Industrial - interruptible sales                   | 18,419                   | 17,069  | 1,350   |
| Industrial - interruptible transportation          | 59,344                   | 65,224  | (5,880) |
| Total volumes                                      | 132,061                  | 131,526 | 535     |
| Utility margin:                                    |                          |         |         |
| Industrial - firm and interruptible sales          | \$3,724                  | \$3,684 | \$40    |
| Industrial - firm and interruptible transportation | 4,760                    | 4,034   | 726     |
| Total utility margin                               | \$8,484                  | \$7,718 | \$766   |



THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. Total sales volumes remained relatively flat while total utility margin increased by 10% or \$0.8 million primarily due to increased usage and other charges resulting from the cold weather event in February 2014.

28

---

Table of Contents

## Cost of Gas

Cost of gas as reported by the utility includes gas purchases, gas drawn from storage inventory, gains and losses from commodity hedges, pipeline demand costs, seasonal demand cost balancing adjustments, regulatory gas cost deferrals, production from gas reserves, and company gas use. The OPUC and WUTC generally require natural gas commodity costs to be billed to customers at the actual cost incurred, or expected to be incurred, by the utility. Customer rates are set each year so that if cost estimates were met we would not earn a profit or incur a loss on gas commodity purchases; however, in Oregon we have an incentive sharing mechanism. See “Regulatory Matters—Rate Mechanisms—Purchased Gas Adjustment” above. In addition to the sharing mechanism, gains and losses from hedge contracts entered into after the annual PGA rates are set for Oregon customers are also required to be shared and can impact net income. See Part II, Item 7, “Application of Critical Accounting Policies and Estimates—Accounting for Derivative Instruments and Hedging Activities” and “Regulatory Matters—Rate Mechanisms—Purchased Gas Adjustment” in our 2013 Form 10-K for additional information, as well as Note 12 in this report.

Cost of gas highlights include:

| In thousands, except as noted                        | Three Months Ended March 31, |           | Change   |
|--|------------------------------|-----------|----------|
|  | 2014                         | 2013      |          |
| Cost of gas  | \$155,201                    | \$142,359 | \$12,842 |
| Total volumes sold and delivered (therms)            | 406,217                      | 400,190   | 6,027    |
| Average cost of gas (cents per therm) <sup>(1)</sup> | \$0.51                       | \$0.48    | \$0.03   |
| Gain (loss) from gas cost incentive sharing          | (1,831                       | )542      | (2,373 ) |

<sup>(1)</sup> This calculation does not include volumes or amounts related to transportation only customers.

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The primary factors contributing to the \$12.8 million or 9% increase in cost of gas were a 2% increase in total sales volumes and a 6% increase in average cost of gas.

During the first quarter of 2014, many parts of the United States experienced record cold weather for an extended period while the Pacific Northwest temperatures were closer to historical averages. The extreme cold weather nationally resulted in a significant withdrawal of gas from storage and higher gas prices. One cold weather event that did impact the Pacific Northwest in early February resulted in a new Company record sendout. Consequently, the higher volumes of gas purchases and higher gas prices resulted in a margin loss of \$1.8 million for the first quarter of 2014 under our gas cost incentive sharing mechanism, compared to a gain of \$0.5 million for the same period in 2013. For a discussion of our gas cost incentive sharing mechanism, see “Regulatory Matters—Rate Mechanisms—Purchased Gas Adjustment” above.

## Business Segments - Gas Storage

Our gas storage segment primarily consists of the non-utility portion of our Mist underground storage facility in Oregon and our 75% ownership interest in the Gill Ranch underground storage facility in California. We also contract with an independent energy marketing company to provide asset management services using our utility and non-utility storage and transportation capacity, the results of which are included in this segment.

Gas storage segment highlights include:

| In thousands, except per share data and as otherwise noted | Three Months Ended March 31, |         | Change |
|--|------------------------------|---------|--------|
|  | 2014                         | 2013    |        |
| Gas storage net income                                     | \$1,627                      | \$1,636 | \$(9 ) |
| EPS - gas storage segment                                  | 0.06                         | 0.06    | —      |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. Net income remained relatively unchanged from the prior period reflecting lower operating revenues offset by a decrease in other expenses. Recent market pricing for storage, particularly in California, has been negatively affected by the abundant supply of natural gas, low volatility of natural gas prices, and available gas storage capacity. We have contracted for the 2014-2015 gas storage year, which begins April 1, 2014, at lower market prices than in previous years. See "Financial Condition—Liquidity and Capital Resources" for more information.

29

---

Table of Contents

## Other

Other primarily consists of NNG Financial's equity investment in KB Pipeline, an equity investment in PGH, and other miscellaneous non-utility investments and business activities. Contributions from our other businesses produced one cent per share for the three months ended March 31, 2014 compared to a small loss in 2013. See Note 4 and Note 11 for further details on our other business segment and our investment in PGH.

## Consolidated Operations

## Operations and Maintenance

Operations and maintenance highlights include:

| In thousands               | Three Months Ended March 31, |          | Change  |
|----------------------------|------------------------------|----------|---------|
|                            | 2014                         | 2013     |         |
| Operations and maintenance | \$35,386                     | \$33,757 | \$1,629 |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The increase in operations and maintenance expense was primarily due to:

- a \$1.0 million increase in utility bad debt expense due to lower comparable amounts in 2013, which was partially driven by a decrease in our allowance for uncollectible accounts in the first quarter of 2013 (see paragraph below for further discussion); and
- a \$0.4 million increase in utility non-payroll expense related to higher system maintenance and safety program costs.

Delinquent account balances have remained low for the past few years despite challenging economic conditions. This sustained favorable trend resulted in a decrease to our allowance for uncollectible accounts in the first quarter of 2013. Our bad debt expense continues to remain at historically low levels for the Company. The utility's annualized bad debt expense as a percent of revenues was 0.16% for the three months ended March 31, 2014 and for several years has remained well below 0.5% of revenues.

We have OPUC approval to defer certain utility pension costs in excess of what is currently recovered in customer rates. The pension cost deferral is recorded to a regulatory balancing account, which stabilizes the recognized amount of operations and maintenance expense. For the three months ended March 31, 2014 and 2013, we deferred pension expenses totaling \$1.1 million and \$2.3 million, respectively. See Note 7 and for further explanation of the pension balancing account, see also "Regulatory Matters—Rate Mechanisms—Pension Deferral," above.

## Income Tax Expense

Income tax expense highlights include:

| Dollars in thousands | Three Months Ended March 31, |          | Change  |
|----------------------|------------------------------|----------|---------|
|                      | 2014                         | 2013     |         |
| Income tax expense   | \$26,985                     | \$25,960 | \$1,025 |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The increase in income tax expense was due to increased pre-tax income in 2014 and a tax charge of \$0.6 million as a result of a higher Oregon state tax rate.

## Other Consolidated Expenses

Interest expense and general taxes remained relatively flat for the three months ended March 31, 2014 compared to the same periods in 2013 as expected. Depreciation expense increased 4% for the three months ended March 31, 2014 compared to 2013 as a result of planned capital expenditures. See "Cash Flows—Investing Activities" below for

additional information. Other income and expense, net also increased for the three months ended March 31, 2014 compared to 2013 as a result of additional regulatory interest income from deferred gas costs and other rate-base investments.

30

---

Table of Contents

## FINANCIAL CONDITION

## Capital Structure

One of our long-term goals is to maintain a strong consolidated capital structure, generally consisting of 45% to 50% common stock equity and 50% to 55% long-term and short-term debt. When additional capital is required, debt or equity securities are issued depending upon both the target capital structure and market conditions. These sources of capital are also used to fund long-term debt retirements and short-term commercial paper maturities. See “Liquidity and Capital Resources” below and Note 6.

Achieving the target capital structure and maintaining sufficient liquidity to meet operating requirements are necessary to maintain attractive credit ratings and have access to capital markets at reasonable costs. Our consolidated capital structure was as follows:

|   | March 31,<br>2014 | 2013    | December 31,<br>2013 |   |
|---|-------------------|---------|----------------------|---|
| Common stock equity   | 50.2              | % 47.9  | % 44.7               | % |
| Long-term debt  | 42.6              | 43.8    | 40.5                 |   |
| Short-term debt, including any current maturities of long-term debt | 7.2               | 8.3     | 14.8                 |   |
| Total   | 100.0             | % 100.0 | % 100.0              | % |

## Liquidity and Capital Resources

At March 31, 2014, we had \$17.9 million of cash and cash equivalents compared to \$8.3 million at March 31, 2013. We also had \$4.0 million in restricted cash at Gill Ranch at both March 31, 2014 and 2013, which is being held as collateral for its long-term debt outstanding. See Notes 6 and 14 regarding the amended debt agreement. In order to maintain sufficient liquidity during periods when capital markets are volatile, we may elect to maintain higher cash balances and add short-term borrowing capacity. In addition, we may also pre-fund utility capital expenditures when long-term fixed rate environments are attractive. As a regulated entity, our issuance of equity securities and most forms of debt securities are subject to approval by the OPUC and WUTC. Our use of retained earnings is not subject to those same restrictions.

For the utility segment, the short-term borrowing requirements typically peak during colder months when the utility borrows money to cover the lag between when it purchases natural gas and when customers pay for the gas. For the utility segment, our short-term liquidity is supported by cash balances, internal cash flow from operations, proceeds from the sale of commercial paper notes, borrowings from multi-year credit facilities, cash available from surrender value in company-owned life insurance policies, and proceeds from the sale of long-term debt. We use utility long-term debt proceeds to finance utility capital expenditures, refinance maturing debt of the utility and provide for general corporate purposes of the utility.

Market conditions have improved over the past few years as reflected by tighter credit spreads and increased access to financing for investment grade issuers. Based on our current debt ratings (see “Credit Ratings” below), we have been able to issue commercial paper and long-term debt at attractive rates and have not needed to borrow from our back-up credit facility. In the event that we are not able to issue new debt due to adverse market conditions or other reasons, we expect that our near term liquidity needs can be met using internal cash flows or, for the utility segment, drawing upon our committed credit facility. We also have a universal shelf registration filed with the SEC for the issuance of secured and unsecured debt or equity securities, subject to market conditions and certain regulatory approvals. As of March 31, 2014, we have Board authorization to issue up to \$325 million of additional first mortgage bonds. We also currently have OPUC approval to issue up to \$25 million of additional long-term debt for approved purposes. We plan to file an application with the OPUC during 2014 to increase our OPUC long-term debt authorization to \$325 million.

In the event that our senior unsecured long-term debt credit ratings are downgraded, or our outstanding derivative position exceeds a certain credit threshold, our counterparties under derivative contracts could require us to post cash, a letter of credit or other form of collateral, which could expose us to additional cash requirements and may trigger increases in short-term borrowings. However, based upon current financial swap and option contracts outstanding, we do not have any collateral demand exposure as the Company had unrealized gains of \$16.5 million at March 31, 2014. See Note 12 and “Credit Ratings” below.

31

---

Table of Contents

Other recent developments that may have a significant impact on our liquidity and capital resources include pension contribution requirements, current tax benefits from bonus depreciation and other tax advantaged investments, environmental expenditures and insurance recoveries, and strategic growth initiatives. See "Cash Flows—Operating Activities" below for additional information.

Short-term liquidity for our gas storage segment is supported by cash balances, internal cash flow from operations, external financing, and funds from its respective parent company. Gill Ranch has limited operational history, with operations commencing in October 2010. The abundant supply of natural gas, low volatility of natural gas prices, and available gas storage capacity in California have resulted in lower storage market prices than we have seen in previous years. As a result, we are anticipating lower estimated future earnings and cash flows for Gill Ranch. The amount and timing of these cash flows from year to year are uncertain as the majority of Gill Ranch's storage contracts are short-term. While we expect short-term storage prices to be challenging, we do not anticipate material changes in our sources of short-term liquidity and had positive cash flow from operations during the first quarter of 2014.

In November 2011, Gill Ranch issued \$40 million of senior secured debt, with a fixed interest rate on \$20 million and a variable interest rate on the remaining \$20 million. The average combined interest rate on the debt was 7.38% per annum through March 31, 2014. This debt is secured by all of the membership interests in Gill Ranch and is nonrecourse to NW Natural and other entities of the consolidated group. Under the debt agreement, Gill Ranch is subject to certain covenants and restrictions. The maturity date of the debt is November 30, 2016; however, we amended the existing agreement with Prudential in April 2014. Under the amended agreement, Gill Ranch is required to pay back \$20 million of variable-rate outstanding debt during the second quarter of 2014 and the EBITDA covenant requirement is suspended through March 31, 2015 with lower EBITDA hurdles thereafter. The amendment also fixes the debt service reserve at \$3 million. Gill Ranch expects to pay the \$20 million of debt in the second quarter of 2014 using available cash and cash flows from operations including cash from intercompany receivables. At March 31, 2014, we were in compliance with all covenants and restrictions under the debt agreement.

Based on several factors, including our current credit ratings, our commercial paper program, current cash reserves, committed credit facilities, and our expected ability to issue long-term debt in the capital markets, we believe the Company's liquidity is sufficient to meet anticipated near-term cash requirements, including all contractual obligations, investing, and financing activities discussed below.

**Short-Term Debt**

Our primary source of utility short-term liquidity is from internal cash flows and the sale of commercial paper. In addition to issuing commercial paper to meet working capital requirements, including seasonal requirements to finance gas purchases and accounts receivable, short-term debt may also be used to temporarily fund utility capital requirements. Commercial paper is periodically refinanced through the sale of long-term debt or equity securities. Our outstanding commercial paper, which is sold through two commercial banks under an issuing and paying agency agreement, is supported by one or more unsecured revolving credit facilities. See "Credit Agreements" below. At March 31, 2014 and 2013, our utility had commercial paper outstanding of \$32.6 million and \$130.8 million, respectively. The effective interest rate on the utility's commercial paper outstanding at March 31, 2014 and 2013 was 0.2% and 0.3%, respectively.



Table of Contents

## Credit Agreements

We have a multi-year credit agreement for unsecured revolving loans totaling \$300 million with an original maturity date of December 20, 2017 and an available extension of commitments for two additional one-year periods, subject to lender approval. In December 2013, we extended our commitment for an additional year to December 20, 2018. All lenders under the new agreement are major financial institutions with committed balances and investment grade credit ratings as of March 31, 2014 as follows:

In thousands

| Lender rating, by category | Loan Commitment |
|----------------------------|-----------------|
| AA/Aa                      | \$189           |
| A/A1                       | 111             |
| BBB/Baa                    | —               |
| Total                      | \$300           |

Based on credit market conditions, it is possible that one or more lending commitments could be unavailable to us if the lender defaulted due to lack of funds or insolvency; however, the Company does not believe this risk to be imminent due to the lenders' strong investment grade credit ratings.

Our credit agreement allows us to request increases in the total commitment amount, up to a maximum of \$450 million. The agreement also permits the issuance of letters of credit in an aggregate amount of up to \$200 million. Any principal and unpaid interest amounts owed on borrowings under the credit agreements is due and payable on or before the maturity date. There were no outstanding balances under this or our prior credit agreement at March 31, 2014 or 2013. The current credit agreement requires us to maintain a consolidated indebtedness to total capitalization ratio of 70% or less. Failure to comply with this covenant would entitle the lenders to terminate their lending commitments and accelerate the maturity of all amounts outstanding. We were in compliance with this covenant at March 31, 2014 and 2013, with consolidated indebtedness to total capitalization ratios of 49.8% and 52.1%, respectively.

The agreement also requires us to maintain credit ratings with Standard & Poor's (S&P) and Moody's Investors Service, Inc. (Moody's) and notify the lenders of any change in our senior unsecured debt ratings or senior secured debt ratings, as applicable, by such rating agencies. A change in our debt ratings by S&P or Moody's is not an event of default, nor is the maintenance of a specific minimum level of debt rating a condition of drawing upon the credit agreement. Rather, interest rates on any loans outstanding under the credit agreements are tied to debt ratings and therefore a change in the debt rating would increase or decrease the cost of any loans under the credit agreements when ratings are changed. See "Credit Ratings" below.

## Credit Ratings

Our credit ratings are a factor in our liquidity, affecting our access to the capital markets including the commercial paper market. Our debt credit ratings also have an impact on the cost of funds and the need to post collateral under derivative contracts. In February 2014, Moody's revised our ratings outlook from negative to stable.

There were no other changes in our credit ratings during the first quarter of 2014. Our credit ratings are dependent upon a number of factors, both qualitative and quantitative, and are subject to change at any time. The disclosure of these credit ratings is not a recommendation to buy, sell or hold NW Natural securities. Each rating should be evaluated independently of any other rating.

## Maturity and Redemption of Long-Term Debt

For the three months ended March 31, 2014, there were no redemptions or maturities of long-term debt. Over the next 12 months the following debt issuances are expected to be redeemed:

- \$20 million of variable interest rate debt issued by Gill Ranch with a coupon rate of 7.00% is expected to be redeemed during the second quarter of 2014. See "Liquidity and Capital Resources" above;

Edgar Filing: NORTHWEST NATURAL GAS CO - Form 10-Q

\$50 million of FMBs with a coupon rate of 3.95% will be redeemed at maturity in July 2014; and  
\$10 million of FMBs with a coupon rate of 8.26% will be redeemed at maturity in September 2014.

See Part II, Item 7, "Financial Condition—Contractual Obligations" in our 2013 Form 10-K for long-term debt maturing over the next five years.

33

---

Table of Contents

## Cash Flows

## Operating Activities

Year-over-year changes in our operating cash flows are primarily affected by net income, changes in working capital requirements, and other cash and non-cash adjustments to operating results.

Operating activity highlights include:

| In thousands                          | Three Months Ended March 31, |           |           |
|---------------------------------------|------------------------------|-----------|-----------|
|                                       | 2014                         | 2013      | Change    |
| Cash provided by operating activities | \$220,132                    | \$106,118 | \$114,014 |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The significant factors contributing to the increase in operating cash flow were as follows:

- an increase of \$87.7 million in deferred environmental recoveries due to receiving insurance proceeds of \$91 million during the first quarter of 2014 as a result of insurance settlements;
- an increase of \$17.9 million from changes in accounts receivable due to higher account balances at the end of 2013 compared to 2012 because of colder weather at the end of 2013;
- an increase of \$12.1 million from changes in accounts payable balances; and
- an increase of \$11.6 million from a decrease in inventory balances.

Partially offsetting these increases was a decrease of \$16.0 million from changes in deferred gas costs balances, which reflected higher actual gas prices than embedded gas prices in the PGA for 2014.

During the three months ended March 31, 2014, we contributed \$2.8 million to our utility's qualified defined benefit pension plan, which was higher than the \$1.3 million in non-cash expense recognized on the income statement, compared to \$1.4 million in contributions and \$1.5 million in non-cash expense for the same three month period in 2013. We expect pension contributions to exceed non-cash expense for the next few years, but contribution amounts will be less in 2014 and 2015 than previously anticipated due to the new federal funding requirements under MAP-21. The amount and timing of future contributions will depend to a certain extent on market interest rates and investment returns on the plans' assets.

Also significantly affecting cash flows over the past few years has been income tax legislation, including the American Taxpayer Relief Act of 2012 (2012 Act), which extended 50% bonus depreciation through 2013 for MACRS property with a recovery period of 20 years or less. These and other tax benefits resulted in net operating tax losses (NOLs) during 2012 and 2013, for regular tax purposes, which are carried forward and available to offset regular taxable income in 2014. As of March 31, 2014, we had an estimated federal income tax payable balance of \$22.4 million. Oregon conformed to federal bonus depreciation beginning in 2011, resulting in state NOL carry-forwards as well. We anticipate fully using the NOL carry-forwards in future years prior to expiration. The NOLs would otherwise expire in 20 years for federal and 15 years for Oregon.

Final tangible property regulations applicable to all taxpayers were issued by the Treasury Department on September 13, 2013. These regulations are generally effective for taxable years beginning on or after January 1, 2014. Procedural guidance related to the final regulations and unit-of-property guidance applicable to natural gas distribution networks are expected to be issued by the end of 2014. We will further evaluate the impact of the regulations after the guidance is issued.

Table of Contents

## Investing Activities

Investing activity highlights include:

| In thousands                            | Three Months Ended March 31, |          |         |
|---|------------------------------|----------|---------|
|   | 2014                         | 2013     | Change  |
| Total cash used in investing activities | \$45,460                     | \$36,266 | \$9,194 |
| Capital expenditures                    | 25,588                       | 22,674   | 2,914   |
| Utility gas reserves                    | 19,681                       | 12,257   | 7,424   |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The increase in cash used in investing activities was primarily due to higher investments in utility gas reserves and higher utility capital expenditures compared to last year.

Under the amended gas reserves agreement, NW Natural agreed to end the drilling program with Encana, which will likely reduce estimated 2014 utility capital expenditures by approximately \$30 million. Currently, we do not have certainty regarding the 2015 level of capital expenditures for gas reserves. See Note 10 for additional information regarding the amended agreement and Part II, Item 7., Financial Condition, "Cash Flows—Investing Activities" in the 2013 Form 10-K.

## Financing Activities

Financing activity highlights include:

| In thousands                            | Three Months Ended March 31, |          |          |
|---|------------------------------|----------|----------|
|   | 2014                         | 2013     | Change   |
| Total cash used in financing activities | \$166,214                    | \$70,438 | \$95,776 |
| Change in short-term debt               | 155,600                      | 59,500   | 96,100   |

THREE MONTHS ENDED MARCH 31, 2014 COMPARED TO MARCH 31, 2013. The increase in cash used in financing activities primarily reflected the use of \$91 million of proceeds from our insurance settlements to reduce our short-term debt balance. Balances decreased \$155.6 million in the first three months of 2014, compared to a decrease of \$59.5 million for the same period in 2013.

## Ratios of Earnings to Fixed Charges

For the three and twelve months ended March 31, 2014 and the 12 months ended December 31, 2013, our ratios of earnings to fixed charges, computed using the Securities and Exchange Commission (SEC) method, were 6.36, 3.17, and 3.16, respectively. For this purpose, earnings consist of net income before taxes plus fixed charges, and fixed charges consist of interest on all indebtedness, the amortization of debt expense and discount or premium and the estimated interest portion of rentals charged to income. The prior period amounts have been corrected for the prior period error identified in the first quarter of 2013. See Exhibit 12 for the detailed ratio calculation.

## Contingent Liabilities

Loss contingencies are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable in accordance with accounting standards for contingencies. See Part II, Item 7, "Application of Critical Accounting Policies and Estimates" in our 2013 Form 10-K. At March 31, 2014, we had a regulatory asset of \$63.5 million for deferred environmental costs, which includes \$95.3 million for additional costs expected to be paid in the future and \$21.4 million of capitalized accrued interest. Additionally, in 2014, a settlement was reached in our environmental insurance recovery litigation with NW Natural to receive \$102 million, of which the Company received approximately \$91 million during the first quarter of 2014. The regulatory asset for deferred environmental costs is calculated net of insurance reimbursements. If it is determined that both the insurance recovery and future customer rate recovery of such costs are not probable, then the costs will be charged to expense in the period such determination is made. For further discussion of contingent liabilities, see Note 13 and see also "Results

of Operations—Rate Mechanisms—Environmental Costs".

35

---

Table of Contents

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

---

In preparing our financial statements using GAAP, management exercises judgment in the selection and application of accounting principles, including making estimates and assumptions that affect reported amounts of assets, liabilities, revenues, expenses and related disclosures in the financial statements. Management considers our critical accounting policies to be those which are most important to the representation of our financial condition and results of operations and which require management's most difficult and subjective or complex judgments, including accounting estimates that could result in materially different amounts if we reported under different conditions or used different assumptions. Our most critical estimates and judgments include accounting for:

- regulatory cost recovery and amortizations;
- revenue recognition;
- derivative instruments and hedging activities;
- pensions and postretirement benefits;
- income taxes; and
- environmental contingencies.

There have been no material changes to the information provided in the 2013 Form 10-K with respect to the application of critical accounting policies and estimates (see Part II, Item 7, "Application of Critical Accounting Policies and Estimates," in the 2013 Form 10-K).

Management has discussed its current estimates and judgments used in the application of critical accounting policies with the Audit Committee of the Board. Within the context of our critical accounting policies and estimates, management is not aware of any reasonably likely events or circumstances that would result in materially different amounts being reported. For a description of recent accounting pronouncements that could have an impact on our financial condition, results of operations or cash flows, see Note 2.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various forms of market risk including commodity supply risk, commodity price and storage value risk, interest rate risk, foreign currency risk, credit risk, and weather risk. We monitor and manage these financial exposures as an integral part of our overall risk management program. No material changes have occurred related to our disclosures about market risk for the three month period ending March 31, 2014. See Part I and Part II, Item 1A, "Risk Factors" in this report and Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk" in the 2013 Form 10-K for details regarding these risks.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us and included in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission (SEC) rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Exchange Act Rule 13a-15(f).

There have been no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The statements contained in Exhibit 31.1 and Exhibit 31.2 should be considered in light of, and read together with, the information set forth in this Item 4(b).

Table of Contents

## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

Other than the proceedings disclosed in Note 13 and those proceedings disclosed and incorporated by reference in Part I, Item 3, "Legal Proceedings" in our 2013 Form 10-K, we have only routine nonmaterial litigation in the ordinary course of business.

## ITEM 1A. RISK FACTORS

There were no material changes from the risk factors discussed in Part I, Item 1A, "Risk Factors" in our 2013 Form 10-K. In addition to the other information set forth in this report, you should carefully consider those risk factors, which could materially affect our business, financial condition or results of operations.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information about purchases of our equity securities that are registered pursuant to Section 12 of the Securities Exchange Act of 1934 during the quarter ended March 31, 2014:

## ISSUER PURCHASES OF EQUITY SECURITIES

| Period                 | (a)<br>Total Number of<br>Shares Purchased <sup>(1)</sup> | (b)<br>Average<br>Price Paid per Share | (c)<br>Total Number of Shares<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs <sup>(2)</sup> | (d)<br>Maximum Dollar Value of<br>Shares that May Yet Be<br>Purchased Under the<br>Plans or Programs <sup>(2)</sup> |
|------------------------|---|--|---|---|
| Balance forward        |   |  | 2,124,528   | \$ 16,732,648   |
| 01/01/14 -<br>01/31/14 | —   | \$—                                    | —   | —   |
| 02/01/14 -<br>02/28/14 | 1,280   | 42.45                                  | —   | —   |
| 03/01/14 -<br>03/31/14 | 6,005   | 42.02                                  | —   | —   |
| Total                  | 7,285   | \$42.09                                | 2,124,528   | \$ 16,732,648   |

<sup>(1)</sup> During the quarter ended March 31, 2014, 7,285 shares of our common stock were purchased on the open market to meet the requirements of our share-based programs. During the quarter ended March 31, 2014, no shares of our common stock were accepted as payment for stock option exercises pursuant to our Restated SOP.

<sup>(2)</sup> We have a common stock share repurchase program under which we purchase shares on the open market or through privately negotiated transactions. We currently have Board authorization through May 31, 2014 to repurchase up to an aggregate of 2.8 million shares or up to an aggregate of \$100 million. During the quarter ended March 31, 2014, no shares of our common stock were purchased pursuant to this program. Since the program's inception in 2000, we have repurchased approximately 2.1 million shares of common stock at a total cost of approximately \$83.3 million.

## ITEM 6. EXHIBITS

See Exhibit Index attached hereto.





Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NORTHWEST NATURAL GAS COMPANY

(Registrant)

Dated: May 2, 2014

/s/ Brody J. Wilson  
Brody J. Wilson  
Principal Accounting Officer  
Controller

39

---

Table of Contents

NORTHWEST NATURAL GAS COMPANY

Exhibit Index to Quarterly Report on Form 10-Q

For the Quarter Ended March 31, 2014

| Exhibit Number | Document   |
|----------------|--|
| 4              | Amendment No. 1 to Note Purchase Agreement, dated April 29, 2014, among Gill Ranch Storage, LLC and the parties listed thereto.  |
| 10             | Second Amendment to Carry and Earning Agreement by and between Encana Oil & Gas (USA) Inc. and NWN Gas Reserves LLC., dated as of March 7, 2014.   |
| 10a            | Form of Special Restricted Stock Unit Award Agreement under the Long-Term Incentive Plan between the Company and an executive officer.   |
| 12             | Statement Re Computation of Ratios of Earnings to Fixed Charges.   |
| 31.1           | Certification of Principal Executive Officer Pursuant to Rule 13a-14(a)/15-d-14(a), Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2           | Certification of Principal Financial Officer Pursuant to Rule 13a-14(a)/15-d-14(a), Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1           | Certification of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101            | The following materials from Northwest Natural Gas Company Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in Extensible Business Reporting Language (XBRL):<br>(i) Consolidated Statements of Income;<br>(ii) Consolidated Balance Sheets;<br>(iii) Consolidated Statements of Cash Flows; and<br>(iv) Related notes. |
| 40             |  |