

**Rates and Regulatory Affairs
Facsimile: 503.721.2516**



October 28, 2011

VIA ELECTRONIC FILING

Dave Danner, Executive Director & Secretary
Washington Utilities and Transportation Commission
1300 S Evergreen Park Drive SW
Post Office Box 47250
Olympia, Washington 98504-7250

Re: UG-100677 – Smart Energy™ Annual Report

Dear Mr. Danner:

Northwest Natural Gas Company, dba NW Natural (“NW Natural” or the “Company”), hereby files its Smart Energy™ Annual Report in compliance with the terms established in Schedule U, Smart Energy™ Program, filed and approved in Docket No. UG-100677.

Please contact me at (503) 226-4211, extension 3590, if you have any questions.

Sincerely,

/s/ Jennifer Gross

Jennifer Gross
Rates & Regulatory Affairs

enclosure

WE REDUCED OUR CARBON FOOTPRINT WITH SMART ENERGY.

Program Year 2010 - 11
Smart Energy™ Annual Report



NW Natural®

SMART ENERGY™
Use Less. Offset The Rest.

INTRODUCTION

According to the terms and conditions of Oregon Schedule 400 and Washington Schedule U, NW Natural is hereby providing the Public Utility Commission of Oregon (OPUC) and the Washington Utilities and Transportation Commission (WUTC) with an annual report detailing the program's participation, funds collected, program costs, and The Climate Trust's offset expenditures for the program year September 1, 2010, through August 31, 2011.

TOTAL ACTIVE ENROLLMENTS

Tables 1a and 1b detail 2010-2011 Smart Energy™ enrollments. As of August 31, 2011, over 12,000 customers were enrolled in the program, increasing enrollment by over 24% from the previous program year. Since the program's inception, a total of 15,319 residential customers have enrolled in Smart Energy™. Of the 12,572 active residential customers enrolled, 6,620 or 54% have selected the volumetric option.

Table 1a demonstrates active enrollments as of August 31, 2011.

Table 1a – Active Enrollment

	Actual				GOAL		
	# of Customers	% of Customers	Enrollments	Enrollment % increase from prior year	# of Customers	% of Customers	Enrollments
SYSTEM TOTAL							
Residential	610,185	2.0%	12,330	24.1%	663,600	2.50%	16,590
Commercial	62,389	0.4%	242	4.8%	65,667	0.40%	263
			12,572	23.6%			16,853

Table 1b – Active Enrollment by State (see note)

Actual counts by State				
	# Customers	% of Customers	Enrollments	Enrollment % increase from prior year
OREGON				
Residential	546,078	2.2%	12,028	21.5%
Commercial	56,987	0.4%	237	4.9%
			12,265	21.1%
WASHINGTON				
Residential	64,107	0.5%	302	655%
Commercial	5,402	0.1%	5	0.0%
			307	

NOTE: Original program design included system counts for customers and enrollments.

CARBON REDUCTION

The commitment of total carbon reductions for the fourth program year will be approximately 44,017 tons. Since the program's inception, Smart Energy™ has obligated funds for a total carbon reduction of approximately 113,010 tons.

The Climate Trust received \$550,216 for offset purchases for program participants during the 2010-2011 program year. This total is itemized below in Table 2.

Table 2 – Carbon Offsets

Offsets	Dollars	Offsets (tons)
2007-2008 Program Year		
NWN Shareholders	\$77,000	6,160
Smart Energy™ Participants	\$94,659	7,573
Subtotal 2007-2008 Program Year	\$171,659	13,733
2008-2009 Program Year		
Smart Energy™ Participants	\$290,854	23,268
2009-2010 Program Year		
Smart Energy™ Participants	\$399,899	31,992
2010-2011 Program Year		
Smart Energy™ Participants	\$550,216	44,017
Program to Date	\$1,412,629	113,010

REPORT FROM THE CLIMATE TRUST

Offset Funds

As of August 31, 2011, program contributions received by The Climate Trust plus money market interest have totaled \$1,419,681 for the purchasing and managing of offset project contracts. Table 3 provides a summary of the funds received and spent by The Climate Trust.

Table 3 - Offset Funds Status: Program to Date

	Funds	Offsets
Funds Received		
NW Natural contribution	\$77,000	6,160
Participant contributions	\$1,335,628	106,850
Interest and other	\$7,053	
<i>Subtotal</i>	<i>\$1,419,681</i>	<i>113,010</i>
Funds Obligated		
Whitesides, ID Dairy	\$142,248	18,813
Farm Power Rexville, WA Dairy	\$121,000	10,500
RES Lochmead, OR Dairy	\$234,900	23,148
Farm Power Lynden, WA Dairy	\$169,807	22,046
<i>Projects Subtotal</i>	<i>\$667,955</i>	<i>74,507</i>
Buffer Account		
Buffer account Contributions	\$263,403	
<i>Buffer account interest</i>	<i>\$469</i>	
<i>NWN W/D</i>	<i>(\$125,000)</i>	
<i>Buffer Account Balance</i>	<i>\$138,872</i>	
Unobligated funds status (less interest)	\$481,270	38,503

Funding Obligation Commitment

The Climate Trust is contractually required to obligate all program year collections within 16 months following the end of a program year. To date, The Climate Trust has obligated funds for 74,507 tons of offsets using program funds, fully meeting the requirement for the first three program years. The Climate Trust's Board of Directors approved a purchase agreement in early September for an Oregon dairy digester project that is projected to generate 25,628 tons of emission reductions. Once this contract is executed, 70% of the fourth program year funds commitment requirement will be met.

Table 4 - Commitment Status

Program Year	Timeline (Sept 1-Aug 31)	Tons Demand	Tons Obligated	PUC Deadline	Status (% met)
1	2007-2008	13,733	13,733	1/1/2010	100%
2	2008-2009	23,268	23,268	1/1/2011	100%
3	2009-2010	31,992	31,992	1/1/2012	100%
4	2010-2011	44,017	5,514	1/1/2013	12%
5	2011-2012	TBD	TBD	1/1//2014	TBD

THE SMART ENERGY™ PROGRAM YEAR SPENDING

The charts below demonstrate the costs associated with activities for the third program year.

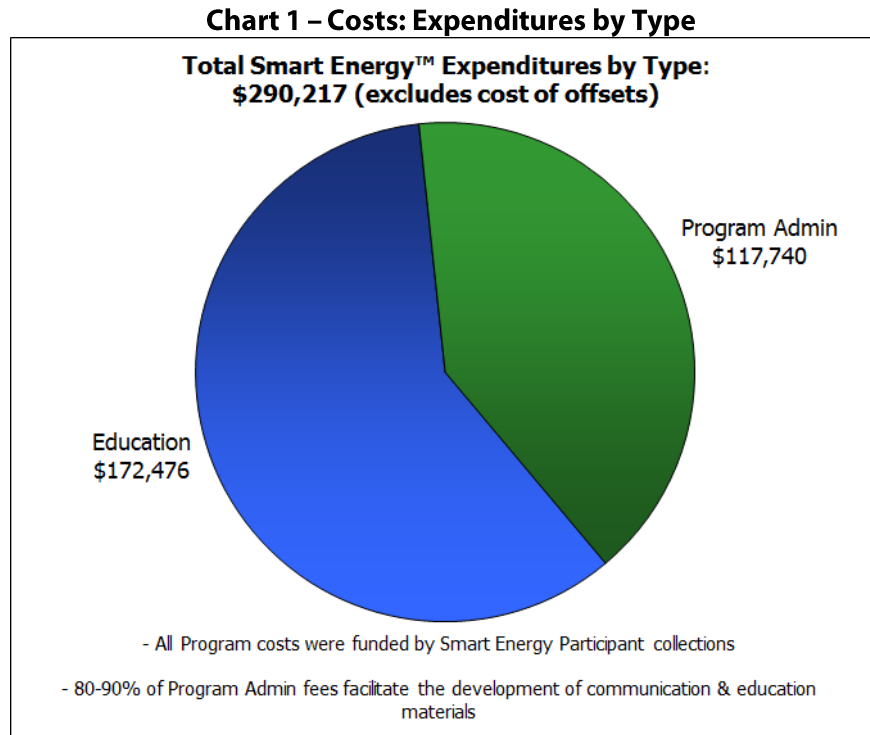


Chart 1 illustrates the dollars spent on customer communications and education and program administration which totaled \$290,217. Administration fees cover the cost of managing the program, of which 80-90% is for facilitating the development of communication and education materials.

Table 6 – Smart Energy™ Updated Historical Expenses by Source (excludes cost of offsets)

	Smart Energy™ Spending			
	NWN Shareholder	Deferral	Smart Energy™ Participants Collections	Total
2007-2008	\$272,280	\$484,020	\$65,973	\$822,273
2008-2009	\$305,634	\$137,980	\$119,409	\$563,023
2009-2010	\$135,473	\$0	\$214,319	\$349,792
2010-2011	\$0	\$0	\$290,217 ^a	\$290,217
Total	\$713,387	\$622,000	\$689,918	\$2,025,304

Note: Prior years have been restated to correct the split between Shareholder and Deferral dollars as a result of calendar year 2009 education costs being funded by Shareholders.

- (a) This amount includes \$83,333 dollars previously held by The Climate Trust. These dollars accumulated due to the Climate Trust's ability to secure offsets at a price better than anticipated. As discussed on page 17 of NW Natural's Mid-Pilot Review filed with the OPUC and The WUTC on October 15, 2010, the Company decided to reallocate these funds toward program marketing and administration in an effort to increase its outreach and stimulate increased penetration while preventing a price increase.

Chart 3 illustrates the monthly communications expenses in relation to the total number of Smart Energy™ participants. The Company was able to maintain the participation level throughout the heating season when enrollment campaigns typically cease. This is notable considering the nation has been experiencing a significant economic recession.

Chart 3 – Education/Communications Costs and Enrollment

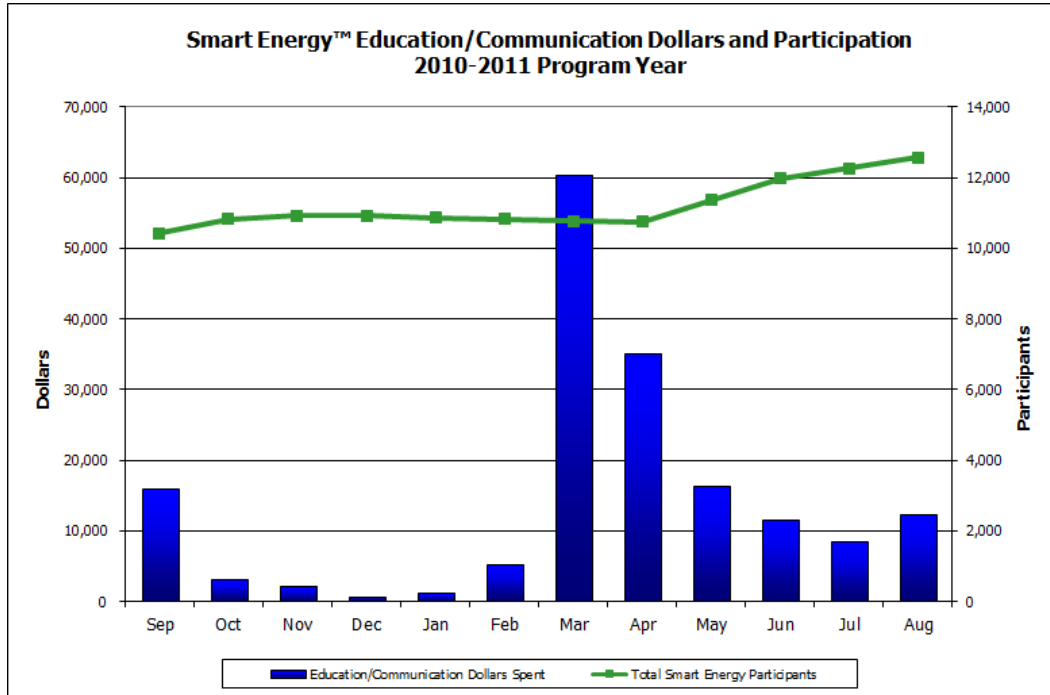
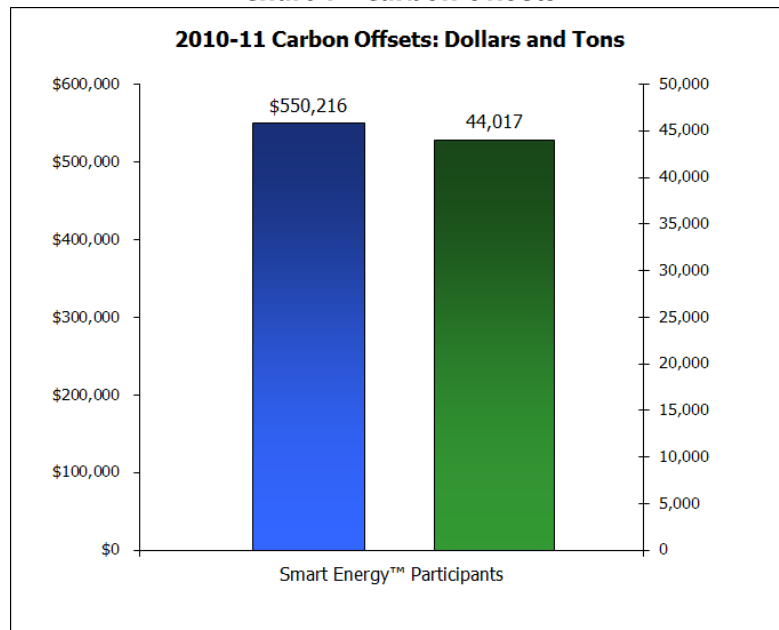


Chart 4 details the funds sent to The Climate Trust for the purchase and retirement of offsets, and the resulting tons offset. For this fourth program year, Smart Energy™ participants have funded \$550,216 towards the offset of 44,017 tons of carbon emissions. Additional detail was provided above in Table 2.

Chart 4 – Carbon Offsets



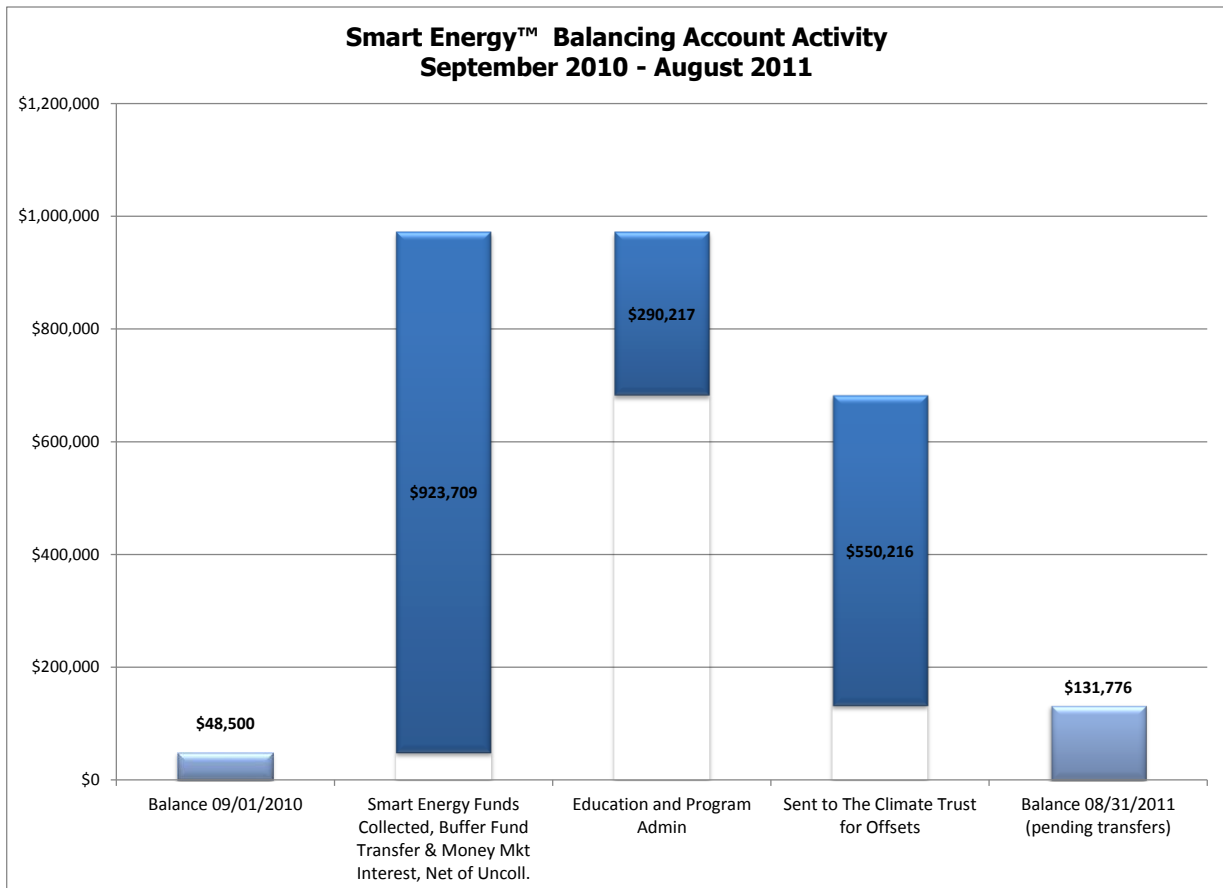
ANALYSIS OF PARTICIPANT FUNDS COLLECTED

The Company continues to use a balancing account to record the activity of the Smart Energy™ program. Increases (credits) to the account include monthly receipts from customer billings and money market interest on this bank account. Decreases (debits) to the account include the cost of the program administration and the transfer of funds to The Climate Trust for the purchase of offsets. Program administration costs consist primarily of the payroll and payroll overheads associated with the program manager. Oregon Schedule 400 and Washington Schedule U provide for the payment of program administration costs from funds collected.

The Company transfers 70% of the funds collected from participants to The Climate Trust. This reflects the projected split of program administrative costs and funds for offset purchases over the course of the five year pilot program. This 70% was determined when the program price was originally established. Using 70% mitigates the funding mismatch due to the seasonality of Smart Energy™ funds collected (half of the participants enrolled in the program select the volumetric option) versus the fairly fixed expenses of program administration. Because the program was able to acquire the obligated offset tons for the first three program years at a cost lower than expected, funds previously directed to The Climate Trust for the purchase of offsets were transferred back to NW Natural to fund additional communication and education costs.

The activity and current balance of the Smart Energy™ balancing account is detailed in Chart 5. The ending credit balance reflects the lag that occurs between when customers are billed and when funds are ultimately transferred to The Climate Trust. Collections through June have been transferred. The portion of July and August collections due to be transferred are approximately \$36,600 and \$35,900, respectively, and will be transferred in October and November, respectively.

Chart 5 – Analysis of funds collected



CARBON OFFSET PROJECTS

Smart Energy™ funding supports the development of regional biodigester projects that capture methane. The resulting biogas is used as an on-demand renewable energy source.

BIODIGESTERS – PROJECT STATUS

The status of current projects and future opportunities are outlined below:

Project I: Threemile Canyon Farms, Boardman, OR

- Project I is a commercial demonstration project. The project broke ground in 2Q 2009 and began operation in January 2010. This project was developed through a partnership with NW Natural, Bonneville Environmental Foundation (BEF), the owner of the dairy operation where the biodigester is sited and a biodigester technology company. This project converts waste into biogas that is then used to offset onsite propane use for the dairy operations. While NW Natural shareholder dollars were used to invest in the development of this project, The Climate Trust has not secured offsets from this project on behalf of Smart Energy™ participants.

Project II:

- This project involving a small dairy operation was reported in previous annual reports as Project II and is no longer under consideration.

Project III: Farm Power Rexville, Mt. Vernon, WA

- The Climate Trust invested Smart Energy™ funds in Farm Power, which is on a dairy farm in Washington that is using the biogas to generate electricity. The project began producing power on August 30, 2009. 1,325 tons were verified and retired on behalf of Smart Energy customers in Q1 2011.

Project IV: Lochmead Farms, Junction City, OR

- This project, located on a small family farm, began operation in 4Q of 2010. The dairy has approximately 1,200 cows. The biogas will be used for power production. Third party verification of the first offsets is expected to be completed in Q1 2012.

Project V: Farm Power Lynden, Lynden, WA

- The Climate Trust invested Smart Energy™ funds in Farm Power, which is on a dairy farm in Washington that is using the biogas to generate electricity. Third party verification of the first offsets is expected to be completed in Q1 2012.

Project VI: Oak Lea Dairy, Aumsville, OR

- NW Natural authorized The Climate Trust to execute and Emissions Reduction Purchase Agreement (ERPA) with the project developer in August and the ERPA was executed in October 2011.

Three other projects in the Pacific Northwest with total tons estimated in excess of 220,000 are under consideration.

SUMMARY

NW Natural considers the fourth year of its Smart Energy™ program a success. Despite extremely challenging economic conditions throughout 2010-11, Smart Energy™ enrollments continued to grow and significant steps were taken in bringing biogas to the region.

The Company continues to make modest but earnest efforts to grow the Smart Energy™ program. In Docket No. UG-100677, the WUTC granted NW Natural approval to offer Smart Energy™ in Washington. Washington customers became eligible to participate on June 1, 2010. Also, on September 16, 2011, the Company made a filing with the OPUC to revise the program's status from pilot to an ongoing offering. The Company also requested that the program be opened up to Oregon Industrial customers. These changes are expected to be made effective December 21, 2011, subject to OPUC approval.

NW Natural is solidly committed to Smart Energy™ and communicating the important messages about climate change, energy efficiency and carbon emissions. The company will continue pursuing the Smart Energy™ mission of encouraging its customers to "Use less. Offset the rest."