

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

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 No. 1-15973



NORTHWEST NATURAL GAS COMPANY

(Exact name of registrant as specified in its charter)

Oregon
(State or other jurisdiction of
incorporation or organization)

93-0256722
(I.R.S. Employer
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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large 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

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 30, 2008, 26,415,248 shares of the registrant's Common Stock (the only class of Common Stock) were outstanding.

Table of Contents

NORTHWEST NATURAL GAS COMPANY
For the Quarterly Period Ended March 31, 2008

		<u>Page Number</u>
<u>PART I. FINANCIAL INFORMATION</u>		
Item 1.	<u>Consolidated Financial Statements</u>	
	<u>Consolidated Statements of Income for the three-month periods ended March 31, 2008 and 2007</u>	1
	<u>Consolidated Balance Sheets at March 31, 2008 and 2007 and December 31, 2007</u>	2
	<u>Consolidated Statements of Cash Flows for the three-month periods ended March 31, 2008 and 2007</u>	4
	<u>Notes to Consolidated Financial Statements</u>	5
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
Item 4.	<u>Controls and Procedures</u>	33
<u>PART II. OTHER INFORMATION</u>		
Item 1.	<u>Legal Proceedings</u>	35
Item 1A.	<u>Risk Factors</u>	35
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	36
Item 5.	<u>Other Information</u>	36
Item 6.	<u>Exhibits</u>	36
	<u>Signature</u>	37

Table of Contents

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

<u>Thousands, except per share amounts</u>	Three Months Ended March 31,	
	<u>2008</u>	<u>2007</u>
Operating revenues:		
Gross operating revenues	\$387,694	\$394,091
Less: Cost of sales	245,920	245,469
Revenue taxes	9,351	9,614
Net operating revenues	<u>132,423</u>	<u>139,008</u>
Operating expenses:		
Operations and maintenance	28,458	28,839
General taxes	8,134	7,817
Depreciation and amortization	17,705	16,785
Total operating expenses	<u>54,297</u>	<u>53,441</u>
Income from operations	78,126	85,567
Other income and expense - net	173	538
Interest charges - net of amounts capitalized	9,430	9,567
Income before income taxes	68,869	76,538
Income tax expense	25,701	28,463
Net income	<u>\$ 43,168</u>	<u>\$ 48,075</u>
Average common shares outstanding:		
Basic	26,409	27,229
Diluted	26,560	27,385
Earnings per share of common stock:		
Basic	\$ 1.63	\$ 1.77
Diluted	\$ 1.63	\$ 1.76

See Notes to Consolidated Financial Statements.

Table of Contents

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

<u>Thousands</u>	<u>March 31,</u> <u>2008</u> <u>(Unaudited)</u>	<u>March 31,</u> <u>2007</u> <u>(Unaudited)</u>	<u>Dec. 31,</u> <u>2007</u>
Assets:			
Plant and property:			
Utility plant	\$2,071,072	\$1,981,639	\$2,052,161
Less accumulated depreciation	627,265	585,008	615,533
Utility plant - net	<u>1,443,807</u>	<u>1,396,631</u>	<u>1,436,628</u>
Non-utility property	68,815	45,767	67,149
Less accumulated depreciation and amortization	8,261	7,149	7,904
Non-utility property - net	<u>60,554</u>	<u>38,618</u>	<u>59,245</u>
Total plant and property	<u>1,504,361</u>	<u>1,435,249</u>	<u>1,495,873</u>
Current assets:			
Cash and cash equivalents	6,417	5,094	6,107
Accounts receivable	82,775	89,489	69,442
Accrued unbilled revenue	56,025	43,468	78,004
Allowance for uncollectible accounts	(4,066)	(4,235)	(2,890)
Regulatory assets	6,288	13,702	17,598
Fair value of non-trading derivatives	34,175	13,698	2,903
Inventories:			
Gas	25,663	41,828	71,079
Materials and supplies	8,834	9,501	8,865
Prepayments and other current assets	<u>20,652</u>	<u>14,761</u>	<u>25,569</u>
Total current assets	<u>236,763</u>	<u>227,306</u>	<u>276,677</u>
Investments, deferred charges and other assets:			
Regulatory assets	179,173	155,297	175,938
Fair value of non-trading derivatives	1,227	3,734	324
Other investments	56,164	48,247	54,070
Other	<u>10,601</u>	<u>8,526</u>	<u>11,179</u>
Total investments, deferred charges and other assets	<u>247,165</u>	<u>215,804</u>	<u>241,511</u>
Total assets	<u>\$1,988,289</u>	<u>\$1,878,359</u>	<u>\$2,014,061</u>

See Notes to Consolidated Financial Statements.

Table of Contents

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

<u>Thousands</u>	<u>March 31, 2008 (Unaudited)</u>	<u>March 31, 2007 (Unaudited)</u>	<u>Dec. 31, 2007</u>
Capitalization and liabilities:			
Capitalization:			
Common stock	\$ 332,182	\$ 363,519	\$ 331,595
Earnings invested in the business	299,923	269,172	266,658
Accumulated other comprehensive income (loss)	(2,840)	(2,324)	(3,502)
Total common stock equity	<u>629,265</u>	<u>630,367</u>	<u>594,751</u>
Long-term debt	<u>512,000</u>	<u>517,000</u>	<u>512,000</u>
Total capitalization	<u>1,141,265</u>	<u>1,147,367</u>	<u>1,106,751</u>
Current liabilities:			
Notes payable	54,600	5,500	143,100
Long-term debt due within one year	5,000	9,500	5,000
Accounts payable	93,061	92,185	119,731
Taxes accrued	23,160	43,116	13,137
Interest accrued	11,287	11,409	2,827
Regulatory liabilities	88,197	41,888	61,326
Fair value of non-trading derivatives	1,703	9,447	14,829
Other current and accrued liabilities	<u>34,970</u>	<u>22,832</u>	<u>29,794</u>
Total current liabilities	<u>311,978</u>	<u>235,877</u>	<u>389,744</u>
Deferred credits and other liabilities:			
Deferred income taxes and investment tax credits	221,670	207,648	206,340
Regulatory liabilities	220,137	208,333	213,764
Pension and other postretirement benefit liabilities	42,709	54,117	41,619
Fair value of non-trading derivatives	4,995	3,108	3,758
Other	<u>45,535</u>	<u>21,909</u>	<u>52,085</u>
Total deferred credits and other liabilities	<u>535,046</u>	<u>495,115</u>	<u>517,566</u>
Commitments and contingencies (see Note 10)	—	—	—
Total capitalization and liabilities	<u>\$1,988,289</u>	<u>\$1,878,359</u>	<u>\$2,014,061</u>

See Notes to Consolidated Financial Statements.

Table of Contents

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

<u>Thousands</u>	Three Months Ended	
	March 31,	
	2008	2007
Operating activities:		
Net income	\$ 43,168	\$ 48,075
Adjustments to reconcile net income to cash provided by operations:		
Depreciation and amortization	17,705	16,785
Deferred income taxes and investment tax credits	14,432	(3,381)
Undistributed earnings (loss) from equity investments	(25)	78
Deferred gas costs - net	3,740	14,242
Non-cash expenses related to qualified defined benefit pension plans	780	1,064
Deferred environmental costs	(2,048)	(2,800)
Income from life insurance investments	(459)	(480)
Deferred regulatory costs and other	(13,679)	(2,940)
Changes in working capital:		
Accounts receivable and accrued unbilled revenue - net	9,822	37,997
Inventories of gas, materials and supplies	45,447	26,799
Prepayments and other current assets	4,917	4,280
Accounts payable	(28,409)	(21,394)
Accrued interest and taxes	18,483	30,371
Other current and accrued liabilities	5,405	1,141
Cash provided by operating activities	119,279	149,837
Investing activities:		
Investment in utility plant	(19,263)	(18,609)
Investment in non-utility property	(1,682)	(3,104)
Contributions to non-utility equity investments	(1,500)	—
Other	(63)	2,660
Cash used in investing activities	(22,508)	(19,053)
Financing activities:		
Common stock issued, net of expenses	1,874	1,737
Common stock repurchased	—	(9,017)
Long-term debt retired	—	(20,000)
Change in short-term debt	(88,500)	(94,600)
Cash dividend payments on common stock	(9,903)	(9,677)
Other	68	100
Cash used in financing activities	(96,461)	(131,457)
Increase (decrease) in cash and cash equivalents	310	(673)
Cash and cash equivalents - beginning of period	6,107	5,767
Cash and cash equivalents - end of period	\$ 6,417	\$ 5,094
Supplemental disclosure of cash flow information:		
Interest paid	\$ 1,017	\$ 1,101
Income taxes paid	\$ 350	\$ 9,000

See Notes to Consolidated Financial Statements.

Table of Contents

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

1. Basis of Financial Statements

The consolidated financial statements include the accounts of Northwest Natural Gas Company (NW Natural), which primarily consist of our regulated gas distribution business, our regulated gas storage business including our wholly-owned subsidiary Gill Ranch Storage, LLC (Gill Ranch), and other businesses including our wholly-owned subsidiary NNG Financial Corporation (Financial Corporation) and a joint venture in a natural gas transmission pipeline (see Note 8).

The information presented in the interim consolidated financial statements is unaudited, but includes all material adjustments, including normal recurring accruals, that management considers necessary for a fair statement of the results for each period reported. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our 2007 Annual Report on Form 10-K (2007 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.

Investments in corporate joint ventures and partnerships in which our ownership interest is 50 percent or less and over which we do not exercise control are accounted for by the equity method or the cost method.

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

2. New Accounting Standards**Adopted Standards**

Fair Value Measurements. In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements," which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. This statement indicates, among other things, that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. SFAS No. 157 defines fair value based upon an exit price model.

Relative to SFAS No. 157, the FASB issued FASB Staff Positions (FSP) 157-1 and 157-2. FSP 157-1 amends SFAS No. 157 to exclude SFAS No. 13, "Accounting for Leases," and its related interpretive accounting pronouncements that address leasing transactions, while FSP 157-2 delays the effective date of the application of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis.

We adopted SFAS No. 157 as of January 1, 2008, with the exception of the application of the statement to nonrecurring nonfinancial assets and liabilities. Nonrecurring nonfinancial assets and liabilities for which we have not applied the provisions of SFAS No. 157 include asset retirement obligations initially measured at fair value and business combinations initially measured at fair value. The adoption of SFAS No. 157 did not have, and is not expected to have, a material effect on our financial condition, results of operations or cash flow.

Table of Contents

Fair Value Option for Financial Assets and Liabilities. In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for years beginning after November 15, 2007. We have elected not to implement the fair value option for financial assets and liabilities.

Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. On January 1, 2008, we adopted Emerging Issues Task Force (EITF) 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards," which provides the accounting requirements for recognizing income tax benefits received on dividends paid to employees holding equity-classified nonvested shares, equity-classified nonvested share units or equity-classified outstanding share options, and how these benefits are charged to retained earnings under SFAS No. 123R, "Share Based Payment." The adoption of EITF 06-11 did not have, and is not expected to have, a material effect on our financial condition, results of operations or cash flow.

Offsetting Amounts Related to Certain Contracts. On January 1, 2008, we adopted FSP FASB Interpretation No. 39-1 (FSP FIN 39-1), "Offsetting of Amounts Related to Certain Contracts." FSP FIN 39-1 requires disclosure when a reporting entity offsets fair value amounts from derivative instruments executed with the same counterparty under master netting arrangements. Our disclosures on FSP FIN 39-1 are included in Note 7.

The adoption and implementation of FSP FIN 39-1 did not have, and is not expected to have, a material effect on our financial condition, results of operations or cash flow.

Recent Accounting Pronouncements

Business Combinations. In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." This statement amends the principles and requirements for how the acquiror accounts for and discloses its business combinations as described under SFAS No. 141. SFAS No. 141R is effective for fiscal years and interim periods beginning after December 15, 2008. Based on our preliminary assessment, this statement is not expected to have a material effect on our financial condition, results of operations or cash flow.

Noncontrolling Interests in Consolidated Financial Statements. In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements." This statement amends the reporting requirements of Accounting Research Bulletin No. 51 for noncontrolling interests in subsidiaries to improve the relevance, comparability and transparency of the financial information disclosed. SFAS No. 160 is effective for fiscal years and interim periods beginning after December 15, 2008. Based on the nature of this new requirement, we may be required to disclose additional information, but it is not expected to have a material effect on our financial condition, results of operations or cash flow.

Derivative Instruments and Hedging Activities. In March 2008, the FASB issued SFAS No. 161, "Accounting for Derivative Instruments and Hedging Activities," which requires enhanced disclosures of derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008.

SFAS No. 161 will expand current disclosures by adding qualitative disclosures about our hedging objectives and strategies, the fair value gains and losses, and our credit-risk-related contingent features in derivative agreements. The disclosures will provide an enhanced understanding of:

- How and why we use derivative instruments;
- How derivative instruments and related hedge items are accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and its related interpretations; and
- How derivative instruments and related hedged items affect our financial condition, results of operations and cash flow.

As SFAS No. 161 relates only to disclosures, there will be no effect on our financial condition, results of operations or cash flow.

Table of Contents3. Earnings Per Share

Basic earnings per share are computed based on the weighted average number of common shares outstanding during each period presented. Diluted earnings per share reflect the potential effects of the exercise of stock options. Diluted earnings per share are calculated as follows:

	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>2008</u>	<u>2007</u>
Net income	<u>\$43,168</u>	<u>\$48,075</u>
Average common shares outstanding - basic	26,409	27,229
Additional shares for stock-based compensation plans	151	156
Average common shares outstanding - diluted	<u>26,560</u>	<u>27,385</u>
Earnings per share of common stock - basic	<u>\$ 1.63</u>	<u>\$ 1.77</u>
Earnings per share of common stock - diluted	<u>\$ 1.63</u>	<u>\$ 1.76</u>

For the three month period ended March 31, 2008, 135,319 common shares were excluded from the calculation of diluted earnings per share because the effect would have been antidilutive. For the three month period ended March 31, 2007, no common shares were excluded from the calculation of diluted earnings per share.

4. Capital Stock

At March 31, 2008, we had 60,000,000 common shares authorized and 26,412,248 common shares outstanding.

We have a Board approved repurchase program for our common stock. During the three months ended March 31, 2008, no shares of common stock were repurchased pursuant to this program. On April 24, 2008, the Board extended the program through May 31, 2009 and confirmed the authorization to repurchase up to an aggregate of 2.8 million or up to an aggregate of \$100 million. As of March 31, 2008, total common stock repurchases under this program since inception in 2000 totaled 2.1 million shares or \$83.3 million.

5. Stock-Based Compensation

Our stock-based compensation plans consist of the Long-Term Incentive Plan (LTIP), the Restated Stock Option Plan (Restated SOP), the Employee Stock Purchase Plan (ESPP) and the Non-Employee Directors Stock Compensation Plan (NEDSCP). These plans are designed to promote stock ownership by employees and officers and, in the case of the NEDSCP, non-employee directors. For additional information on our stock-based compensation, see Part II, Item 8., Note 4, in the 2007 Form 10-K.

Table of Contents

Long-Term Incentive Plan. A total of 500,000 shares of NW Natural's common stock have been authorized for awards under the terms of the LTIP as stock bonus, restricted stock or performance-based stock awards. During the quarter ended March 31, 2008, 48,500 performance-based shares were granted under the LTIP, based on target-level awards, with a weighted-average grant date fair value of \$10.89 per share. During February 2008, the Board of Directors amended and restated our Deferred Compensation Plan for Directors and Executives to eliminate the ability to defer any LTIP stock award payouts into cash accounts. Stock-based compensation related to the outstanding LTIP share awards was re-valued as of the amendment date, and the accounting for these awards was changed from the liability method to the equity method in accordance with SFAS No. 123R. The fair value was estimated as of the date of grant using the Monte-Carlo option pricing model based on the following weighted-average assumptions:

Stock price on valuation date	\$ 43.29
Performance term (in years)	3.0
Dividends paid per share	\$ 0.375
Dividend yield	3.4%
Dividend discount factor	0.9026

Restated Stock Option Plan. In February 2008, we granted 114,050 stock options under the Restated SOP, with an exercise price equal to the closing market price of our common stock on the date of grant, vesting over the four-year period following date of grant and a term of 10 years and 7 days. The fair value was estimated as of the date of grant using the Black-Scholes option pricing model based on the following weighted-average assumptions:

Risk-free interest rate	2.8%
Expected life (in years)	4.7
Expected market price volatility factor	18.4%
Expected dividend yield	3.5%
Forfeiture rate	3.8%

As of March 31, 2008, there was \$1.4 million of unrecognized compensation cost related to the unvested portion of outstanding stock option awards expected to be recognized over a period extending through 2011.

Table of Contents

6. Long-Term Debt

At March 31, 2008 and 2007 and December 31, 2007, we had outstanding long-term debt as follows:

<u>Thousands</u>	<u>March 31,</u> <u>2008</u> <u>(Unaudited)</u>	<u>March 31,</u> <u>2007</u> <u>(Unaudited)</u>	<u>Dec. 31,</u> <u>2007</u>
<u>Medium-Term Notes</u>			
First Mortgage Bonds:			
6.80 % Series B due 2007 ⁽¹⁾	\$ —	\$ 9,500	\$ —
6.50 % Series B due 2008	5,000	5,000	5,000
4.11 % Series B due 2010	10,000	10,000	10,000
7.45 % Series B due 2010	25,000	25,000	25,000
6.665% Series B due 2011	10,000	10,000	10,000
7.13 % Series B due 2012	40,000	40,000	40,000
8.26 % Series B due 2014	10,000	10,000	10,000
4.70 % Series B due 2015	40,000	40,000	40,000
5.15 % Series B due 2016	25,000	25,000	25,000
7.00 % Series B due 2017	40,000	40,000	40,000
6.60 % Series B due 2018	22,000	22,000	22,000
8.31 % Series B due 2019	10,000	10,000	10,000
7.63 % Series B due 2019	20,000	20,000	20,000
9.05 % Series A due 2021	10,000	10,000	10,000
5.62 % Series B due 2023	40,000	40,000	40,000
7.72 % Series B due 2025	20,000	20,000	20,000
6.52 % Series B due 2025	10,000	10,000	10,000
7.05 % Series B due 2026	20,000	20,000	20,000
7.00 % Series B due 2027	20,000	20,000	20,000
6.65 % Series B due 2027	20,000	20,000	20,000
6.65 % Series B due 2028	10,000	10,000	10,000
7.74 % Series B due 2030	20,000	20,000	20,000
7.85 % Series B due 2030	10,000	10,000	10,000
5.82 % Series B due 2032	30,000	30,000	30,000
5.66 % Series B due 2033	40,000	40,000	40,000
5.25 % Series B due 2035	10,000	10,000	10,000
	<u>517,000</u>	<u>526,500</u>	<u>517,000</u>
Less long-term debt due within one year	5,000	9,500	5,000
Total long-term debt	<u>\$ 512,000</u>	<u>\$ 517,000</u>	<u>\$ 512,000</u>

⁽¹⁾ Redeemed at maturity in May 2007.

7. Use of Financial Derivatives

We enter into forward contracts and other related financial transactions that qualify as derivative instruments under SFAS No. 133, as amended by SFAS No. 138 and SFAS No. 149 (collectively referred to as SFAS No. 133). We utilize derivative financial instruments primarily to manage commodity prices related to natural gas supply requirements and interest rates related to existing or anticipated debt issuances (see Part II, Item 8., Note 11, in the 2007 Form 10-K).

Table of Contents

At March 31, 2008 and 2007, unrealized gains and losses from mark-to-market valuations of our derivative instruments were primarily reported as regulatory liabilities or regulatory assets because the realized gains or losses at settlement are either included, or are expected to be included, in utility rates pursuant to regulatory deferral mechanisms (see Part II, Item 8., Note 1, in the 2007 Form 10-K). Estimated fair value of unrealized gains and losses were as follows:

<u>Thousands</u>	<u>March 31, 2008</u>		<u>March 31, 2007</u>		<u>Dec. 31, 2007</u>	
	<u>Current</u>	<u>Non-Current</u>	<u>Current</u>	<u>Non-Current</u>	<u>Current</u>	<u>Non-Current</u>
Fair Value Gain (Loss), net:*						
Natural gas hedges	\$32,580	\$ (155)	\$4,282	\$ 626	\$(12,099)	\$(2,104)
Interest rate hedge contract	—	(3,613)	—	—	—	(1,330)
Foreign currency forward purchase contracts	(108)	—	(31)	—	173	—
Total	<u>\$32,472</u>	<u>\$(3,768)</u>	<u>\$4,251</u>	<u>\$ 626</u>	<u>\$(11,926)</u>	<u>\$(3,434)</u>

* Some derivative instruments include offsetting fair value amounts as they are executed with the same counterparty under the same master netting arrangement.

In the first quarter of 2008, we realized net gains of \$4.3 million from the settlement of natural gas hedge contracts, which were recorded as reductions to the cost of gas, compared to net losses of \$7.6 million in the same period of 2007, which were recorded as increases to the cost of gas. The currency exchange rate in all foreign currency forward purchase contracts is included in our cost of gas at settlement; therefore, no gain or loss was recorded from the settlement of those contracts. The interest rate hedge contract outstanding at December 31, 2007 and March 31, 2008 qualifies as a cash flow hedge for accounting purposes, and changes in the value of this cash flow hedge is included in deferred regulatory accounts or other comprehensive income, assuming 100 percent hedge effectiveness. There were no realized gains or losses from the interest rate hedge during the first quarter of 2008.

As of March 31, 2008, all outstanding natural gas hedge contracts will mature on or before October 31, 2009. The maturity date for our interest rate swap contract is September 30, 2008. We expect to cash settle this contract concurrently with our next long-term debt issuance, which is expected to occur in the second half of 2008.

8. Segment Information

Our core business segment is the local gas distribution segment, also referred to as the "utility," which involves the distribution and sale of natural gas. Another business segment, "gas storage," represents natural gas storage services provided to intrastate and interstate customers and asset optimization services under a contract with an independent energy marketing company. Gas storage also includes Gill Ranch, our wholly-owned subsidiary. The remaining business segment, "other," primarily consists of our wholly-owned subsidiary, Financial Corporation, as well as various other non-utility investments, including an investment in a leveraged aircraft lease and our equity investment in a proposed natural gas pipeline project with TransCanada Gas Transmission Northwest (GTN). On April 23, 2008, we sold our investment in the aircraft (see Note 13).

Table of Contents

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

<u>Thousands</u>	<u>Three Months Ended March 31,</u>			
	<u>Utility</u>	<u>Gas Storage</u>	<u>Other</u>	<u>Total</u>
2008				
Net operating revenues	\$ 127,379	\$ 4,997	\$ 47	\$ 132,423
Depreciation and amortization	17,379	326	—	17,705
Income from operations	73,877	3,843	406	78,126
Net income	40,542	2,353	273	43,168
Total assets at March 31, 2008	\$1,908,870	\$ 65,969	\$13,450	\$1,988,289
2007				
Net operating revenues	\$ 135,549	\$ 3,410	\$ 49	\$ 139,008
Depreciation and amortization	16,563	222	—	16,785
Income from operations	82,595	2,941	31	85,567
Net income	46,108	1,795	172	48,075
Total assets at March 31, 2007	\$1,831,806	\$ 39,004	\$ 7,549	\$1,878,359

9. Pension and Other Postretirement Benefits

The following table provides the components of net periodic benefit cost for our qualified and non-qualified defined benefit pension plans and other postretirement benefit plans:

<u>Thousands</u>	<u>Three Months Ended March 31,</u>			
	<u>Pension Benefits</u>		<u>Other Postretirement Benefits</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Service cost	\$ 1,655	\$ 2,159	\$ 133	\$ 148
Interest cost	4,301	3,995	349	320
Expected return on plan assets	(4,777)	(4,636)	—	—
Amortization of loss	96	539	—	1
Amortization of prior service cost	314	245	49	49
Amortization of transition obligation	—	—	103	103
Net periodic benefit cost	1,589	2,302	634	621
Amount allocated to construction	(379)	(515)	(207)	(202)
Net amount charged to expense	<u>\$ 1,210</u>	<u>\$ 1,787</u>	<u>\$ 427</u>	<u>\$ 419</u>

See Part II, Item 8., Note 7, in the 2007 Form 10-K for more information about our pension and other postretirement benefit plans.

Employer Contributions

During the three months ended March 31, 2008, we did not make and were not required to make cash contributions to our qualified non-contributory defined benefit pension plans, but cash contributions in the form of ongoing benefit payments of \$0.6 million were made for our unfunded, non-qualified supplemental pension plans and other postretirement benefit plans. See Part II, Item 8., Note 7, in the 2007 Form 10-K for a discussion of estimated future payments.

Table of Contents**10. Commitments and Contingencies****Environmental Matters**

We own, or have previously owned, properties that may require environmental remediation or action. We accrue all material loss contingencies relating to these properties that we believe to be probable of assertion and reasonably estimable. We continue to study the extent of our potential environmental liabilities, but due to the numerous uncertainties surrounding the course of environmental remediation and the preliminary nature of several environmental site investigations, the range of potential loss beyond the amounts currently accrued, and the probabilities thereof, cannot be reasonably estimated. See Part II, Item 8., Note 12, in the 2007 Form 10-K. The status of each site currently under investigation is provided below.

Gasco site. We own property in Multnomah County, Oregon that is the site of a former gas manufacturing plant that was closed in 1956 (the Gasco site). The Gasco site has been under investigation by us for environmental contamination under the Oregon Department of Environmental Quality's (ODEQ) Voluntary Clean-Up Program. In June 2003, we filed a Feasibility Scoping Plan and an Ecological and Human Health Risk Assessment with the ODEQ, which outlined a range of remedial alternatives for the most contaminated portion of the Gasco site. In May 2007, we completed a revised upland remediation investigation report and submitted it to the ODEQ for review. In 2008, the estimated liability for this site decreased by \$0.4 million due to actual costs paid at this site during the first three months of 2008. We have a net liability of \$20.9 million at March 31, 2008 for the Gasco site, which is estimated at the low end of the range of potential liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

Siltronic site. We previously owned property adjacent to the Gasco site that now is the location of a manufacturing plant owned by Siltronic Corporation (the Siltronic site). We are currently working with the ODEQ to develop a study of manufactured gas plant wastes on the uplands at this site. In 2008, the estimated liability for this site decreased by less than \$0.1 million due to actual costs paid at this site during the first three months of 2008. The net liability at March 31, 2008 for the Siltronic site is \$1.5 million, which is at the low end of the range of potential additional liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

Portland Harbor site. In 1998, the ODEQ and the U.S. Environmental Protection Agency (EPA) completed a study of sediments in a 5.5-mile segment of the Willamette River (Portland Harbor) that includes the area adjacent to the Gasco and Siltronic sites. The Portland Harbor was listed by the EPA as a Superfund site in 2000 and we were notified that we are a potentially responsible party. We then joined with other potentially responsible parties, referred to as the Lower Willamette Group, to fund environmental studies in the Portland Harbor. Subsequently, the EPA approved a Programmatic Work Plan, Field Sampling Plan and Quality Assurance Project Plan for the Portland Harbor Remedial Investigation/Feasibility Study (RI/FS), completion of which is currently expected in 2009. The EPA and the Lower Willamette Group are conducting focused studies on approximately nine miles of the lower Willamette River, including the 5.5-mile segment previously studied by the EPA. In 2007, we received a revised estimate and updated our estimate for additional expenditures related to RI/FS development and environmental remediation. In 2008, the estimated liability for this site decreased by \$0.5 million due to actual costs paid at this site during the first three months of 2008. As of March 31, 2008, we have a net liability of \$13.3 million for this site, which is at the low end of the range of the potential liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

In April 2004, we entered into an Administrative Order on Consent providing for early action removal of a deposit of tar in the river sediments adjacent to the Gasco site. We completed the removal of the tar deposit in the Portland Harbor in October 2005 and on November 5, 2005, the EPA approved the completed project. The total cost of removal, including technical work, oversight, consultant fees, legal fees and ongoing monitoring, was about \$10.8 million. To date, we have paid \$9.8 million on work related to the removal of the tar deposit. As of March 31, 2008, we have a net liability of this site of \$1.0 million remaining for our estimate of ongoing costs, which is at the low end of the range of the potential liability because no amount within the range is considered to be more likely than another and the high end of the range cannot be estimated.

Table of Contents

Central Service Center site. In 2006, we received notice from the ODEQ that our Central Service Center in southeast Portland (the Central Service Center site) was assigned a high priority for further environmental investigation. Previously there were three manufactured gas storage tanks on the premises. The ODEQ believes there could be site contamination associated with releases of condensate from stored manufactured gas as a result of historic gas handling practices. In the early 1990s, we excavated waste piles and much of the contaminated surface soils and removed accessible waste from some of the abandoned piping. In early 2007, we received notice that this site has been added to the ODEQ's list of sites where releases of hazardous substances have been confirmed and its list where additional investigation or cleanup is necessary. As of March 31, 2008, we have an estimated liability of \$0.5 million for this site. We cannot reasonably estimate a range of liability until studies are completed.

Front Street site. The Front Street site was the former location of a gas manufacturing plant operated by our predecessor. Although it is outside the geographic scope of the current Portland Harbor site sediment studies, the EPA directed the Lower Willamette Group to collect a series of surface and subsurface sediment samples off the river bank adjacent to where that facility was located. Based on the results of that sampling, the EPA notified the Lower Willamette Group that additional sampling would be required. Until the results of that sampling are evaluated, a future cost cannot be reasonably estimated.

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

Accrued Liabilities Relating to Environmental sites. Until 2007, we had not been able to determine the timing of our environmental liabilities and therefore had classified no liabilities as current prior to June 2007. The following table summarizes the accrued liabilities relating to environmental sites at March 31, 2008 and 2007 and December 31, 2007:

Thousands	March 31, 2008		March 31, 2007		Dec. 31, 2007	
	Current	Non-Current	Current	Non-Current	Current	Non-Current
Gasco site	\$ 8,444	\$12,406	\$ —	\$6,249	\$6,901	\$14,342
Siltronic site	1,502	—	—	62	—	1,540
Portland Harbor site	1,454	12,887	—	1,703	—	14,821
Central Service Center site	—	529	—	—	—	529
Other sites	—	84	—	155	—	167
Total	<u>\$11,400</u>	<u>\$25,906</u>	<u>\$ —</u>	<u>\$8,169</u>	<u>\$6,901</u>	<u>\$31,399</u>

Regulatory and Insurance Recovery for Environmental Matters. In May 2003, the Oregon Public Utility Commission (OPUC) approved our request for deferral of environmental costs associated with specific sites, including the Gasco, Siltronic and Portland Harbor sites. An extension request of the original deferral order is pending with the OPUC, which will allow us to defer and seek recovery of unreimbursed environmental costs in a future general rate case through early 2009. The extension request also asks for additional named sites to be included in the deferral order. Beginning in 2006, the OPUC authorized us to accrue interest on deferred environmental cost balances, subject to an annual demonstration that we have maximized our insurance recovery or made substantial progress in securing insurance recovery for unrecovered environmental expenses. As of March 31, 2008, we have paid a cumulative total of \$26.1 million relating to the named sites since the effective date of the deferral authorization.

On a cumulative basis, we have recognized a total of \$68.2 million for environmental costs, including legal, investigation, monitoring and remediation costs. Of this total, \$30.9 million has been spent to date and \$37.3 million is reported as an outstanding liability. At March 31, 2008, we had a regulatory asset of \$63.4 million, which includes \$26.1 million of total paid expenditures to date, \$33.4 million for additional environmental costs expected to be paid in the future and accrued interest of \$3.9 million. We believe the recovery of these deferred charges is probable through the regulatory process. We intend to pursue recovery of an insurance receivable and environmental regulatory deferrals from insurance carriers under our general liability insurance policies, and the regulatory asset will be reduced by the amount of any corresponding insurance recoveries. We consider insurance recovery of some portion of our environmental costs probable based on a combination of factors, including a review of the terms of our insurance policies,

Table of Contents

the financial condition of the insurance companies providing coverage, a review of successful claims filed by other utilities with similar gas manufacturing facilities, and Oregon legislation that allows an insured party to seek recovery of "all sums" from one insurance company. We have initiated settlement discussions with a majority of our insurers but continue to anticipate that our overall insurance recovery effort will extend over several years.

We anticipate that our regulatory recovery of environmental cost deferrals will not be initiated within the next 12 months because we will not have completed our insurance recovery efforts during that time period. As such we have classified our regulatory assets for environmental cost deferrals as non-current. The following table summarizes the regulatory assets relating to environmental matters at March 31, 2008 and 2007 and December 31, 2007:

<u>Thousands</u>	<u>Non-Current Regulatory Assets</u>		
	<u>March 31, 2008</u>	<u>March 31, 2007</u>	<u>Dec. 31, 2007</u>
Gasco site	\$ 29,414	\$ 10,836	\$ 29,042
Siltronic site	2,247	477	2,227
Portland Harbor site	30,880	16,770	30,869
Central Service Center site	545	15	545
Other sites	300	199	371
Total	<u>\$ 63,386</u>	<u>\$ 28,297</u>	<u>\$ 63,054</u>

Legal Proceedings

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

Oregon Steel Mills site. In 2004, NW Natural was served with a third-party complaint by the Port of Portland (Port) in a Multnomah County Circuit Court case, Oregon Steel Mills, Inc. v. The Port of Portland. The Port alleges that in the 1940s and 1950s petroleum wastes generated by 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. In March 2005, motions to dismiss by ourselves and other third-party defendants were denied on the basis that the failure of the Port to plead and prove that we were in violation of law was an affirmative defense that may be asserted at trial, but did not provide a sufficient basis for dismissal of the Port's claim. No date has been set for trial and discovery is ongoing. We do not expect that the ultimate disposition of this matter will have a material adverse effect on our financial condition, results of operations or cash flows.

Table of Contents**11. Comprehensive Income**

Items that are excluded from net income and charged directly to common stock equity are included in accumulated other comprehensive income (loss), net of tax. The amount of accumulated other comprehensive loss in total common stock equity is \$2.8 million at March 31, 2008, which is related to employee benefit plan liabilities and changes in price risk management activities. The following table provides a reconciliation of net income to total comprehensive income for the three months ended March 31, 2008 and 2007.

<u>Thousands</u>	<u>Three Months Ended</u>	
	<u>March 31,</u>	
	<u>2008</u>	<u>2007</u>
Net income	\$43,168	\$48,075
Amortization of employee benefit plan liability, net of tax	55	32
Change in unrealized loss from price risk management activities, net of tax	604	—
Total comprehensive income	<u>\$43,827</u>	<u>\$48,107</u>

12. Fair Value of Financial Instruments

We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. As of March 31, 2008, we recorded our derivatives at fair value according to SFAS No. 157. As we elected not to implement SFAS No. 159, we did not measure our long-term debt at fair value (see Note 2).

In accordance with SFAS No. 157, we use the following fair value hierarchy for determining our derivative fair value measurements:

- Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets;
- Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market; and
- Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions market participants would use in pricing the asset or liability.

It is our policy to use quoted market prices whenever available, or to maximize the use of observable inputs and minimize the use of unobservable inputs when quoted market prices are not available, when developing fair value measurements. Derivative contracts outstanding at March 31, 2008, were measured at fair value using models or other market accepted valuation methodologies derived from observable market data. These models are primarily industry-standard models that consider various inputs including: (a) quoted futures prices for commodities, (b) forward currency prices, (c) time value, (d) volatility factors, (e) current market and contractual prices for underlying instruments, and (f) market interest rates and yield curves as well as other relevant economic measures.

The following table provides the fair value hierarchy of our derivative assets and liabilities as of March 31, 2008:

<u>Thousands</u>	<u>Fair Value Measurements at March 31, 2008 Using</u>			
	<u>Quoted prices in</u> <u>active markets</u> <u>(Level 1)</u>	<u>Significant other</u> <u>observable</u> <u>inputs</u> <u>(Level 2)</u>	<u>Significant</u> <u>unobservable</u> <u>inputs</u> <u>(Level 3)</u>	<u>Total Carrying</u> <u>Value at</u> <u>March 31, 2008</u>
Derivative assets	\$ —	\$ 35,402	\$ —	\$ 35,402
Derivative liabilities	—	(6,698)	—	(6,698)
	<u>\$ —</u>	<u>\$ 28,704</u>	<u>\$ —</u>	<u>\$ 28,704</u>

Table of Contents

All fair value measurements of our derivative contracts outstanding at March 31, 2008 were determined to be within Level 2 of the fair value hierarchy. The fair value of our derivative contracts were primarily reported as regulatory assets or regulatory liabilities because the realized gains or losses at settlement are either included, or expected to be included, in utility rates pursuant to regulatory deferral mechanisms (see Part II, Item 8., Note 1. in the 2007 Form 10-K).

13. Subsequent Events

On April 23, 2008, NW Natural sold its investment in a Boeing 737-300 aircraft for approximately \$6.2 million cash, plus accrued rents. The airplane was purchased in 1987 and leased to Continental Airlines, and currently the airplane continues under lease to Continental. An after-tax gain of approximately \$1.1 million will be recognized in the second quarter of 2008.