NW NATURAL
COST ALLOCATION MANUAL
WASHINGTON

Appendix A - Affiliated Interest Report

OVERVIEW

The purpose of Northwest Natural Gas Company's ("NW Natural") Cost Allocation Manual is to describe the methodologies for allocating direct, indirect and shared services costs between the utility and non-utility activities, and affiliates.

NW NATURAL'S NON-UTILITY ACTIVITIES & AFFILIATES

The following is a list of NW Natural's non-utility activities and affiliates. Following the list, cost allocation methods for each non-utility activity or affiliate will be discussed:

1. Amortization of Business Energy Tax Credits
2. Appliance Center/Miscellaneous Merchandising
3. Business Development
4. Classical Chinese Gardens Block
5. Company-Owned Life Insurance
6. Coos County Pipeline
7. Corporate Philanthropy
8. Corporate Structure
9. Development Revenue/Expense
10. Enerfin Contracts
11. Gill Ranch
12. Interstate Storage
13. KB Pipeline Company
14. Leveraged Lease
15. Lobbying, Civic, and Political Contributions
16. NNG Financial Corporation
17. Non-Operating Advertising
18. Non Utility Tax Expense (Benefit)
19. Northwest Energy Corporation
20. Northwest Energy Sub Corporation
21. Note Receivable for Vancouver property
22. Oil Storage Tanks/Dock Lease
23. Other Deductions
24. Palomar Pipeline Project
25. Parking
26. Regulatory & Tax Penalties
27. Revenue from Utility Property
28. Service Solutions
29. Sesquicentennial

30. Sherwood House
31. Smart Energy

GENERAL

NW Natural has a limited amount of its assets invested in affiliates or non-utility activities. At December 31, 2008, these assets accounted for 5.5% of total assets, and revenue from them was 3.8% of gross operating revenues. (See Table 1). The vast majority of the Company's activities are related to utility operations, and it has maintained a utility parent-non-regulated subsidiary organization structure.

LABOR ALLOCATION METHODS

NW Natural has two methods by which labor can be allocated to non-utility accounts. Either method may be used for a particular non-utility activity.

The methods are:

1. Direct Charge:
All NW Natural field employees account for their time on daily time tickets. If non-utility activity work is performed, the appropriate non-utility account is reported on the time ticket.

The labor of individual salaried employees, both bargaining and non-bargaining, is allocated through the PeopleSoft payroll system based on estimated percentage of time spent on utility and non-utility activities. The allocations are reviewed annually or if job changes or transfers occur.

2. Exception Time Card:
Each NW Natural salaried employee, both bargaining and non-bargaining, has an individual standard departmental account distribution. If an employee spends time on non-utility activities, the employee is required to account for that time and report the hours to Accounting. Accounting then prepares and records a journal entry transferring the labor to the non-utility account at the individual salary rate of that employee. An overhead load is added at the same rate that is used throughout the company. (See Payroll Overheads). In addition, an Administrative Overhead load of 27.5% of labor cost is added to cover the cost of rented space, furniture, and equipment.

Payroll Overheads

Vacation, Sick & Holiday Pay

For Bargaining Unit – Field employees, vacation, sick and holiday pay is charged to a 601 Clearing account. To allocate these costs throughout the year to where Field Hourly labor is actually charged, a percentage overhead load of 15% is added to such labor. The intent is to fully allocate all vacation, sick and holiday pay by year-end resulting in a zero balance in Clearing. For Bargaining Unit Clerical and all Non-Bargaining Office employees, vacation, sick and holiday pay is charged directly to departmental accounts where salaries and wages are assigned.

Other Payroll Overheads

All NW Natural employee benefit costs are initially charged into a Clearing account. NW Natural allocates the costs of employee benefits and payroll taxes by adding a percentage load to all labor charges. The percentage load is set at a rate adequate to fully allocate all such actual costs by year-end. The rate is determined at the beginning of the year based on estimated costs. Because benefit cost rates may differ depending on employee grade, employees are categorized into four classes, with different overhead rates for each established class. The employee classes are:

Bargaining Unit – Clerical
Bargaining Unit – Field
Non Bargaining
Executives

In 2008, the following costs were allocated as overhead (company averages):

Health	20.9% of payroll
Pension	10.1% of payroll
Post-Retirement Medical	3.4% of payroll
Workers Compensation	1.8% of payroll
Deferred Comp Match	3.0% of payroll
Payroll Taxes	10.3% of payroll
Key Goal Bonus	4.2% of payroll
Incentive Bonus	4.2% of payroll

Over or under allocation of costs is charged or credited to corporate expense. For the payroll taxes embedded in the overheads rates charged to O&M accounts, a separate entry is made to transfer this cost to 408 as required by FERC accounting.

Discussion of Individual Non-Utility Activities

Amortization of Business Energy Tax Credits

To encourage energy conservation, NW Natural offered to customers who wanted to weatherize their homes and who qualified for a tax rebate from the Oregon Dept of Revenue, the option of receiving a discounted prepayment from NW Natural for the tax credit they would otherwise receive at tax time on their income tax return. The company is then able to claim this tax credit in place of the gas customer. The cost of this program has been expensed in account 426-2625 over an authorized amortization period. The expense was offset by reduced tax expense. This program ended in 2008, when all energy payments were fully amortized.

Appliance Center

NW Natural's Appliance Center is a retail store that demonstrates and sells natural gas appliances to the general public. NW Natural has one store located in Portland. The Accounting Unit for the revenues and expenses for the Appliance Center is 11490.

The accounting for the product sales and cost of sales at the Appliance Center are as follows:

Activity 415	Merchandise Revenue
Activity 416	Merchandise Expenses

<u>Direct Costs:</u>
Certain NW Natural employees work exclusively on matters related to the operation of the Appliance Center. The cost of the exempt and hourly employees and all related payroll overheads (see Payroll Overheads) is charged to Activity 416. In addition, expenses incurred in the operation of the Appliance Center are charged to Activity 416.

NW Natural owns the building in which the Appliance Center operates and rent is charged to Activity 416 based on the percentage of building square feet that is occupied by the Appliance Center. Revenue that the company receives from this rent is recorded in activity 412 "Rent from Utility Property". The company periodically adjusts rent based on market rates. Property taxes are included as a component of the rent. Market rental rates were last evaluated in 2001.

NW Natural has made Leasehold Improvements to the property and has capitalized these costs in Account 186005, Appliance Center Leasehold Improvements. NW Natural is amortizing the cost of these improvements over fourteen years, which is an estimate of the life of the improvements. Amortization expense is charged to Activity 416. The Accumulated Amortization of the Appliance Center Leasehold Improvements is in Account 186006.

<u>Shared and Indirect Services:</u>

NW Natural purchases liability insurance on behalf of the Appliance Center. The Risk Services Department obtains insurance for the consolidated corporate entity in the open market. The premiums are initially charged to NW Natural accounts. An allocation for the Appliance Center is subsequently made by journal entry. NW Natural's intent is to use an allocation methodology that does not result in utility subsidization to the Appliance Center. The policies obtained include the Appliance Center's replacement value.

An additional charge for management oversight is made on a monthly basis by taking 1.5% of the selling expenses in Activity 911, Activity 912, and Activity 916 and charging Activity 416.

Business Development

Beginning in 2006, several sites in the western U.S. have been and are being investigated for potential underground gas storage development. The selection of the Gill Ranch site in the San Joaquin Valley of northern California came out of this effort. (see Gill Ranch Storage, LLC section of this manual).

General expenses not directly attributable to Gill Ranch are classified as Business Development. A percentage of three employees salaries is allocated to 426-1505. In addition, other employees who work in this area on an irregular basis, time track this time which is also allocated to 426-1505. An overhead load for all employee time is added at the same rate that is used by NW Natural. (See Payroll Overheads). Consulting and other invoice charges are directly charged.

Classical Chinese Gardens Block

NW Natural owns the land that is presently used for the Classical Chinese Garden. The land is held in Non-Utility Plant in account 121044. It consists of one square block from Northwest Second to Northwest Third and from Northwest Everett to Northwest Flanders in Portland. NW Natural has leased the Property to the City of Portland under a long-term lease for 100 years for $1 per year.

Direct Costs:
None

Shared and Indirect Services:
NW Natural provides no insurance coverage. Property taxes are the responsibility of the operator of the Garden.

Company-Owned and Trust Owned Life Insurance

NW Natural has a Corporate-Owned Life Insurance (COLI) Plan where it has purchased key-person life insurance contracts to provide informal funding for long-term, people-related liabilities including post-retirement medical benefits. The policies are owned by and payable to NW Natural and are increasing whole-life insurance. Similarly, NW

Natural also has Trust-Owned Life Insurance Plans (TOLI) where the policies provide informal funding for non-qualified employee benefits and are owned by and payable to the Trust. Costs and benefits relating to these investments are recorded in accounts 124100 through 124109, including the build-up of cash surrender value.

For accounting purposes, life insurance premiums are charged to a non-utility account, Account 426-2385 - Life Insurance. Correspondingly, any income generated from these policy investments are credited to the same account.

Since nominal time is spent on administering this program, A&G costs are immaterial. Also, since current practice is to record life insurance gains and losses plus premium costs to a non-utility account, there is very little exposure to under-allocating costs to non-utility accounts.

Coos County Pipeline

An intrastate natural gas transmission pipeline to Coos County was built in 2004 and became operational in January 2005, for the purpose of providing natural gas service to the Southern Oregon Coast service area of NW Natural's franchise. Coos County owns this pipeline and has contracted with NW Natural to operate it. NW Natural and Avista Utilities were the only shippers on the Coos County Pipeline as of the end of 2008.

NW Natural collects the costs of operation in a clearing account, activity 616. These costs include payroll costs of management and of operating employees who work on the pipeline. Each month these costs are cleared to non-utility expense 421-6056. NW Natural bills Coos County monthly for the operating costs and records this as non-utility revenue in the same account 421-6056. Coos County then bills NW Natural and Avista Utilities standard monthly amounts based on an annual budget, allocated by projected volumetric flows for each shipper. These costs are trued up at the end of each year, based on actual operating costs and actual volumes delivered for each shipper. NW Natural charges this payment to Cost of Gas.

NW Natural bills an additional monthly amount of $2,200 to Coos County as "compensation" to NW Natural, per the operations contract between the two parties. The contract allows this amount to increase each year for inflation. This revenue is recorded in account 421-6059.

Corporate Philanthropy

NW Natural generally donates 1% of the average net income before tax for the three years immediately preceding the budget year. Donations are made to non-profit organizations, including those associated with education, arts, social welfare, and the environment.

<u>Direct Costs:</u>
The donations are charged to non-utility accounts 426-2180 (Oregon), and 426-2185 (Washington).

No accounting services are allocated.

Corporate Structure

In 2007, NW Natural incurred legal fees in its investigation of the feasibility and desirability of alternate corporate structures. This effort concluded in 2007, but some residual costs were not paid until early 2008. The fees were directly charged to 426-5329.

Development Revenue & Expense

NW Natural provided consulting services to NorthernStar Energy LLC (NE) to assist it in permitting the Bradwood Landing Pipeline, which would be interconnected with Bradwood Landing LLC's proposed Bradwood Landing LNG import terminal to be located on the Columbia River in Clatsop County, Oregon.

For these consulting services, NW Natural was compensated a flat monthly amount plus any out-of-pocket expenses. Employee direct costs were time tracked and allocated to this project in 421-6266. An overhead load was added at the same rate that is used by NW Natural. (See Payroll Overheads). Out-of-pocket direct costs and reimbursements from NE are also recorded here.

The consulting arrangement was concluded in mid-2008.

Enerfin Contracts-Mist

NW Natural has a contract with Enerfin Corporation whereby the price of gas purchased from Enerfin for production at Mist is reduced by $0.01 per therm. This reduction is intended to offset general plant expenses for NW Natural's operation of Miller Station. This mutually beneficial agreement allows Enerfin to save money by not having to duplicate NW Natural plant and equipment at Miller Station.

<u>Direct Costs</u>:
The $0.01 per therm gas savings is credited to income account 415-4390. Labor provided by NW Natural employees for technical services such as meter calibration is charged directly to 416-4390 on daily time tickets. An overhead load is added at the same rate that is used by NW Natural. (See Payroll Overheads).

<u>Shared and Indirect Services:</u>
None for this activity

Gill Ranch Storage, LLC

The Gill Ranch Storage, LLC (Gill Ranch) subsidiary was formed in 2007. In 2007, NW Natural entered into a Joint Project Agreement with Pacific Gas & Electric Company ("PG&E") for the co-development of the project. Ownership in the project is structured as tenants in common. Phase I of the project, which is targeting a 2010 in-service date, will be 75% owned by Gill Ranch and 25% by PG&E as co-tenants. Costs of the project will be allocated to the two companies in proportion to their ownership interests. Each company will separately finance, tariff, market and contract for its portion of the project capacity. Gill Ranch is the Operator of the project through at least the first three years of commercial operation. Gill Ranch has its own set of corporate books as a subsidiary of NW Natural.

<u>Shared and Indirect Services:</u>
In accordance with the contract between PG&E and Gill Ranch, any NW Natural employee time charged to the project is calculated as follows:

1. Base Hourly rate – annual salary of the individual employee working on the project, divided by 2,080 hours to determine the employee's base hourly rate.

The base hourly rate is then adjusted upward by:

2. 15% for non productive time for training, vacations, sick leave & holidays;
3. 60.4% for payroll taxes, health insurance, dental insurance, 401k contributions, pensions and annual incentive programs.
4. 10% for project and long term incentive programs
5. The adjusted hourly rate (sum of #1- #4) is then adjusted upwards by an additional 60% to reflect other indirect and administrative costs such as information technology, human resources, accounts payable, rent, building services, accounting and legal.
6. The concluded hourly rate as calculated in #5, multiplied by the number of hours worked by the employee on the project is the amount that is billed to the project.

NW Natural bills Gill Ranch quarterly. Interest is added for accumulated balances older than one quarter.

<u>Direct</u> – Consulting and other invoice charges are charged directly.

<u>Insurance</u> – Gill Ranch as operator is obligated to maintain insurance policies commensurate with the risk. Coverage should include "All Risk" insurance, Workers Comp, automobile liability and umbrella/excess insurance. The policies are endorsed to provide that the insurer shall waive any right of recovery that the insurer may have or acquire against the Owners and their Affiliates. Each owner is named as an insured.

In 2008, the Risk Services Department of NW Natural obtained insurance for the consolidated entity in the open market. The cost of all premiums is initially charged to NW Natural accounts. An allocation for Gill Ranch related insurance coverage was subsequently made by journal entry to Gill Ranch. NW Natural's insurance broker provides information on the amount that should be allocated to subsidiary companies. Allocation is based on the underwriting principles for each type of policy. NW Natural's intent is to use an allocation methodology that does not result in utility subsidization to the affiliate. Once the project construction is complete, the insurance will be purchased directly by Gill Ranch.

Interstate Storage

NW Natural owns and operates the Mist underground natural gas storage facility in Columbia County near Mist, Oregon. In addition to the use of such storage facilities for its retail core customers, NW Natural has pre-built some storage facilities in advance of core need and uses the excess capacity of other existing facilities to provide storage services to customers in the interstate and intrastate market. NW Natural provides the interstate storage service under a limited jurisdiction blanket certificate issued to it by FERC under Section 284.224 of FERC's regulations. *See*, Northwest Natural Gas Company, 95 FERC ¶ 61,242 (2001). Under that certificate, NW Natural is authorized to provide FERC jurisdictional bundled firm and interruptible storage and related transportation services to and from its Mist storage field in interstate commerce. In addition, NW Natural provides an intrastate firm storage service for eligible intrastate customers and sites in Oregon under Tariff Schedule 80 (experimental). The terms of Rate Schedule 80 mirror NW Natural's FERC-authorized interstate service. Since the provision of the storage services is accomplished by the use of some shared storage and transportation assets that are included in the core rate base, NW Natural has sharing agreements in place with its Oregon and Washington regulators. In Oregon, the sharing arrangement for both storage services and asset optimization assistance is set forth in NW Natural's Tariff Schedules 185 and 186. These sharing agreements are in lieu of specific allocations of costs.

KB Pipeline Company

KB Pipeline Company (KBPC) is a wholly owned subsidiary of NNGFC. KBPC owns a ten percent (10%) interest in the Kelso-Beaver Pipeline, an approximately 18-mile interstate natural gas pipeline regulated by the Federal Energy Regulatory Commission (FERC) that runs between Kelso, Washington, and delivery points near the PGE Beaver Plant in Clatskanie, Oregon. Approximately 17 miles of the pipeline is in Washington, with the remaining one mile located in Oregon. The other co-owners of the Kelso-Beaver Pipeline are: Portland General Electric Company (79.5%) and B-R Pipeline Company (10.5%). Each of the co-owners has a separate FERC certificate regarding the flow of gas on its share of the pipeline.

KBPC has no separate employees of its own. Since Cascade Natural Gas now operates the pipeline, no NW Natural employees charge time to KBPC except for minor administrative time.

Direct Costs:
NW Natural provides administrative support for KBPC. The cost is based on individual employee hours reported times actual salary rate. (See Labor Allocation Methods). An overhead load is added at the same rate that is used by NW Natural. (See Payroll Overheads).

Under the Gas Transportation Agreement between KBPC and NW Natural dated September 26, 1991, NW Natural pays KBPC a monthly demand charge equal to 96.83 cents per MMBtu under the contract. Based on the contract MDQ of 19,300 MMBtus, this amounts to a total monthly charge of $18,688.19. NW Natural charges 804 and credits the intercompany account 146016. See the Affiliated Interest Report for further information on this demand charge. Additionally, if KBPC actually transports gas for NW Natural, there is an additional volumetric/commodity charge payable by NW Natural to KBPC equal to 1.44 cents per MMBtu of gas transported. The rates charged by KBPC to NW Natural for gas transportation services on the Kelso-Beaver Pipeline were approved by FERC in KBPC's 1991 certificate order.

All intercompany balances flow through the intercompany account of KBPC's parent company, NNGFC.

Shared and Indirect Services:

The Risk Services Department obtains insurance for the consolidated NW Natural entities in the open market. The cost of all premiums is initially charged to NW Natural accounts. An allocation for KBPC-related insurance coverage is subsequently made by journal entry to the intercompany account for FC, 146016. The policies obtained for KBPC name KBPC as the beneficiary.

KBPC does pay property taxes indirectly in the two states that the pipeline operates. The portion of the pipeline located in Washington is considered an asset of PGE (the majority owner), for property tax purposes. PGE pays 100% of property taxes assessed to Cowlitz County, Washington. PGE then bills KBPC for its pro-rata share of these property taxes. The Oregon portion of pipeline property is shown on the property rolls of Columbia County, Oregon as property of NW Natural. The tax for these specific tax lots is paid by NW Natural, and then billed to KBPC.

KBPC-related income taxes are offset through the intercompany account of KBPC's parent company, NNGFC (see NNG Financial Corporation.)

Leveraged Lease

NW Natural had a certain beneficial interest in a Boeing 737 aircraft, which was leased, operated, and maintained by Continental Airlines, pursuant to a lease agreement. NW Natural sold the aircraft in April 2008. During its ownership of the plane, NW Natural was Owner Participant and Continental was the Lessee. Several lenders had provided financing. Prior to the sale, the investment was carried in asset account 174, offset by accounts for deferred income tax, 283033, and deferred income tax credit, 255033.

Direct Costs:

NW Natural did not allocate direct labor to the leveraged lease investment. (See Shared & Indirect Services below). Continental provided for its own insurance.

Consulting invoices related to the leveraged lease investment were charged directly to FERC account 421.

Shared and Indirect Services:

FC managed the leveraged lease investment for NW Natural, pursuant to a management agreement dated June 30, 1996, when Oregon Natural Gas Development Company's (ONGDC's) beneficial interest in the airplane was transferred to NW Natural as the result of ONGDC's merger into NW Natural. The Agreement called for NW Natural to pay FC a fee of $250 per month for performing services under the Agreement. The fee was charged to FERC account 421 and credited to the FC's intercompany account, 146016.

During the months of negotiating the sale of the aircraft, additional employee time was charged to this account. The cost of this labor was based on individual employee hours reported times actual salary rate. (See Labor Allocation Methods). An overhead load was also added at the same rate that is used by NW Natural. (See Payroll Overheads). Lease revenue was recorded in 421-6265.

Lobbying, Civic, and Political Contributions

NW Natural provides resources to participate in federal, state, and local government affairs, as well as in local civic organizations and initiatives. The company also administers PAC funds that receive contributions from both employees and the company.

<u>Direct Costs:</u>
426-4955 - Contributions to political candidates
426-4935 - Contributions for ballot measures and opinion research on issues.
426-2085 - Chamber of Commerce dues
426-2575 - Social Club dues

<u>Shared and Indirect Services:</u>
A portion of two employee's salaries and expenses are charged to 426-4950 and 426-4935. No accounting administration cost is allocated.

NNG Financial Corporation

NNG Financial Corporation (FC) has investments in a gas pipeline known as KB Pipeline Company (see KB Pipeline section of this manual), and one low-income housing project.

<u>Direct Costs:</u>
FC has no employees of its own, but NW Natural employees provide administrative support. The cost of this support is charged to FC through a monthly journal entry recorded in an intercompany account, 146016. The cost is based on individual employee hours reported times actual salary rate. (See Labor Allocation Methods). An overhead load is added at the same rate that is used by NW Natural. (See Payroll Overheads).

Invoices applicable to FC but billed through NW Natural are charged directly to the intercompany account 146016.

FC has no real or personal property and therefore FC neither pays nor is allocated any property taxes. NW Natural files federal and state income taxes on a consolidated basis. For each taxable year, FC income may cause the consolidated tax liability to increase or decrease. Monthly payments are made to NW Natural by FC for any corresponding increase in the consolidated tax liability. Conversely, payments are made from NW Natural to FC when FC losses decrease the consolidated tax liability. A separate intercompany account is used to track tax balances. That account is 146096.

FC currently has no line of credit and no parent guaranty of debt.

All intercompany balances are paid in cash on a monthly basis to the receivable company.

Shared and Indirect Services:
NW Natural acquires corporate insurance coverage which includes FC. The Risk Services Department obtains insurance for the consolidated entity in the open market. The cost of all premiums is initially charged to NW Natural accounts. An allocation for FC related insurance coverage is subsequently made by journal entry to the intercompany account for FC, 146016. NW Natural's insurance broker provides information on the amount that should be allocated to subsidiary companies. Allocation is based on the underwriting principles for each type of policy. NW Natural's intent is to use an allocation methodology that does not result in utility subsidization to the affiliate.

NW Natural provides management oversight for FC. The labor cost of this management is discussed above under "Direct Costs".

Non Operating Advertising

NW Natural charges some advertising and consumer incentive or contest expense to 416-4080, a non-utility account. The charges are for advertising to promote the benefits of natural gas and high-efficiency natural gas equipment, and to incent customers to sign up for payment programs such as Paperless Billing, Equal Pay, and Auto Pay.

A small payroll allocation for two employees is made to the account for the minimal time involved in managing this area. Invoices from advertising vendors are charged directly.

NW Energy Corporation

Northwest Energy Corporation (NW Energy) is a wholly owned subsidiary of NW Natural. NW Energy was formed in 2001 to serve as the holding company for NW Natural and Portland General Electric (PGE) if the proposed acquisition of PGE had been completed. However, the acquisition was eventually terminated in May 2003, with all transaction costs in connection with the acquisition effort being charged to Non-Utility Expense. NW Energy has had no active operations.

Shared and Indirect Services:
NW Natural purchases corporate excess Directors & Officers liability insurance, which includes NW Energy. This insurance is charged to 426-2380.

NW Energy Sub Corporation

Northwest Energy Sub Corporation was created in 2001 to effect the corporate reorganization to a holding company if the acquisition of Portland General Electric

Company had been completed. As explained under NW Energy Corporation, the acquisition effort was terminated in 2002. Sub corporation is currently inactive.

Shared and Indirect Services:
NW Natural purchases corporate excess Directors & Officers liability insurance, which includes NW Energy Sub Corporation. This insurance is charged to 426-2380.

Note Receivable for Commercial Property sold in Vancouver, Washington

Land in Vancouver, Washington was acquired in 1992 for purposes of potentially becoming the site of a Clark County district service center. The property is considered situs in Washington. The site has since been determined to be unsatisfactory for its intended purpose and was sold in December 2004. The property was sold on contract and the outstanding note balance resides in account 124099. The debtor makes quarterly payments. The gain associated with the sale is amortized over the contract period as payments are made by the buyer, in acct 421.

Oil Storage Tanks/Dock Lease

NW Natural leases oil storage tanks and a loading/unloading dock at its Linnton property to an outside party, which uses the facilities to store bunker oil for its ship refueling business.

Direct Costs:
The investment, accumulated depreciation, and deferred income taxes are accounted for in Non-Utility plant, accounts 121001, 121002, 121003, 122027, 283031 and 283032. Rental Income is credited to account 418-4140 and depreciation is charged to account 418-2115.

Income taxes are charged to non-utility taxes, account 409-3075 and 409-3145. Property taxes are billed to, and paid by the lessee.

NW Natural purchases liability insurance coverage for the Dock facility. The Risk Services Department obtains insurance for the consolidated corporate entity in the open market. The policies obtained include the Dock facility's replacement value. This insurance is charged to 426-2380.

Lessees provide their own insurance coverage.

Shared and Indirect Services:
No accounting or management costs are currently charged to this business segment.

Other Deductions

The Other Deductions account, 426-2445, is used for miscellaneous write-offs or other non-utility expenses not readily classifiable in any other utility or non-utility accounts.

Palomar Pipeline Project

NW Natural and Gas Transmission Northwest Corporation (GTN) indirectly equally own an interest in Palomar Gas Transmission, LLC (PGT) which is developing a proposed interstate gas pipeline, known as the Palomar Pipeline. *See*, FERC Docket No. PF07-13-000. If approved by the Federal Energy Regulatory Commission (FERC), the Palomar Pipeline will be a FERC jurisdictional pipeline. Prospective scheduled in-service is November 2011.

There are two potential development scenarios of the Palomar Pipeline:

1) "Full" Palomar (Eastern and Western Zones): This project would connect a proposed LNG terminal on the Columbia River to the GTN mainline near Madras, Oregon. There would also be an interconnection with Northwest Pipeline's Grants Pass lateral and NW Natural's South Mist Pipeline Extension at Molalla.
2) Palomar East (Eastern Zone only): This project would connect NW Natural's South Mist Pipeline Extension at Molalla, Oregon, to the GTN mainline near Madras, Oregon. This reduced scale would potentially occur if the proposed LNG terminal on the Columbia River is either terminated or significantly delayed.

<u>Core Customer costs</u>
Pursuant to the Eastern Zone Precedent Agreement, NW Natural is a prospective anchor shipper on the Eastern Zone of the proposed Palomar Pipeline. Separate Precedent Agreements for each zone have been executed and approved by the OPUC. Any out-of-pocket costs incurred on behalf of representing core customers (e.g. legal) are being allocated to the utility. Employee direct costs are not being time tracked.

<u>Conduct Guidelines</u>
NW Natural has developed a set of internal Conduct Guidelines given the dual roles NW Natural has in the Palomar project. Among other things, a NW Natural employee was designated with the responsibility for the negotiation of the terms for NW Natural's Precedent Agreement as a shipper with Palomar. Palomar was represented by GTN employees in these negotiations. Different NW Natural employees are designated to approve the Precedent Agreement, one representing the utility as a shipper and the other representing the Company's ownership interest in PGT.

Expenses are charged to 421-2051, and consist of allocations of NW Natural employee time as explained in "Labor Allocation Methods". Out-of-pocket direct costs are also charged to 421-2051.

Parking

In 2008, a net total of $72,940 was charged to Account 5047 –"Parking". The amounts were charged out to the following account classes:

Class	Costs	Reimbursements	Totals
Non Utility	188,540	(150,853)	37,687
O&M	44,329	(18,174)	26,155
Construction	8,816	0	8,816
Other	282	0	282
Totals	241,967	(169,027)	72,940

Parking costs are recorded as direct invoice charges from parking vendors and as payments to employees working on utility business. Parking reimbursement is collected from employees for personal parking. Non Utility is charged to 426-2463.

Regulatory & Tax Penalties

Any regulatory or tax penalties are charged to 426-2495.

Revenue from Utility Property

(See appliance center). Account 412 "Revenue from Utility Property" receives the credit for rent income received from the Appliance Center.

Service Solutions

NW Natural provides a repair and maintenance referral service to customers with equipment problems or who desire equipment servicing. Customers call the Service Solutions Center and a representative connects the customer with a NW Natural Certified Contractor. Participating dealers agree to complete the service call within one week unless otherwise requested by the customer, or within 24 hours on an emergency basis. Dealers must meet strict qualification standards and agree to pay annual fees that are used to fund the program.

Expenses are tracked in 416-4857, and offset by fees paid by the participating dealers. This revenue is recorded in 416-6550. The expenses include directly charged labor and overhead, depreciation on original CIS (Customer Information System) program development expenses, and an answering service vendor.

Sesquicentennial

NW Natural is celebrating its 150th anniversary in 2009. The sesquicentennial budget supports special events and projects as well as public relations and marketing support, to promote the company's image and long-term value to customers, shareholders and communities in Oregon. The NW Natural sesquicentennial celebration is also coordinating and supporting promotions with the State of Oregon, which is also celebrating its 150th anniversary in 2009. Costs consist of directly charged invoices to 426-2967, and will include some exception labor time during 2008-2009. This labor is charged with the same payroll overhead load that is used by NW Natural (see Payroll Overhead).

Sherwood House

The Sherwood House is a residential home located at 24540 SW Old Hwy 99, in Sherwood, Oregon. The home and the land it is on were acquired by NW Natural because the land was needed for the Sherwood valve site of Phase 4 of the South Mist Pipeline Extension. The home cannot be partitioned from the property; therefore it is being leased to a private party.

The land is classed as utility property since it is needed for the valve site. The house is not needed for utility operations and is carried in account 121045. Rental income is recorded in 418-6427. Depreciation on the house is recorded in 421-2116.

Smart Energy

Smart Energy is an Oregon tariffed utility program which provides Oregon customers an opportunity to offset the carbon dioxide emissions from their use of natural gas by purchasing carbon offsets. The program became effective on September 1, 2007. The ongoing costs of this program are paid by program participants. The start-up costs for the first 3 years of the 5-year pilot program are being paid for by NW Natural Shareholders and all Oregon customers. The costs are recorded in 426-02972.

Shareholders fund the cost of purchasing offsets to cover the carbon dioxide emissions from the natural gas used to heat NW Natural's facilities for the five-year duration of the program.

Cost Allocation Manual for NW Natural

Appendix 2008

Line	Name of Affiliate or Non-Utility activity	Assets @ 12/31/08	Year ended 2008 Gross Revenues	Year ended 2008 Expenses
1	Amortization of Business Energy Tax Credits	-	-	8,665
2	Appliance Center/Misc Merchandising	1,341,419	4,171,403	3,720,818
3	Business Development	-	-	373,546
4	Classical Chinese Gardens Block	438,739	-	-
5	Company Owned Life Insurance	48,278,508	2,190,413	-
6	Coos County Pipeline	-	226,137	213,232
7	Corporate Philanthropy	-	-	1,162,697
8	Corporate Structure	-	-	10,579
9	Development Revenue/Expense	-	64,573	73,689
10	Enerfin Contracts-Mist	-	74,484	50,839
11	Gill Ranch	13,065,593	-	(17,242)
12	Interstate Storage	51,682,452	27,371,166	19,025,134
13	KB Pipeline Corporation (included under NNGFC)	-	-	-
14	Leveraged Lease	-	1,960,393	842,515
15	Lobbying, Civic,and Political Contributions	-	-	768,795
16	NNG Financial Corporation	1,275,408	224,258	197,085
17	Non Utility Tax Expense (Benefit)	-		142,158
18	Non-Operating Advertising	-		79,241
19	Northwest Energy Corporation	-		
20	Northwest Energy Sub Corporation	-		
21	Note Receivable for Vancouver Property	506,122	44,682	
22	Oil Storage Tanks/Dock Lease	342,737	363,426	41,459
23	Other Deductions	-	-	49,532
24	Palomar Pipeline Project	14,245,110	815,582	51,000
25	Parking (Non Utility only)	-	-	36,812
26	Regulatory & Tax Penalties	-	-	911
27	Revenue from Utility Property	-	41,520	-
28	Senate Bill 408	-	1,760,146	691,561
29	Service Solutions	-	185,632	147,665
30	Sesquicentennial	-	-	43,012
31	Sherwood House	157,316	4,950	1,946
32	Smart Energy	-	-	2,528
		131,333,404	39,498,765	27,718,177
	Total Consolidated Corporation	2,378,152,000	1,037,855,000	
		5.5%	3.8%	