NORTHWEST NATURAL GAS CO
Form 10-K
February 28, 2012

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

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

OR

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

For the transition period from ___________ to____________

Commission file number 1-15973

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

Oregon	93-0256722
(State or other jurisdiction of incorporation or organization)	(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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [X] No [ ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes [ ] No [X]

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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

Large Accelerated Filer –––[X] 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 [X]

As of June 30, 2011, the registrant had 26,672,812 shares of its Common Stock outstanding. The aggregate market value of these shares of Common Stock (based upon the closing price of these shares on the New York Stock Exchange on that date) held by non-affiliates was $1,189,774,420.

At February 24, 2012, 26,791,793 shares of the registrant's Common Stock (the only class of Common Stock) were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement of the registrant, to be filed in connection with the 2012 Annual Meeting of Shareholders, are incorporated by reference in Part III.

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GLOSSARY OF TERMS

Average weather: equal to the 25-year average degree days based on temperatures established in our last Oregon general rate case.

Bcf: one billion cubic feet, a volumetric measure of natural gas, roughly equal to 10 million therms or one trillion Btu’s.

Btu: British thermal unit, a basic unit of thermal energy measurement. One Btu equals the energy required to raise one pound of water one degree Fahrenheit at atmospheric pressure and 60 degrees Fahrenheit. One hundred thousand Btu’s equal one therm.

Core utility customers: residential, commercial and industrial customers receiving firm service from the utility.

Cost of gas sold: the delivered cost of natural gas sold to customers, including the cost of gas purchased or withdrawn/produced from storage inventory or reserves, gains and losses from gas commodity hedges, pipeline demand costs, seasonal demand cost balancing adjustments, regulatory gas cost deferrals and company gas use.

Decoupling: a rate mechanism, also referred to as our conservation tariff, which is designed to break the link between earnings and the quantity of natural gas consumed by customers. The design is intended to allow the utility to encourage customers to conserve energy while not adversely affecting its earnings due to reductions in sales volumes.

Degree days: units of measure that reflect temperature-sensitive consumption of natural gas, calculated by subtracting the average of a day’s high and low temperatures from 65 degrees Fahrenheit.

Interruptible service: natural gas service offered to customers (usually large commercial or industrial users) under contracts or rate schedules that allow for interruptions when necessary to meet the needs of firm service customers.

Liquefied natural gas (LNG): the cryogenic liquid form of natural gas. To reach a liquid form at atmospheric pressure, natural gas must be cooled to approximately -260 degrees Fahrenheit.

Purchased gas adjustment (PGA): a regulatory mechanism for adjusting customer rates to reflect changes in the expected cost to acquire and deliver natural gas supplies.

Return on equity (ROE): a measure of corporate profitability, calculated as net income divided by average common stock equity. Authorized ROE refers to the equity rate approved by a regulatory agency for utility investments funded by common stock equity.

Sales service: service provided whereby a customer purchases both natural gas commodity supply and transportation from the utility.

Therm: the basic unit of natural gas measurement, equal to 100,000 Btu’s.

Transportation service: service provided whereby a customer purchases natural gas commodity directly from a supplier but pays the utility to transport the gas over its distribution system to the customer’s facility.

Demand cost: a component in core utility customer rates that covers the cost of securing firm pipeline capacity to meet peak demand, whether that capacity is used or not.

Firm service: natural gas service offered to customers under contracts or rate schedules that will not be disrupted to meet the needs of other customers, particularly during cold weather.

General rate case: a periodic filing with state or federal regulators to establish equitable rates and balance the interests of all classes of customers and our shareholders.

Utility margin: utility gross revenues less the associated cost of gas sold, including regulatory adjustments and applicable revenue taxes. Also referred to as utility net operating revenues.

Weather normalization: a rate mechanism applied to residential and commercial customers' bills to adjust residential and commercial customer billings based on temperature variances from average weather, with rate decreases when the weather is colder than average and rate increases when the weather is warmer than average.

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Forward-Looking Statements

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

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

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

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

NORTHWEST NATURAL GAS COMPANY
PART I

ITEM 1. BUSINESS

Overview

Northwest Natural Gas Company (NW Natural) was incorporated under the laws of Oregon in 1910. Our company and its predecessors have supplied gas service to the public since 1859, and we have been doing business as NW Natural since 1997. We maintain operations in Oregon, Washington and California and conduct businesses through NW Natural, its subsidiaries and joint ventures. A reference to NW Natural ("we," "us" or "our") in this report means NW Natural and its subsidiaries and joint ventures unless otherwise noted.

Business Segments

We operate in two primary reportable business segments, Local Gas Distribution and Gas Storage. We also have other investments and business activities not specifically related to one of these two reporting segments that we aggregate and report as Other.

Local Gas Distribution

We are principally engaged in the distribution of natural gas in Oregon and southwest Washington. We refer to this business segment as our local gas distribution segment or utility. Our local gas distribution segment involves building and maintaining a safe and reliable pipeline distribution system, purchasing gas from producers and marketers, contracting for the transportation of gas over pipelines from regional supply basins to our service territory, and reselling the gas to customers subject to rates, terms and conditions approved by the Public Utility Commission of Oregon (OPUC) or by the Washington Utilities and Transportation Commission (WUTC). Local gas distribution also includes transporting gas owned by customers from an interstate pipeline connection, or city gate, to the customers' facilities for a fee, also approved by the OPUC or WUTC. Approximately 90 percent of our consolidated assets and consolidated net income have been related to the local gas distribution segment over the last few years. The OPUC has allocated to us as our exclusive service area a major portion of western Oregon, including the Portland metropolitan area, most of the Willamette Valley and the coastal area from Astoria to Coos Bay. We also hold certificates from the WUTC granting us exclusive rights to serve portions of three southwest Washington counties bordering the Columbia River. We provide gas service in 124 cities and neighboring communities in 15 Oregon counties, as well as in 16 cities and neighboring communities in three Washington counties. The city of Portland is the principal retail and manufacturing center in the Columbia River Basin, and is a major port for trade with Asia.

See Note 4 to the Consolidated Financial Statements for information on local gas distribution assets and results of operations for the years ended December 31, 2011, 2010 and 2009.

Regulation and Rates

Our utility segment is subject to regulation with respect to, among other matters, rates and systems of accounts by the OPUC, the WUTC, and Federal Energy Regulatory Commission (FERC). The OPUC and WUTC also regulate NW Natural's issuance of securities. In 2011, approximately 90 percent of our utility gas volumes were delivered to, and utility operating revenues were derived from, Oregon customers and the balance from Washington customers. . The OPUC and the WUTC generally require the natural gas commodity cost to be billed to customers at the same cost incurred or expected to be incurred by the utility. We have not historically earned a profit or incurred a loss on gas commodity purchases; however, in Oregon we have an incentive sharing provision whereby we can either increase or decrease margin revenues from gas cost variances as compared to gas costs embedded in the PGA. Under this provision, our net income is affected by differences between actual and expected purchased gas costs, which occur primarily because of market fluctuations and volatility affecting unhedged gas purchases. In addition, we recently entered into a regulatory agreement where we receive a rate base return on our investment in gas reserves. See Part II, Item 7., "Results of Operations—Regulatory Matters—Rate Mechanisms—Purchased Gas Adjustment and Results of Operations—Regulatory Matters—Rate Mechanisms—Gas Reserves".

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We file general rate case and rate tariff requests periodically with the OPUC, WUTC and FERC to change the rates we charge our utility and storage customers. On December 30, 2011, we filed an application for a general rate increase at the OPUC. We requested an increase in authorized annual Oregon jurisdictional revenues of $43.7 million, or 6.2 percent, with an overall rate of return on capital of 8.28 percent, including a return on common equity of 10.3 percent, and an authorized equity to capitalization ratio of 50 percent. We also requested the establishment of a rate mechanism through which deferred costs related to our environmental liabilities will be recovered through rates. The new rates are requested to be effective by November 1, 2012. We expect the OPUC to make a decision on this rate case by the end of October 2012.

Our most recent general rate case in Washington was approved in December 2008, and new rates were effective on January 1, 2009 (see Part II, Item 7., "Results of Operations—Regulatory Matters—General Rate Cases," below).

We are required under our Mist interstate storage certificate authority to file with FERC every five years either a petition for rate approval or a cost and revenue study to change or justify maintaining the existing rates for the interstate storage service. For further information, see Part II, Item 7., "Results of Operations—Regulatory Matters," and "Business Segments—Gas Storage," below.

Gas Supply

Our gas supply strategy is based on forecasted customer requirements, which considers estimated load growth by type of customer, attrition, conservation, distribution system constraints, interstate pipeline capacity and contractual limitations and the forecasted transfer of large customers between sales service and transportation-only service. We perform sensitivity analyses based on factors such as weather variations and price elasticity effects. We have a diverse portfolio of short-, medium- and long-term firm gas supply contracts that are supplemented during periods of peak demand with gas from storage facilities either owned by or contractually committed to us.

To achieve our gas supply strategy, we employ a gas purchasing strategy that emphasizes a diversity of supply sources; a diverse portfolio of contract types and durations; strategic uses of gas storage facilities and capacity recall agreements; a variety of gas cost management strategies; and physical acquisition of gas supplies.

We purchase our gas supplies at liquid trading points to facilitate competition and price transparency. These trading points include the NOVA Inventory Transfer (NIT) point in Alberta (also referred to as AECO), Huntingdon/Sumas and Station 2 in British Columbia, and multiple receipt points in the U.S. Rocky Mountains.

Diversity of Supply Sources

We purchase natural gas for our core utility customers from three supply basins located between western Canada and the U.S. Rocky Mountain areas. Currently, about 65 percent of our supply comes from Canada, with the balance coming primarily from the U.S. Rocky Mountain region. We believe that gas supplies available in the western United States and Canada are adequate to serve our core utility requirements for the foreseeable future, but we continue to evaluate our long-term supply mix based on projections of gas production and pricing in the U.S. Rocky Mountain regions as well as other regions in North America. We believe that the cost of natural gas coming from western Canada and the U.S. Rocky Mountain regions will continue to track the broader U.S. market prices. Additionally, we expect increased availability of gas supplies throughout North America as a result of the extraction of shale gas resources and the building of new transmission pipeline projects to increase capacity out of the U.S. Rocky Mountain region.

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Diverse Supply Portfolio of Contract Types and Durations

We maintain a diverse portfolio of short-, medium-, and long-term firm gas supply contracts. We typically enter into gas purchase contracts for:

- year-round baseload supply;
- additional baseload supply for the winter heating season;
- winter heating season contracts where we have the option to call on all or some of the supplies on a daily basis; and
- spot purchases, taking into account forecasted customer requirements, storage injections and withdrawals and seasonal weather fluctuations.

At December 31, 2011, we have contracts with gas suppliers for deliveries ranging from three months to four years, which provide for a maximum of 2.0 million therms of firm gas per day during the winter heating season and 0.7 million therms per day year-round. These contracts have a variety of pricing structures and purchase obligations. In addition, we have another 1.3 million therms per day of firm gas supplies whereby we can purchase supplies for delivery to our system during the winter heating season. During 2011, we purchased a total of 808 million therms of gas under contracts with durations outlined in the chart below.

Contract Duration (primary term)	Percent of Purchases
Long-term (one year or longer)	29
Short-term (more than one month, less than one year)	26
Spot (one month or less)	45
Total	100

We typically renew or replace our gas supply contracts with new agreements from existing and new suppliers. Aside from the asset management of our core utility gas supplies by the independent energy marketing company (see "Gas Cost Management Strategy—Asset management," below), no individual supplier generally provides more than 10 percent of our supply requirements. In 2011, one supplier provided 11 percent of our supply requirements. Firm year-round supply contracts have remaining terms ranging from one to four years. Currently, all firm gas supply contracts use price formulas tied to monthly index prices.

In addition to our year-round contracts, we continue to contract in advance for firm gas supplies to be delivered only during the winter heating season primarily under short-term contracts. During 2011, new short-term purchase contracts were entered into with 17 suppliers, which in addition to our year- round contracts provide for a total of up to 2.0 million therms per day. We intend to enter into new purchase contracts during 2012 for roughly the same volume of gas with existing or new suppliers, as needed, to replace contracts that will expire in 2012.

We also buy gas on the spot market as needed to meet utility customer demand. We have flexibility under the terms of some firm supply contracts, to purchase spot gas in lieu of the firm contract volumes thereby allowing us to take advantage of more favorable pricing on the spot market from time to time.

We continue to purchase a small amount of gas from a non-affiliated producer in the Mist gas field in Oregon. The production area is situated near our underground gas storage facilities. Current production supplies are less than 2 percent of our total annual purchase requirements. Production from these wells varies as existing wells are depleted and new wells are drilled.

In 2011, we entered into an agreement with Encana Oil & Gas (USA) Inc. (Encana) to develop physical gas reserves that are expected to supply a portion of our utility customers' requirements over the next 30 years. The volume of gas produced and allocated to us under the agreement will increase in the early years as we continue to invest in drilling, with volumes expected to peak at