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

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

Form 10-Q

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

For the quarterly period ended March 31, 2014

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to____________
Commission file number 1-15973

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

Oregon	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

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 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 [ ] (Do not check if a Smaller Reporting Company)	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]

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

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

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

Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks, and changes in circumstances that are difficult to predict. Our actual results may differ materially from those contemplated by the forward-looking statements. We therefore caution you against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future performance. Important factors that could cause actual results to differ materially from those in the forward-looking statements are discussed in our 2013 Annual Report on Form 10-K, Part I, Item 1A. “Risk Factors” and Part II, Item 7. and Item 7A., “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures about Market Risk,” and in Part I, Items 2 and 3, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures About Market Risk,” and Part II, Item 1A, “Risk Factors,” herein.

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

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ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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

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

See Notes to Unaudited Consolidated Financial Statements.

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NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

See Notes to Unaudited Consolidated Financial Statements.

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NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

See Notes to Unaudited Consolidated Financial Statements.

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NORTHWEST NATURAL GAS COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

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

See Notes to Unaudited Consolidated Financial Statements.

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

1. ORGANIZATION AND PRINCIPLES OF CONSOLIDATION

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

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

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

Information presented in these interim unaudited consolidated financial statements is unaudited, but includes all material adjustments that management considers necessary for a fair statement of the results for each period reported including normal recurring accruals. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our 2013 Annual Report on Form 10-K (2013 Form 10-K). A significant part of our business is of a seasonal nature; therefore, results of operations for interim periods are not necessarily indicative of the results for a full year.

2. SIGNIFICANT ACCOUNTING POLICIES

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

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Regulatory Accounting

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

	Regulatory Assets		
	March 31,		December 31,
In thousands	2014	2013	2013
Current:			
Unrealized loss on derivatives[1]	$1,191	$3,450	$1,891
Other[2]	26,643	35,551	20,744
Total current	$27,834	$39,001	$22,635
Non-current:			
Unrealized loss on derivatives[1]	$96	$642	$615
Pension balancing[3]	27,328	17,322	25,713
Deferred income taxes	49,007	53,065	51,814
Pension and other postretirement benefit liabilities[3]	123,399	178,377	125,855
Environmental costs[4]	63,517	125,671	148,389
Other[2]	21,699	9,376	17,217
Total non-current	$285,046	$384,453	$369,603

	Regulatory Liabilities		
	March 31,		December 31,
In thousands	2014	2013	2013
Current:			
Gas costs	$9,137	$8,694	$7,510
Unrealized gain on derivatives[1]	15,788	8,054	5,290
Other[2]	12,761	11,491	15,535
Total current	$37,686	$28,239	$28,335
Non-current:			
Gas costs	$2,602	$1,407	$2,172
Unrealized gain on derivatives[1]	1,078	2,836	1,880
Accrued asset removal costs	299,026	285,437	296,294
Other[2]	6,152	3,455	3,139
Total non-current	$308,858	$293,135	$303,485

(1) Unrealized gains or losses on derivatives are non-cash items and, therefore, do not earn a rate of return or a carrying charge. These amounts are recoverable through utility rates as part of the annual Purchased Gas Adjustment (PGA) mechanism when realized at settlement.

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

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

(4) Environmental costs relate to specific sites approved for regulatory deferral by the Public Utility Commission of Oregon (OPUC) and Washington Utilities and Transportation Commission (WUTC). In Oregon, we earn a carrying charge on cash amounts paid, whereas amounts accrued but not yet paid do not earn a carrying charge until expended. In Washington, a carrying charge related to deferred amounts will be determined in a future proceeding. For further information on environmental matters, see Note 13.

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New Accounting Standards

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

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

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

3. EARNINGS PER SHARE

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

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

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4. SEGMENT INFORMATION

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

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

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

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Utility Margin

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

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

5. STOCK-BASED COMPENSATION

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

Long-Term Incentive Plan

Performance-Based Stock Awards

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

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

Performance-Based Restricted Stock Units (RSUs)

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

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Restated Stock Option Plan

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

6. DEBT

Short-Term Debt

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

Current Maturities of Long-Term Debt

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

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

Long-Term Debt

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

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

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

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

In thousands	March 31, 2014	2013	December 31, 2013
Carrying amount	$741,700	$691,700	$741,700

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

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

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7. PENSION AND OTHER POSTRETIREMENT BENEFIT COSTS

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

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

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

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

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

Employer Contributions to Company-Sponsored Defined Benefit Pension Plan

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

Multiemployer Pension Plan

In addition to the Company-sponsored defined benefit pension plan described above, the Company also contributed to a multiemployer pension plan for our utility's union employees known as the Western States Office and Professional Employees International Union Pension Fund (plan's EIN is 94-6076144) prior to December 2013. Effective December 22, 2013, the Company withdrew from the plan as allowed under the terms of its current collective bargaining agreement. Vested participants will receive all benefits accrued through the date of the withdrawal. As the plan was underfunded at the time of withdrawal, the Company was assessed a withdrawal liability of $8.3 million, which requires NW Natural to pay $0.6 million each year to the plan for the next 20 years. The cost of withdrawal liability was deferred to a regulatory account on the balance sheet.

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Defined Contribution Plan

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

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

8. INCOME TAX

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

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

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

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

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

9. PROPERTY, PLANT, AND EQUIPMENT

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

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

10. GAS RESERVES

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

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

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

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

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11. INVESTMENTS

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

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

12. DERIVATIVE INSTRUMENTS

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

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

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

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

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

Purchased Gas Adjustment

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

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

Unrealized and Realized Gain/Loss

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

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

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

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

Credit Risk Management of Financial Derivatives Instruments

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

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

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

Fair Value

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

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

13. ENVIRONMENTAL MATTERS

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

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

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

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

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Environmental Sites

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

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

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

	March 31,		December 31,
In thousands	2014	2013	2013
Cash paid[(1)]	$106,105	$75,620	$98,817
Total regulatory asset deferral[(2)]	63,517	125,671	148,389

[(1)] Includes $20.1 million reclassified to utility plant in 2013 associated with the water treatment station of which a portion was paid in 2012.

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

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

GASCO/SILTRONIC SEDIMENTS. In 2009, NW Natural and Siltronic Corporation entered into a separate Administrative Order on Consent with the EPA to evaluate and design specific remedies for sediments adjacent to the Gasco uplands and Siltronic uplands sites. NW Natural submitted a draft Engineering Evaluation/Cost Analysis (EE/CA) to the EPA in May 2012 to provide the estimated cost of potential remedial alternatives for this site. At this time, the estimated costs for the various sediment remedy alternatives in the draft EE/CA range from $39.4 million to $350 million. We have recorded a liability of $39.4 million for the sediment clean-up, which reflects the low end of the EE/CA range as well as costs for the additional studies and design work needed before the clean-up can occur, and for regulatory oversight throughout the clean-up. At this time, we believe sediments at this site represent the largest portion of our liability related to the Portland Harbor site, discussed above.

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

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

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

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

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

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

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

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

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

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

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Legal Proceedings

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

OREGON STEEL MILLS SITE. In 2004, NW Natural was served with a third-party complaint by the Port of Portland (the Port) in a Multnomah County Circuit Court case, Oregon Steel Mills, Inc. v. The Port of Portland. The Port alleges that in the 1940s and 1950s petroleum wastes generated by our predecessor, Portland Gas & Coke Company, and 10 other third-party defendants, were disposed of in a waste oil disposal facility operated by the United States or Shaver Transportation Company on property then owned by the Port and now owned by Oregon Steel Mills. The complaint seeks contribution for unspecified past remedial action costs incurred by the Port regarding the former waste oil disposal facility as well as a declaratory judgment allocating liability for future remedial action costs. No date has been set for trial. Although the final outcome of this proceeding cannot be predicted with certainty, we do not expect that the ultimate disposition of this matter will have a material effect on our financial condition, results of operations or cash flows.

14. SUBSEQUENT EVENTS

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

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

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

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

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

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

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EXECUTIVE SUMMARY

Key financial highlights include:

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

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

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

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

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

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

ISSUES AND CHALLENGES

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

GAS PRICES AND SUPPLIES. Our gas acquisition strategy is designed to secure sufficient supplies of natural gas to meet the needs of our utility customers and to hedge gas prices, so we can effectively manage costs, reduce price volatility, and maintain a competitive advantage. Our utility’s annual Purchased Gas Adjustment (PGA) mechanisms in Oregon and Washington, combined with our gas price hedging strategies, enable us to reduce earnings exposure for the Company and secure lower and more stable gas costs for customers. We typically hedge gas prices on 75% of our utility’s annual sales requirement based on normal weather, including both physical and financial hedges.&#