



**Northern Natural Gas Company**

**Financial Statements (Unaudited) as of and for the  
Quarterly Period Ended June 30, 2018**

**Northern Natural Gas Company**  
**Balance Sheets (Unaudited)**  
(Amounts in thousands, except share data)

	As of	
	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 20,928	\$ 21,005
Accounts receivable, net	60,014	82,748
Accounts receivable from affiliates	4,153	8,953
Notes receivable from BHE	225,000	175,000
Transportation and exchange gas receivables	18,905	14,098
Inventories	31,591	30,038
Income tax receivable	31,201	9,998
Other current assets	17,996	18,059
<b>Total current assets</b>	<b>409,788</b>	<b>359,899</b>
Property, plant and equipment, net	3,089,809	3,015,628
Regulatory assets	102,319	128,723
Other assets	46,459	45,003
<b>Total assets</b>	<b>\$ 3,648,375</b>	<b>\$ 3,549,253</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 54,273	\$ 54,779
Accounts payable to affiliates	1,020	1,401
Accrued interest	12,260	12,260
Accrued property, income and other taxes	54,954	52,030
Transportation and exchange gas payables	19,333	11,167
Derivative contracts	5,366	12,224
Current portion of long-term debt	199,990	199,871
Other current liabilities	25,803	24,614
<b>Total current liabilities</b>	<b>372,999</b>	<b>368,346</b>
Long-term debt	595,932	595,922
Regulatory liabilities	422,347	455,299
Deferred income taxes	501,017	495,073
Asset retirement obligations	32,825	32,367
Other long-term liabilities	26,004	22,208
<b>Total liabilities</b>	<b>1,951,124</b>	<b>1,969,215</b>
Commitments and contingencies (Notes 6 and 8)		
<b>Shareholder's equity:</b>		
Series A preferred stock - 1,000 shares authorized, \$0.01 par value, no shares issued and outstanding	—	—
Common stock - 10,000 shares authorized, \$1.00 par value, 1,002 shares issued and outstanding	1	1
Additional paid-in capital	981,868	981,868
Retained earnings	715,382	598,169
<b>Total shareholder's equity</b>	<b>1,697,251</b>	<b>1,580,038</b>
<b>Total liabilities and shareholder's equity</b>	<b>\$ 3,648,375</b>	<b>\$ 3,549,253</b>

The accompanying notes are an integral part of these financial statements.

**Northern Natural Gas Company**  
**Statements of Income (Unaudited)**  
(Amounts in thousands)

	<b>Six-Month Periods Ended June 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Operating revenue:</b>		
Transportation	\$ 361,714	\$ 310,367
Storage	29,159	28,556
Gas, liquids and other sales	83,980	22,597
Total operating revenue	474,853	361,520
 <b>Operating costs and expenses:</b>		
Operating and maintenance	111,324	94,849
Cost of gas and liquids sales	89,891	23,192
Depreciation and amortization	40,490	38,221
Taxes, other than income taxes	27,414	26,787
Total operating costs and expenses	269,119	183,049
 <b>Operating income</b>	205,734	178,471
 <b>Other income (expense):</b>		
Interest expense, net	(19,276)	(19,247)
Interest income	2,985	2,011
Other, net	5,202	4,759
Total other income (expense)	(11,089)	(12,477)
 <b>Income before income tax expense</b>	194,645	165,994
Income tax expense	47,432	66,048
<b>Net income</b>	\$ 147,213	\$ 99,946

The accompanying notes are an integral part of these financial statements.

**Northern Natural Gas Company**  
**Statements of Changes in Shareholder's Equity (Unaudited)**  
(Amounts in thousands)

	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Total</u>
<b>Balance, December 31, 2016</b>	\$ 1	\$ 981,868	\$ 427,549	\$ 1,409,418
Net income	—	—	99,946	99,946
<b>Balance, June 30, 2017</b>	<u>\$ 1</u>	<u>\$ 981,868</u>	<u>\$ 527,495</u>	<u>\$ 1,509,364</u>
<b>Balance, December 31, 2017</b>	\$ 1	\$ 981,868	\$ 598,169	\$ 1,580,038
Net income	—	—	147,213	147,213
Dividends on common stock	—	—	(30,000)	(30,000)
<b>Balance, June 30, 2018</b>	<u>\$ 1</u>	<u>\$ 981,868</u>	<u>\$ 715,382</u>	<u>\$ 1,697,251</u>

The accompanying notes are an integral part of these financial statements.

**Northern Natural Gas Company**  
**Statements of Cash Flows (Unaudited)**  
(Amounts in thousands)

	<b>Six-Month Periods Ended June 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 147,213	\$ 99,946
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	40,490	38,221
Amortization of debt issuance costs	261	225
Deferred income taxes	(1,097)	11,710
Other, net	1,348	1,106
Changes in other operating assets and liabilities:		
Accounts receivable and other assets	43,240	33,121
Inventories	(1,553)	729
Accounts payable and other accrued liabilities	(2,870)	1,479
Gas balancing activities	(20,447)	(7,687)
Accrued property, income and other taxes	(18,279)	39,035
Net cash flows from operating activities	<u>188,306</u>	<u>217,885</u>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(108,060)	(72,467)
Purchases of marketable securities	(9,107)	(4,867)
Proceeds from sales of marketable securities	5,517	2,370
Net cash flows from investing activities	<u>(111,650)</u>	<u>(74,964)</u>
<b>Cash flows from financing activities:</b>		
Dividends on common stock	(30,000)	—
Issuance of promissory notes by BHE	(110,000)	(175,000)
Proceeds from redemption of promissory notes from BHE	60,000	15,000
Net cash flows from financing activities	<u>(80,000)</u>	<u>(160,000)</u>
<b>Net change in cash and cash equivalents and restricted cash and cash equivalents</b>	<b>(3,344)</b>	<b>(17,079)</b>
<b>Cash and cash equivalents and restricted cash and cash equivalents at beginning of period</b>	<b>29,759</b>	<b>60,132</b>
<b>Cash and cash equivalents and restricted cash and cash equivalents at end of period</b>	<b><u>\$ 26,415</u></b>	<b><u>\$ 43,053</u></b>

The accompanying notes are an integral part of these financial statements.

**Northern Natural Gas Company**  
**Notes to Financial Statements**  
**(Unaudited)**

**(1) General**

Northern Natural Gas Company (the "Company") is an indirect wholly owned subsidiary of Berkshire Hathaway Energy Company ("BHE"), a holding company that owns locally managed businesses principally engaged in the energy industry. BHE is a consolidated subsidiary of Berkshire Hathaway Inc. ("Berkshire Hathaway"). The Company owns the largest interstate natural gas pipeline system in the United States, as measured by pipeline miles, which reaches from west Texas to Michigan's Upper Peninsula (the "System"). The Company primarily transports and stores natural gas for utilities, municipalities, gas marketing companies and industrial and commercial users. The System consists of two commercial segments. Its traditional end-use and distribution market area in the northern part of its system, referred to as the Market Area, includes points in Iowa, Nebraska, Minnesota, Wisconsin, South Dakota, Michigan and Illinois. Its natural gas supply and delivery service area in the southern part of its system, referred to as the Field Area, includes points in Kansas, Texas, Oklahoma and New Mexico. The Market Area and Field Area are separated at a Demarcation Point. The System consists of 14,700 miles of natural gas pipelines, including 6,300 miles of mainline transmission pipelines and 8,400 miles of branch and lateral pipelines, with a Market Area design capacity of 5.9 billion cubic feet ("Bcf") per day, a Field Area delivery capacity of 1.7 Bcf per day to the Market Area and 1.3 Bcf per day to the West Texas area and over 79 Bcf of firm service and operational storage cycle capacity in five storage facilities. The System is configured with approximately 2,300 active receipt and delivery points which are integrated with the facilities of local distribution companies ("LDC"). Many of the Company's LDC customers are part of combined utilities that also use natural gas as a fuel source for electric generation. The Company delivers over 1.0 trillion cubic feet of natural gas to its customers annually.

The Company has no subsidiaries and does not hold a controlling financial interest in any other entity. The unaudited Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. Accordingly, they do not include all of the disclosures required by GAAP for annual financial statements. Management believes the unaudited Financial Statements contain all adjustments (consisting only of normal recurring adjustments) considered necessary for the fair presentation of the unaudited Financial Statements as of June 30, 2018 and for the six-month periods ended June 30, 2018 and 2017. The results of operations for the six-month period ended June 30, 2018 are not necessarily indicative of the results to be expected for the full year. The Company has evaluated subsequent events through August 28, 2018, which is the date the unaudited Financial Statements were available to be issued.

The preparation of the unaudited Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the unaudited Financial Statements and the reported amounts of revenue and expenses during the period. Actual results may differ from the estimates used in preparing the unaudited Financial Statements. Note 2 of Notes to Financial Statements included in the Company's audited Financial Statements for the year ended December 31, 2017 describes the most significant accounting policies used in the preparation of the unaudited Financial Statements. There have been no significant changes in the Company's assumptions regarding significant accounting estimates and policies during the six-month period ended June 30, 2018.

## **(2) New Accounting Pronouncements**

In August 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-12, which amends FASB Accounting Standards Codification ("ASC") Topic 815, "Derivatives and Hedging." The amendments in this guidance update the hedge accounting model to enable entities to better portray the economics of their risk management activities in the financial statements, expands an entity's ability to hedge non-financial and financial risk components and reduces complexity in fair value hedges of interest rate risk. In addition, it eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in fair value of a hedging instrument to be presented in the same income statement line as the hedged item and also eases certain documentation and assessment requirements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2018 for public entities. For nonpublic entities, this guidance is effective for annual reporting periods beginning after December 15, 2019 and interim reporting periods within annual reporting periods beginning after December 15, 2020. This guidance is required to be adopted using a modified retrospective approach by means of a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption, with early adoption permitted. The Company is currently evaluating the impact of adopting this guidance on its Financial Statements and disclosures included within Notes to Financial Statements.

In February 2016, the FASB issued ASU No. 2016-02, which creates FASB ASC Topic 842, "Leases" and supersedes Topic 840 "Leases." This guidance increases transparency and comparability among entities by recording lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. A lessee should recognize in the balance sheet a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous guidance. In January 2018, the FASB issued ASU No. 2018-01 that provides for an optional transition practical expedient allowing companies to not have to evaluate existing land easements if they were not previously accounted for under ASC Topic 840, "Leases." This guidance is effective for interim and annual reporting periods beginning after December 15, 2018 for public entities. For nonpublic entities, this guidance is effective for annual reporting periods beginning after December 15, 2019 and interim reporting periods within annual reporting periods beginning after December 15, 2020. This guidance is required to be adopted using a modified retrospective approach, with early adoption permitted. The Company plans to adopt this guidance effective January 1, 2019 and is currently evaluating the impact on its Financial Statements and disclosures included within Notes to Financial Statements.

## **(3) Cash and Cash Equivalents and Restricted Cash and Cash Equivalents**

In November 2016, the FASB issued ASU No. 2016-18, which amends FASB ASC Subtopic 230-10, "Statement of Cash Flows - Overall." The amendments in this guidance require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company adopted this guidance January 1, 2018.

Cash equivalents consist of funds invested in money market mutual funds and other investments with a maturity of three months or less when purchased. Cash and cash equivalents exclude amounts where availability is restricted by legal requirements, loan agreements or other contractual provisions. Restricted cash and cash equivalents as of June 30, 2018 and December 31, 2017, consist substantially of escrow funds held to provide the Company with protection against customer credit risk. A reconciliation of cash and cash

equivalents and restricted cash and cash equivalents as of June 30, 2018 and December 31, 2017, as presented in the Statements of Cash Flows is outlined below and disaggregated by the line items in which they appear on the Balance Sheets (in thousands):

	<b>As of</b>	
	<b>June 30, 2018</b>	<b>December 31, 2017</b>
Cash and cash equivalents	\$ 20,928	\$ 21,005
Restricted cash and cash equivalents in other current assets	108	2,912
Restricted cash and cash equivalents in other assets	5,379	5,842
Total cash and cash equivalents and restricted cash and cash equivalents	<u>\$ 26,415</u>	<u>\$ 29,759</u>

#### **(4) Income Taxes**

##### *Tax Cuts and Jobs Act*

The Tax Cuts and Jobs Act ("2017 Tax Reform") impacts many areas of income tax law. The most material items include the reduction of the federal corporate tax rate from 35% to 21% effective January 1, 2018 and limitations on bonus depreciation for utility property. In March 2018, the FASB issued ASU No. 2018-05 to assist in the implementation process of 2017 Tax Reform by allowing for calculations to be classified as provisional and subject to remeasurement. There are three different classifications for the accounting: (1) completed, (2) not complete but reasonably estimable or (3) not complete and amounts are not reasonably estimable. The Company has recorded the impacts of 2017 Tax Reform and believes all the impacts to be complete with the exception of the interpretations of the bonus depreciation rules. The Company has determined the amounts recorded and the interpretations relating to bonus depreciation to be provisional and subject to remeasurement during the measurement period upon obtaining the necessary additional information to complete the accounting. The Company believes its interpretations to be reasonable, however, as the guidance is clarified estimates may change. The accounting is estimated to be completed by December 2018. Additional bonus depreciation guidance was issued by the Internal Revenue Service during August 2018 in the form of proposed regulations. The Company is currently evaluating the impact of this guidance on its Financial Statements. Refer to footnote 8 for more information.

A reconciliation of the federal statutory income tax rate to the effective income tax rate applicable to income before income tax expense is as follows:

	<b>Six-Month Periods Ended June 30,</b>	
	<b>2018</b>	<b>2017</b>
Federal statutory income tax rate	21.0%	35.0%
State income tax, net of federal tax benefit	5.8	4.8
Effects of rate making	(2.4)	—
Effective income tax rate	<u>24.4%</u>	<u>39.8%</u>

#### **(5) Employee Benefit Plans**

The Company is a participant in benefit plans sponsored by MidAmerican Energy Company ("MEC"), an indirect wholly owned subsidiary of BHE. The MidAmerican Energy Company Retirement Plan provides pension benefits for eligible employees ("pension plan") and the MidAmerican Energy Company Welfare Benefit Plan provides certain postretirement health care and life insurance benefits for eligible retirees ("other



postretirement plan") on behalf of the Company. The Company's contributions to the pension plan and other postretirement plan totaled \$0.6 million and \$0.4 million for the six-month periods ended June 30, 2018 and 2017, respectively. As of June 30, 2018, the Company recorded in other long-term liabilities its portion of the under funded status of the pension plan and in other assets its portion of the over funded status of the other postretirement plan of \$7.1 million and \$30.9 million, respectively. As of December 31, 2017, the Company recorded in other long-term liabilities its portion of the under funded status of the pension plan and in other assets its portion of the over funded status of the other postretirement plan of \$7.1 million and \$30.2 million, respectively. Amounts attributable to the Company were allocated from MEC to the Company in accordance with the intercompany administrative service agreement. Offsetting regulatory assets and liabilities have been recorded related to the amounts not yet recognized as a component of net periodic benefit costs that will be included in regulated rates.

## **(6) Risk Management and Hedging Activities**

The Company is exposed to the impact of market fluctuations in natural gas prices as supply and demand are impacted by, among many other unpredictable items, weather, market liquidity, customer usage, storage and transportation constraints. The Company does not engage in a material amount of proprietary trading activities.

The Company has established a risk management process that is designed to identify, assess, manage, mitigate, monitor and report each of the various types of risk involved in its business. To mitigate a portion of its natural gas price risk, the Company uses commodity derivative contracts generally at fixed prices to hedge natural gas for operational and preferred deferred delivery ("PDD") storage, fuel requirements and other transactions. The Company uses natural gas commodity swaps to hedge the margin on forecasted gas sales and purchases required for operational storage balancing purposes and to hedge the margin on anticipated future PDD storage contracts.

Interest rate risk exists on future debt issuances. The Company manages its interest rate risk by limiting its exposure to variable interest rates primarily through the issuance of fixed-rate long-term debt and by monitoring market changes in interest rates. Additionally, the Company may from time to time enter into interest rate derivative contracts, such as interest rate swaps or locks, to mitigate the Company's exposure to interest rate risk. The Company does not hedge all of its commodity price and interest rate risks, thereby exposing the unhedged portion to changes in market prices.

There have been no significant changes in the Company's accounting policies related to derivatives. Refer to Note 7 for additional information on derivative contracts.

The following table, which reflects master netting arrangements and excludes contracts that have been designated as normal under the normal purchases or normal sales exception afforded by GAAP, summarizes the fair value of the Company's derivative contracts not designated as hedging contracts, on a gross basis, and reconciles those amounts to the amounts presented on a net basis on the Balance Sheets (in thousands):

	<b>Derivative Liabilities</b>		<b>Total</b>
	<b>Current</b>	<b>Noncurrent</b>	
<b>As of June 30, 2018</b>			
Commodity assets <sup>(1)</sup>	\$ 54	\$ —	\$ 54
Commodity liabilities <sup>(1)</sup>	(5,420)	—	(5,420)
<b>Total derivatives - net basis<sup>(2)</sup></b>	<b>\$ (5,366)</b>	<b>\$ —</b>	<b>\$ (5,366)</b>
<b>As of December 31, 2017</b>			
Commodity assets <sup>(1)</sup>	\$ 982	\$ —	\$ 982
Commodity liabilities <sup>(1)</sup>	(13,206)	—	(13,206)
<b>Total derivatives - net basis<sup>(2)</sup></b>	<b>\$ (12,224)</b>	<b>\$ —</b>	<b>\$ (12,224)</b>

- (1) The Company's commodity derivatives not designated as hedging contracts are included in regulated rates, and as of June 30, 2018 and December 31, 2017, a regulatory asset of \$5.4 million and \$12.2 million, respectively, was recorded related to the net derivative liability of \$5.4 million and \$12.2 million, respectively.
- (2) The net notional amounts of outstanding commodity derivative contracts with fixed price terms that comprise the mark-to-market values included above are 3 million dth of sales, net and 0.4 million dth of purchases, net of natural gas, as of June 30, 2018 and December 31, 2017, respectively.

#### *Not Designated as Hedging Contracts*

The following table reconciles the beginning and ending balances of the Company's regulatory assets and summarizes the pre-tax gains and losses on open commodity derivative contracts recognized in regulatory assets, as well as amounts reclassified to earnings for the six-month periods ended June 30 (in thousands):

	<b>2018</b>	<b>2017</b>
<b>Beginning balance</b>	\$ 12,224	\$ 64,532
Changes in fair value recognized in regulatory assets	(159)	902
Net gains reclassified to operating revenue	990	191
Net losses reclassified to unamortized contract value regulatory asset	(1,712)	(1,627)
Net losses reclassified to cost of gas and liquids sales	(5,977)	(5,750)
<b>Ending balance</b>	<b>\$ 5,366</b>	<b>\$ 58,248</b>

#### *Credit Risk*

The Company is exposed to counterparty credit risk associated with wholesale energy supply and marketing activities with other utilities, energy marketing companies, financial institutions and other market participants. Credit risk may be concentrated to the extent the Company's counterparties have similar economic, industry or other characteristics and due to direct or indirect relationships among the counterparties. Before entering into a transaction, the Company analyzes the financial condition of each significant wholesale counterparty, establishes limits on the amount of unsecured credit to be extended to each counterparty and evaluates the

appropriateness of unsecured credit limits on an ongoing basis. To further mitigate wholesale counterparty credit risk, the Company enters into netting and collateral arrangements that may include margining and cross-product netting agreements and obtain third-party guarantees, letters of credit and cash deposits. If required, the Company exercises rights under these arrangements, including calling on the counterparty's credit support arrangement.

### *Collateral and Contingent Features*

In accordance with industry practice, certain derivative contracts contain credit support provisions that in part base certain collateral requirements on credit ratings for senior unsecured debt as reported by one or more of the three recognized credit rating agencies. These derivative contracts may either specifically provide bilateral rights to demand cash or other security if credit exposures on a net basis exceed specified rating-dependent threshold levels ("credit-risk-related contingent features") or provide the right for counterparties to demand "adequate assurance," or in some cases terminate the contract, in the event of a material adverse change in creditworthiness. These rights can vary by contract and by counterparty. As of June 30, 2018, the Company's credit ratings from the three recognized credit rating agencies were investment grade.

The aggregate fair value of the Company's derivative contracts in liability positions with specific credit-risk-related contingent features totaled \$5.4 million and \$13.2 million as of June 30, 2018 and December 31, 2017, respectively. If all credit-risk-related contingent features for derivative contracts in liability positions had been triggered as of June 30, 2018 and December 31, 2017, the Company would have been required to post \$5.4 million and \$12.2 million, respectively, of collateral. The Company's collateral requirements could fluctuate considerably due to market price volatility, changes in credit ratings, changes in legislation or regulation, or other factors.

## **(7) Fair Value Measurements**

The carrying value of the Company's cash, certain cash equivalents, receivables, payables and accrued liabilities approximates fair value because of the short-term maturity of these instruments. The Company has various financial assets and liabilities that are measured at fair value on the Financial Statements using inputs from the three levels of the fair value hierarchy. A financial asset or liability classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The three levels are as follows:

- Level 1 - Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2 - Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).
- Level 3 - Unobservable inputs reflect the Company's judgments about the assumptions market participants would use in pricing the asset or liability since limited market data exists. The Company develops these inputs based on the best information available, including its own data.

The following table presents the Company's assets and liabilities recognized on the Balance Sheets and measured at fair value on a recurring basis (in thousands):

	<b>Input Levels for Fair Value Measurements</b>			<b>Other<sup>(1)</sup></b>	<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>		
<b><u>As of June 30, 2018</u></b>					
<b>Assets:</b>					
Commodity derivatives	\$ —	\$ 54	\$ —	\$ (54)	\$ —
Money market mutual funds <sup>(2)</sup>	35,144	—	—	—	35,144
Investment funds	11,822	—	—	—	11,822
	<u>\$ 46,966</u>	<u>\$ 54</u>	<u>\$ —</u>	<u>\$ (54)</u>	<u>\$ 46,966</u>
<b>Liabilities - commodity derivatives</b>	<u>\$ —</u>	<u>\$ (5,420)</u>	<u>\$ —</u>	<u>\$ 54</u>	<u>\$ (5,366)</u>
<b><u>As of December 31, 2017</u></b>					
<b>Assets:</b>					
Commodity derivatives	\$ —	\$ 982	\$ —	\$ (982)	\$ —
Money market mutual funds <sup>(2)</sup>	30,876	—	—	—	30,876
Investment funds	8,298	—	—	—	8,298
	<u>\$ 39,174</u>	<u>\$ 982</u>	<u>\$ —</u>	<u>\$ (982)</u>	<u>\$ 39,174</u>
<b>Liabilities - commodity derivatives</b>	<u>\$ —</u>	<u>\$ (13,206)</u>	<u>\$ —</u>	<u>\$ 982</u>	<u>\$ (12,224)</u>

(1) Represents netting under master netting arrangements.

(2) Amounts are included in cash and cash equivalents, other current assets and other assets on the Balance Sheets. The fair value of these money market mutual funds approximates cost.

Derivative contracts are recorded on the Balance Sheets as either assets or liabilities and are stated at estimated fair value unless they are designated as normal purchases or normal sales and qualify for the exception afforded by GAAP. When available, the fair value of derivative contracts is estimated using unadjusted quoted prices for identical contracts in the market in which the Company transacts. When quoted prices for identical contracts are not available, the Company uses forward price curves. Forward price curves represent the Company's estimates of the prices at which a buyer or seller could contract today for delivery or settlement at future dates. The Company bases its forward price curves upon market price quotations, when available, or internally developed and commercial models, with internal and external fundamental data inputs. Market price quotations are obtained from independent energy brokers, exchanges, direct communication with market participants and actual transactions executed by the Company. Market price quotations for certain major natural gas and crude oil trading hubs are generally readily obtainable for the applicable term of the Company's outstanding derivative contracts; therefore, the Company's forward price curves for those locations and periods reflect observable market quotes. The estimated fair value of these derivative contracts is a function of underlying forward commodity prices, related volatility, counterparty creditworthiness and duration of contracts. Refer to Note 6 for further discussion regarding the Company's risk management and hedging activities.

The Company's investments in money market mutual funds and investment funds are stated at fair value with realized and unrealized gains and losses recognized in earnings. A readily observable quoted market price or net asset value of an identical security in an active market is used to record the fair value.

## **(8) Commitments and Contingencies**

### *Regulatory Matters*

In July 2018, the Federal Energy Regulatory Commission ("FERC") issued a final rule adopting procedures for determining which natural gas pipelines may be collecting unjust and unreasonable rates in light of the recent reduction in the federal corporate tax rate from 2017 Tax Reform. Under the final rule, all interstate natural gas pipelines must file an informational filing on Form No. 501-G in order for the FERC to evaluate each respective natural gas pipeline's rates. The Company's filing is due by October 11, 2018. The FERC also previously issued a Notice of Inquiry on the additional impacts of 2017 Tax Reform on jurisdictional rates, particularly whether, and if so how, the FERC should address changes relating to accumulated deferred income tax amounts after the federal corporate tax rate reduction and bonus depreciation rules, as well as whether other features of 2017 Tax Reform require FERC action. The Notice of Inquiry relating to accumulated deferred income taxes remains pending before the FERC and the Company is monitoring the proceeding. The Company expects the impact, if any, would be prospective. The Company also continues to monitor developments that may impact our regulatory liabilities resulting from 2017 Tax Reform.

### *Legal Matters*

The Company is party to a variety of legal actions arising out of the normal course of business. Plaintiffs occasionally seek punitive or exemplary damages. The Company does not believe that such normal and routine litigation will have a material impact on its financial results. The Company is also involved in other kinds of legal actions, some of which assert or may assert claims or seek to impose fines, penalties and other costs in substantial amounts and are described below.

The Company's storage gas migrated from its former certificated storage field boundaries near Cunningham, Kansas and was produced on leaseholds held by Nash Oil & Gas, Inc. ("Nash"), L.D. Drilling Company ("LD Drilling"), Val Energy, Inc. ("Val Energy") and Iuka-Carmi Development, LLC. In order to mitigate its losses, the Company initiated the following actions:

- In September 2009, the Company filed an application with the FERC to extend the boundaries of the Cunningham natural gas storage facility. In June 2010, FERC issued an order granting the Company certificate authority to extend the boundaries of the Cunningham natural gas storage facility by 12,320 acres. The Company either acquired leases or purchased the property on 3,696 acres, or 30% of the extension area. In July 2010, the Company filed a complaint in federal district court to acquire the remaining necessary interests by eminent domain. The federal district court issued a decision in February 2015, adopting a condemnation panel's recommended award of \$7.3 million. In July 2017, the Tenth Circuit Court of Appeals reversed the federal district court award requiring the Company to pay for the value of storage gas remaining in the extension area and rejected the appeals of the defendants for additional compensation for storage rights and wells that were converted to observation wells. The decision reduced the condemnation award by approximately \$6.0 million. In August 2017, the case was remanded to the federal district court for final disposition.
- The Company filed a lawsuit in December 2008 against Nash, LD Drilling and Val Energy in the United States District Court for the District of Kansas ("District Court") for nuisance, conversion and unjust enrichment related to the storage gas losses from the June 2010 FERC order through February 2011 after which the third-party wells in the extension area were shut-in. The conversion and unjust enrichment claims related to production of storage gas before the date of the certificate expansion order have been dismissed. In May 2016, the court issued an order lifting the stay that had

been in place since August 2011. The trial has been indefinitely postponed because of the retirement of the presiding judge. The conversion claim was voluntarily dismissed in April 2018.

- In December 2009, the Company filed a lawsuit in the 13<sup>th</sup> Judicial District, District Court, Pratt County, Kansas ("Pratt County State District Court") against ONEOK Field Services Company ("ONEOK") and Lumen Energy Corporation ("Lumen") alleging conversion based on their purchase of the storage gas from the producers. In April 2010, the Pratt County State District Court granted the defendants' motion for summary judgment, finding that the Company does not have title to storage gas that has migrated beyond adjoining property. The Company appealed the decision and in March 2013, the Kansas Supreme Court determined that the Company lost title to storage gas when it migrated and was produced beyond one mile of the storage field certificated boundaries. The case has been remanded for a determination of the Company's recovery of conversion damages from ONEOK and Lumen for storage gas produced after the June 2010 FERC order. In August 2014, the Pratt County State District Court granted the producers' motion for summary judgment, finding the Company did not have a viable conversion claim related to the gas produced after June 2, 2010. The Company appealed the decision to the Kansas Court of Appeals and the case was transferred to the Kansas Supreme Court in October 2017. Oral argument is set for September 2018. The proceeds from June 2010 through February 2011 when the wells were shut-in will continue to be held in suspense pending appeal with the Kansas Court of Appeals. The Company has valued these amounts at approximately \$4.7 million.

In December 2011, state court petitions were filed against the Company in three counties in Kansas, alleging trespass, nuisance and unjust enrichment, arising out of the migration of the Company's storage gas. The cases were moved to federal district court in Wichita, Kansas in December 2011, at the request of the Company. The case will likely remain stayed.

While it is not possible to predict with certainty the outcome of the aforementioned litigation and other contingencies, the Company believes that the ultimate resolution of these matters will not have a material adverse effect on the Company's financial results.

## **(9) Revenue from Contracts with Customers**

### *Adoption*

In May 2014, the FASB issued ASU No. 2014-09, which created FASB ASC Topic 606, "Revenue from Contracts with Customers" and superseded ASC Topic 605, "Revenue Recognition." The guidance replaced industry-specific guidance and established a single five-step model to identify and recognize revenue from contracts with customers ("Customer Revenue"). The core principle of the guidance is that an entity should recognize revenue upon transfer of control of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The Company adopted this guidance for all applicable contracts as of January 1, 2018 under a modified retrospective method and the adoption did not have a cumulative effect impact at the date of initial adoption.

### *Transportation and Storage Services*

The majority of the Company's revenue is derived from transportation and storage services provided under a FERC approved tariff. The performance obligations, which involve the transportation and storage of natural gas for customers, are satisfied over time as services are provided. Revenue recognized is equal to what the Company has the right to invoice as it corresponds directly with the value to the customer of the Company's performance to date and includes billed and unbilled amounts. As of June 30, 2018 and December 31, 2017,

unbilled revenue was \$4.2 million and \$8.1 million, respectively, and is included in accounts receivables, net on the Balance Sheets. Payments for amounts billed are generally due from the customer within 10 days of billing.

### *Gas, Liquids and Other Sales*

The majority of gas, liquids and other sales relate to natural gas sales made for operational purposes. These transactions typically have a term of one month. Rates charged are based on contractual arrangements that establish the transaction price. The performance obligation is satisfied over time and the revenue is recognized when the company has the right to invoice.

### *Revenue Disaggregation*

The Company recognizes revenue upon transfer of control of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. Revenue not considered Customer Revenue ("Other Revenue") consists of revenue recognized in accordance with ASC 815, "Derivatives and Hedging".

The following table summarizes the Company's revenue for the six-month period ended June 30, 2018 (in thousands):

Customer Revenue:	
Transportation Service	\$ 361,714
Storage service	29,159
Gas, liquids and other sales	83,190
Total Customer Revenue	<u>474,063</u>
Other Revenue	790
Total	<u><u>\$ 474,853</u></u>

### *Contract Assets and Liabilities*

In the event one of the parties to a contract has performed before the other, the Company would recognize a contract asset or contract liability depending on the relationship between the Company's performance and the customer's payment. As of June 30, 2018 and December 31, 2017, there were no contract assets or contract liabilities recorded on the Balance Sheets.

### *Remaining Performance Obligations*

The following table summarizes the Company's revenue it expects to recognize in future periods related to significant unsatisfied performance obligations for fixed contracts with expected durations in excess of one year as of June 30, 2018 (in thousands):

Less than 12 months	\$ 644,592
More than 12 months	4,459,365
Total	<u><u>\$ 5,103,957</u></u>

## **(10) Other Related Party Transactions**

The Company provided gas transportation, storage and other services to MEC totaling \$34.4 million and \$33.5 million for the six-month periods ended June 30, 2018 and 2017, respectively. MEC provides certain administrative and management services, including executive, financial, legal, human resources, payroll and tax, to the Company. Expenses incurred by MEC and billed to the Company are based on the individual services and expense items provided and were \$3.5 million and \$2.9 million for the six-month periods ended June 30, 2018 and 2017, respectively. MEC also provided electricity and other services to the Company of \$0.3 million and \$0.4 million for the six-month periods ended June 30, 2018 and 2017, respectively. The Company reimbursed MEC \$32.2 million and \$30.6 million for the six-month periods ended June 30, 2018 and 2017, respectively, for payroll, healthcare benefits and other benefit payments that MEC processed on behalf of the Company.

BHE provides certain administrative and management services, including executive, financial, legal and tax, to the Company. Expenses incurred by BHE and billed to the Company are based on the individual services and expense items provided and were \$1.5 million and \$1.1 million for the six-month periods ended June 30, 2018 and 2017, respectively. Income tax transactions with BHE resulted in net payments of \$61.4 million and \$9.3 million for the six-month periods ended June 30, 2018 and 2017, respectively.

As of June 30, 2018 and December 31, 2017, the Company had net accounts payable to BHE and certain subsidiaries for intercompany transactions totaling \$1.0 million and \$1.4 million, respectively. The Company also had accounts receivable from affiliates of \$4.2 million and \$9.0 million as of June 30, 2018 and December 31, 2017, respectively.

The Company provides certain administrative and management services, including executive, financial, regulatory, legal, information technology, human resources and procurement, to Kern River Gas Transmission Company ("Kern River"), an indirect wholly owned subsidiary of BHE. The Company billed Kern River \$0.8 million and \$1.0 million for the six-month periods ended June 30, 2018 and 2017, respectively, for these services.

The Company possesses demand promissory notes from BHE. The balance of the demand promissory notes as of June 30, 2018 and December 31, 2017 was \$225.0 million and \$175.0 million, respectively. The notes contain variable interest rates based on 30-day London Interbank Offered Rate plus a fixed spread per annum. Interest income of \$2.4 million and \$1.8 million was recorded for the six-month periods ended June 30, 2018 and 2017, respectively.

## **(11) Subsequent Events**

In July and August 2018, BHE redeemed promissory notes from the Company totaling \$225.0 million and \$30.0 million, respectively. In July 2018, BHE issued a promissory note to the Company totaling \$460.0 million.

In July 2018, the Company issued \$450.0 million of its 4.30% Senior Bonds due 2049. The Company used the net proceeds to repay at maturity all of its \$200.0 million 5.75% Senior Notes due July 2018 and for general corporate purposes.