Kern River Funding Corporation
Issuer

Kern River Gas Transmission Company
Guarantor

Financial Statements and
Independent Auditors' Report

As of and for the
Years Ended December 31, 2012 and 2011

<u>**TABLE OF CONTENTS**</u>

Kern River Gas Transmission Company

Kern River Funding Corporation

Kern River Gas Transmission Company

Financial Statements – Regulatory Basis

As of and for the Years Ended December 31, 2012 and 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's discussion and analysis of certain significant factors that have affected the financial condition and results of operations of Kern River Gas Transmission Company (the "Company") during the periods included herein. This discussion should be read in conjunction with the Company's historical Financial Statements – Regulatory Basis and the notes thereto included elsewhere in this report. The Company's actual results in the future could differ significantly from the historical results.

Forward-Looking Statements

The Company may make forward-looking statements that involve judgments, assumptions and other uncertainties beyond its control. These forward-looking statements may include, among others, statements concerning revenue and cost trends, cost recovery, cost reduction strategies and anticipated outcomes, pricing strategies, changes in the utility industry, planned capital expenditures, financing needs and availability, statements of the Company's expectations, beliefs, future plans and strategies, anticipated events or trends and similar comments concerning matters that are not historical facts. These types of forward-looking statements are based on current expectations and involve a number of known and unknown risks and uncertainties that could cause the actual results and performance of the Company to differ materially from any expected future results or performance, expressed or implied, by the forward-looking statements. Important factors that could cause actual results to differ materially from those expectations include: market-related effects on revenues and other operating uncertainties, uncertainties relating to economic and political conditions and uncertainties regarding the impact of regulations, changes in government policy and competition. The Company undertakes no obligation to update forward-looking statements, whether as a result of new information, future events or otherwise. The foregoing review of factors should not be construed as exclusive.

Results of Operations for the Years Ended December 31, 2012 and 2011

Operating revenue increased $18.5 million for 2012 compared to 2011 primarily due to the Apex Expansion project being placed in service in October 2011 and the Molycorp Mountain Pass Lateral project being placed in service in June 2012, partially offset by contract expirations with capacity sold at lower rates as a result of the step down expiration of initial contracts.

Operation and maintenance increased $4.0 million for 2012 compared to 2011 primarily due to higher pipeline maintenance costs, employee benefit costs, and a reduction in labor charged to capital projects.

Total depreciation and amortization, including regulatory debits and credits, increased $7.6 million for 2012 compared to 2011 primarily due to a favorable allowance for funds used during construction ("AFUDC") tax gross up in 2011 for the Apex Expansion project and a favorable adjustment in 2011 to the 2010 Expansion levelized depreciation.

Property and other taxes increased $1.9 million for 2012 compared to 2011 due to the Apex Expansion project.

Total income tax expense increased $0.2 million for 2012 compared to 2011 due to a deferred tax adjustment for a California income tax rate change, partially offset by lower income before income tax expense.

Allowance for other funds used during construction ("Equity AFUDC") decreased $8.0 million for 2012 compared to 2011 due to the Apex Expansion project being placed in service in October 2011.

Interest on long-term notes payable to subsidiary decreased $4.5 million for 2012 compared to 2011 due to the scheduled repayments of the principal outstanding on long-term notes payable to subsidiary.

Allowance for borrowed funds used during construction decreased $4.7 million for 2012 compared to 2011 due to the Apex Expansion project being placed in service in October 2011.

Liquidity and Capital Resources

The Company's cash flow from transportation revenue is generally adequate to meet its obligations and commitments. In addition, the Company has access to funds through a variety of sources, including commercial banks and capital markets. Although the Company believes that such sources of liquidity will be sufficient to satisfy its obligations and capital expenditure commitments for the foreseeable future, the Company's cash flow may be affected by a variety of factors, including regulatory policies, competition, market-oriented revenue price spreads, its ability to renew long-term firm gas transportation service agreements and the creditworthiness of the Company's firm transportation customers.

MidAmerican Energy Holdings Company ("MEHC") and Berkshire Hathaway Inc. ("Berkshire Hathaway") entered into an Equity Commitment Agreement (the "Berkshire Equity Commitment") pursuant to which Berkshire Hathaway has agreed to purchase up to $2.0 billion of MEHC's common equity upon any requests authorized from time to time by MEHC's Board of Directors. The proceeds of any such equity contribution shall only be used for the purpose of (a) paying when due MEHC's debt obligations and (b) funding the general corporate purposes and capital requirements of MEHC's regulated subsidiaries, including the Company. Berkshire Hathaway will have up to 180 days to fund any such request in increments of at least $250 million pursuant to one or more drawings authorized by MEHC's Board of Directors. The funding of each drawing will be made by means of a cash equity contribution to MEHC in exchange for additional shares of MEHC's common stock. The Company has no right to make or to cause MEHC to make any equity contribution requests. The Berkshire Equity Commitment expires on February 28, 2014.

The Company's cash and cash equivalents were $45.9 million as of December 31, 2012 and $30.1 million as of December 31, 2011.

Net cash flows from operating activities for the year ended December 31, 2012 was $248.6 million and for the year ended December 31, 2011 was $227.0 million. The increase was due to higher revenue collections and lower income tax payments, partially offset by higher operations and maintenance expenses and higher interest payments due to the timing of such payments.

Net cash flows from investing activities for the year ended December 31, 2012 was $(51.4) million and for the year ended December 31, 2011 was $(192.7) million. The decrease was due to lower spending on the Apex Expansion project, partially offset by higher expenditures on the Molycorp Mountain Pass Lateral project. Capital expenditures, net of salvage proceeds and excluding non-cash transactions such as Equity AFUDC, are expected to be $32.4 million for the year ended December 31, 2013. Capital expenditure needs are reviewed regularly by management and may change significantly as a result of these reviews, which may consider, among other factors, customer contracts, changes in rules and regulations, including environmental; outcomes of regulatory procedures; changes in income tax laws; general business conditions; load projections; the cost and efficiency of construction labor, equipment and materials; and the cost and availability of capital. In addition, there can be no assurance that costs related to capital expenditures will be fully recovered. The Company expects to meet its capital expenditure requirements with cash flows from operations.

Net cash flows from financing activities for the year ended December 31, 2012 was $(181.3) million and for the year ended December 31, 2011 was $(19.3) million. The change was principally due to distributions to partners in 2012 of $93.5 million, compared to contributions from partners of $55.0 million in 2011.

Deloitte.

Deloitte & Touche LLP
First National Tower
1601 Dodge Street, Ste. 3100
Omaha, NE 68102-1649
USA

Tel: +1 402 346 7788
Fax: +1 402 997 7875
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Partners of
Kern River Gas Transmission Company
Salt Lake City, Utah

We have audited the accompanying financial statements of Kern River Gas Transmission Company (the "Company"), which comprise of the balance sheets — regulatory basis as of December 31, 2012 and 2011, and the related statements of income – regulatory basis, comprehensive income – regulatory basis, changes in partners' capital – regulatory basis and cash flows – regulatory basis for the years then ended, and the related notes to the financial statements – regulatory basis.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the regulatory-basis financial statements referred to above present fairly, in all material respects, the assets, liabilities and partners' capital of Kern River Gas Transmission Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases.

Basis of Accounting

As discussed in Note 2 to the financial statements, these financial statements were prepared in accordance with the accounting requirements of the Federal Energy Regulatory Commission as set forth in its applicable Uniform System of Accounts and published accounting releases, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Deloitte & Touche LLP

April 18, 2013

KERN RIVER GAS TRANSMISSION COMPANY
BALANCE SHEETS – REGULATORY BASIS
(Amounts in thousands)

	As of December 31,	
	2012	**2011**
ASSETS		
Utility plant, net	$ 1,813,765	$ 1,852,936
Other property and investments	27,729	22,802
Current and accrued assets:		
Cash and cash equivalents	45,867	30,099
Customer accounts receivable	33,827	33,799
Other accounts receivable, net	2,005	481
Transportation and exchange gas receivables	2,084	1,555
Plant materials and operating supplies	10,152	9,900
Other current and accrued assets	4,790	881
Total current and accrued assets	98,725	76,715
Deferred debits:		
Deferred income taxes	118,913	131,544
Regulatory assets	91,989	98,312
Other deferred debits	7,846	10,721
Total assets	$ 2,158,967	$ 2,193,030
PARTNERS' CAPITAL AND LIABILITIES		
Partners' capital:		
Contributed capital	$ 893,871	$ 893,871
Retained deficit	(14,276)	(26,223)
Accumulated other comprehensive (loss) income, net	(31)	34
Total partners' capital	879,564	867,682
Long-term notes payable to subsidiary – less current portion	548,120	627,862
Other non-current liabilities:		
Provision for rate refunds	-	516
Other non-current liabilities	16	585
Total other non-current liabilities	16	1,101
Current and accrued liabilities:		
Current portion of long-term notes payable to subsidiary	79,742	87,843
Accounts payable	5,534	9,519
Customer deposits	28,337	22,554
Income taxes payable	9,752	4,384
Accrued interest	967	4,256
Accrued property and other taxes	3,312	3,795
Other current and accrued liabilities	8,241	9,190
Total current and accrued liabilities	135,885	141,541
Deferred credits:		
Deferred income taxes	484,964	470,527
Regulatory liabilities	108,016	82,970
Other deferred credits	2,402	1,347
Total liabilities	1,279,403	1,325,348
Total partners' capital and liabilities	$ 2,158,967	$ 2,193,030

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

KERN RIVER GAS TRANSMISSION COMPANY
STATEMENTS OF INCOME – REGULATORY BASIS
(Amounts in thousands)

	Years Ended December 31,	
	2012	**2011**
Operating revenue – transportation	$ 383,394	$ 364,869
Operating costs and expenses:		
Operation and maintenance	37,571	33,555
Depreciation and amortization	84,295	69,877
Regulatory debits and credits, net	32,613	39,372
Property and other taxes	17,620	15,664
Income tax expense	66,132	62,966
Total operating costs and expenses	238,231	221,434
Operating income	145,163	143,435
Other income (expense):		
Interest income	5	15
Allowance for other funds used during construction	573	8,640
Other, net	386	(120)
Income tax expense	(392)	(3,256)
Total other income (expense)	572	5,279
Interest charges:		
Interest on long-term notes payable to subsidiary	37,188	41,655
Amortization of deferred financing costs	2,814	3,143
Miscellaneous interest expense	867	955
Allowance for borrowed funds used during construction	(581)	(5,255)
Total interest charges	40,288	40,498
Net income	$ 105,447	$ 108,216

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

KERN RIVER GAS TRANSMISSION COMPANY
STATEMENTS OF COMPREHENSIVE INCOME – REGULATORY BASIS
(Amounts in thousands)

	Years Ended December 31,			
	2012		2011	
Net income	$	105,447	$	108,216
Other comprehensive (loss) income -				
Changes in fair value on cash flow hedges, net of tax of $(40) and $7		(65)		12
Comprehensive income	$	105,382	$	108,228

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

KERN RIVER GAS TRANSMISSION COMPANY
STATEMENTS OF CHANGES IN PARTNERS' CAPITAL – REGULATORY BASIS
(Amounts in thousands)

	Contributed Capital	Retained Deficit	Accumulated Other Comprehensive Income (Loss), Net	Total Partners' Capital
Balance, December 31, 2010	$ 838,871	$ (134,439)	$ 22	$ 704,454
Net income	-	108,216	-	108,216
Other comprehensive income – cash flow hedges	-	-	12	12
Contributions from partners	55,000	-	-	55,000
Balance, December 31, 2011	893,871	(26,223)	34	867,682
Net income	-	105,447	-	105,447
Other comprehensive loss – cash flow hedges	-	-	(65)	(65)
Distributions to partners	-	(93,500)	-	(93,500)
Balance, December 31, 2012	$ 893,871	$ (14,276)	$ (31)	$ 879,564

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

KERN RIVER GAS TRANSMISSION COMPANY
STATEMENTS OF CASH FLOWS – REGULATORY BASIS
(Amounts in thousands)

	Years Ended December 31, 2012	Years Ended December 31, 2011
Cash flows from operating activities:		
Net income	$ 105,447	$ 108,216
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and depletion	84,295	69,877
Amortization	37,905	49,963
Allowance for other funds used during construction	(573)	(8,640)
Deferred income taxes, net	24,756	15,867
Receivables	245	(942)
Plant materials and operating supplies	(723)	(1,095)
Payables and accrued expenses	1,405	2,110
Other regulatory assets	(2,595)	(7,342)
Other regulatory liabilities	(25)	(46)
Provision for rate refunds	(516)	516
Other, net	(1,069)	(1,529)
Net cash flows from operating activities	248,552	226,955
Cash flows from investing activities:		
Capital expenditures	(50,155)	(192,705)
Increase in restricted cash	(1,286)	-
Net cash flows from investing activities	(51,441)	(192,705)
Cash flows from financing activities:		
Repayments of long-term notes payable to subsidiary	(87,843)	(74,329)
Distributions to partners	(93,500)	-
Contributions from partners	-	55,000
Net cash flows from financing activities	(181,343)	(19,329)
Net change in cash and cash equivalents	15,768	14,921
Cash and cash equivalents at beginning of period	30,099	15,178
Cash and cash equivalents at end of period	$ 45,867	$ 30,099
Supplemental disclosures:		
Interest paid, net of amounts capitalized	$ 39,907	$ 33,828
Income taxes paid	$ 36,400	$ 47,160
Non-cash investing transactions -		
Accruals related to utility plant additions	$ 7,786	$ 13,446

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

KERN RIVER GAS TRANSMISSION COMPANY
NOTES TO FINANCIAL STATEMENTS – REGULATORY BASIS

(1) Organization and Operations

Kern River Gas Transmission Company (the "Company") is an indirect wholly owned subsidiary of MidAmerican Energy Holdings Company ("MEHC"), a holding company that owns subsidiaries principally engaged in the energy business. MEHC is a consolidated subsidiary of Berkshire Hathaway Inc. ("Berkshire Hathaway"). The Company owns an interstate natural gas pipeline system that extends from supply areas in the Rocky Mountains to consuming markets in Utah, Nevada and California. The Company's pipeline system consists of 1,700 miles of natural gas pipelines, including 1,400 miles of mainline section and 300 miles of common facilities, with a design capacity of 2,166,575 decatherms ("Dth") per day. The Company owns the entire mainline section, which extends from the system's point of origination near Opal, Wyoming, through the Central Rocky Mountains area into Daggett, California. The mainline section consists of 1,300 miles of 36-inch diameter pipeline and 100 miles of various laterals that connect to the mainline. The common facilities are jointly owned by the Company and Mojave Pipeline Company ("Mojave") as tenants-in-common, and ownership may increase or decrease pursuant to the capital contributions made by each respective joint owner. The Company has exclusive rights to 1,613,392 Dth per day of the common facilities' capacity, and Mojave has exclusive rights to 414,001 Dth per day of capacity. Operation and maintenance of the common facilities are the responsibility of Mojave Pipeline Operating Company ("Mojave Pipeline Operating"), an affiliate of Mojave. The Company reimburses Mojave for its share of the pipeline expenses. The common facilities and associated operating costs are included in the Financial Statements – Regulatory Basis on a prorated basis. Except for quantities of natural gas owned for operational purposes, the Company does not own the natural gas that is transported through its system. The Company's transportation operations are subject to a regulated tariff that is on file with the Federal Energy Regulatory Commission ("FERC"). The tariff rates are designed to provide the Company with an opportunity to recover its costs of providing services and earn a reasonable return on its investments. The Company also owns Kern River Funding Corporation ("Funding") which is an entity organized to issue and make payments on debt securities for the Company.

(2) Summary of Significant Accounting Policies

Basis of Presentation

The Financial Statements – Regulatory Basis have been prepared based upon the accounting regulations of the FERC pursuant to the Code of Federal Regulations, Title 18, Part 201, Uniform System of Accounts ("FERC accounting regulations"). Therefore, the Financial Statements – Regulatory Basis contain certain differences from general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), including the recognition of income taxes and certain regulatory assets for levelized depreciation and financial statement classifications such as deferred income taxes, income tax expense and accumulated negative salvage.

The Financial Statements – Regulatory Basis present the Company's stand-alone information. In accordance with FERC accounting regulations, the Company's 100% ownership of Funding is accounted for by the equity method. The Company's investment in Funding is included in other deferred debits on the Balance Sheets – Regulatory Basis.

The Company has evaluated subsequent events through April 18, 2013, which is the date the Financial Statements – Regulatory Basis were available to be issued.

Use of Estimates in Preparation of Financial Statements

The preparation of the Financial Statements – Regulatory Basis in conformity with FERC accounting regulations requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the Financial Statements – Regulatory Basis and the reported amounts of revenue and expenses during the period. These estimates include, but are not limited to, the effects of regulation; income taxes; long-lived asset recovery; and accounting for contingencies. Actual results may differ from the estimates used in preparing the Financial Statements – Regulatory Basis.

Accounting for the Effects of Certain Types of Regulation

The Company prepares its Financial Statements in accordance with authoritative guidance for regulated operations, which recognizes the economic effects of regulation. Accordingly, the Company is required to defer the recognition of certain costs or income if it is probable that, through the ratemaking process, there will be a corresponding increase or decrease in future regulated rates. Regulatory assets and liabilities are established to reflect the impacts of these deferrals and are recognized in earnings as they are recovered in regulated rates.

The Company's rates for transportation service are primarily derived on the basis of a levelized cost-of-service. In the FERC orders certificating the Company's original system and subsequent expansions, the FERC approved depreciation expense schedules designed to maintain a constant total cost-of-service over the initial contract terms ("Period One") or the period eligible customers elect to take service upon the expiration of the Period One contracts ("Period Two"). Rather than recovering plant costs through the depreciation allowance in rates on a straight-line basis, the Company's annual depreciation recovery in rates increases as the return on equity, interest expense and income taxes decrease, to obtain a constant or level cost-of-service. Because application of a straight-line depreciation rate to the Company's plant investment would result in substantial depreciation expense in the Company's early years of service, the effect of levelization has been to transfer some portion of the Company's cost recovery from the early years to the later years of the customers' initial contract terms. The cumulative difference between the composite or straight-line method described above and the plant cost recovered through levelized depreciation is recorded as a regulatory asset or liability to be recovered or returned in future years. Refer to Note 4 of Notes to Financial Statements – Regulatory Basis for additional information regarding regulatory matters and the Company's levelized rates.

The Company continually evaluates the applicability of the guidance for regulated operations and whether its regulatory assets and liabilities are probable of inclusion in future regulated rates by considering factors such as a change in the regulator's approach to setting regulated rates from cost-based ratemaking to another form of regulation, other regulatory actions or the impact of competition that could limit the Company's ability to recover its costs. The Company believes the application of the guidance for regulated operations is appropriate and its existing regulatory assets and liabilities are probable of inclusion in future regulated rates. The evaluation reflects the current political and regulatory climate at the federal level. If it becomes no longer probable that the deferred costs or income will be included in future regulated rates, the related regulatory assets and liabilities will be written-off to net income, returned to customers, or re-established as accumulated other comprehensive (loss) income ("AOCI").

Cash Equivalents and Restricted Cash

Cash equivalents consist of funds invested in money market 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 amounts are included in other property and investments and other current and accrued assets on the Balance Sheets – Regulatory Basis.

Allowance for Doubtful Accounts

Receivables are stated at the outstanding principal amount, net of an estimated allowance for doubtful accounts. The allowance for doubtful accounts is based on the Company's assessment of the collectability of amounts owed to the Company by its customers. This assessment requires judgment regarding the ability of customers to pay or the outcome of any pending disputes. As of December 31, 2012 and 2011, there was no significant allowance for doubtful accounts.

Transportation Imbalances

Shippers schedule their volumes into the Company's system with subsequent deliveries to various markets. Imbalance receivables from and payables to shippers are created when receipts to the system from shippers vary from deliveries off the system, excluding quantities retained by the pipeline for fuel. Receipts and deliveries from third parties in connection with balancing and other natural gas service contracts also result in imbalances. Temporary encroachments on line pack due to transportation imbalances are valued at current market prices and recorded as transportation and exchange gas receivables and other current and accrued liabilities on the Balance Sheets – Regulatory Basis with offsetting entries to operation and maintenance on the Statements of Income – Regulatory Basis. Settlement of imbalances occurs in accordance with the contractual terms of the agreements and timing of delivery of natural gas based on operational conditions.

Plant Materials and Supplies

Plant materials and supplies consist mainly of replacement parts used in the periodic overhaul of gas compressor units and materials for construction, operation and maintenance and are stated at average cost, except for compressor engines which are stated at historical cost.

Utility Plant, Net

General

Additions to utility plant are recorded at cost. The Company capitalizes all construction related material, direct labor and contract services, as well as indirect construction costs, which include debt and equity allowance for funds used during construction ("AFUDC") on rate base assets. The cost of additions and betterments are capitalized, while costs incurred that do not improve or extend the useful lives of the related assets are generally expensed. The Company is permitted to earn a return on the cost of its rate base assets as well as recover these costs through depreciation expense over the useful lives of the assets.

Depreciation and amortization are generally computed by applying the composite or straight-line method based on either estimated useful lives or mandated recovery periods as prescribed by the FERC. Under the composite method when utility plant is retired, the original cost of the property retired is charged to accumulated depreciation and amortization, net of salvage and removal costs. For general plant, the original cost of the property retired is charged to accumulated depreciation and amortization at the end of the depreciable lives of the asset vintages. Retirement gains or losses are not included in income except in the case of sales of operating units.

The Company capitalizes AFUDC, which represents the cost of debt and equity funds necessary to finance the construction of regulated facilities, as a component of utility plant, with offsetting credits to the Statements of Income – Regulatory Basis. AFUDC is computed based on guidelines set forth by the FERC.

Line Pack Gas

Line pack gas is accounted for utilizing the fixed asset accounting method as prescribed by the FERC. Under this approach, line pack gas volumes are classified as utility plant, net and valued at cost. In addition, line pack is classified as either recoverable or non-recoverable. Non-recoverable line pack is depreciated while recoverable line pack is not depreciated.

Asset Retirement Obligations

The Company recognizes asset retirement obligations ("ARO") when it has a legal obligation to remove or abandon-in-place an asset upon retirement. The Company's AROs are primarily related to the retirement of long-lived assets that result from the acquisition, construction, development or normal use of assets. The fair value of an ARO liability is recognized in the period in which it is incurred, if a reasonable estimate of fair value can be made, and is added to the carrying amount of the associated asset, which is then depreciated over the remaining useful life of the asset. The Company has concluded that it is legally obligated to remove, or abandon-in-place, its pipeline and related equipment upon the final retirement of the pipeline. While interim removal or abandonment-in-place and replacement of such equipment is probable, the final retirement dates of these assets are not determinable, and therefore, the liabilities for their removal cannot be reasonably estimated.

Negative Salvage

Negative salvage is the amount recovered in transportation rates for the estimated removal cost after salvage proceeds at the time the asset is removed from service. The Company recognizes a negative salvage reserve for final abandonment and removal of its gas transmission system in accumulated depreciation and amortization and, as of December 31, 2012 and 2011, the balance of this reserve was $22.3 million and $19.2 million, respectively. The annual negative salvage allowance, which is 0.12% of transmission plant and is reflected in depreciation and amortization on the Statements of Income – Regulatory Basis, was $3.1 million and $2.8 million for the years ended December 31, 2012 and 2011, respectively.

Impairment

The Company evaluates long-lived assets for impairment, including utility plant, when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable or the assets are being held for sale. Upon the occurrence of a triggering event, the asset is reviewed to assess whether the estimated undiscounted cash flows expected from the use of the asset plus the residual value from the ultimate disposal exceeds the carrying value of the asset. If the carrying value exceeds the estimated recoverable amounts, the asset is written down to the estimated fair value. The impacts of regulation are considered when evaluating the carrying value of regulated assets. For all other assets, any resulting impairment loss is reflected on the Statements of Income – Regulatory Basis. There were no impairments for the years ended December 31, 2012 and 2011.

Revenue Recognition

Revenue from customers is recognized as natural gas is delivered or services are provided. The majority of the Company's transportation revenue is derived from fixed reservation charges based on contractual quantities and regulated rates. The remaining revenue is market-oriented, which is based on market-indexed, discounted or negotiated rates, and commodity charges. The rates are applied to scheduled quantities. Differences between scheduled quantities and actual measured quantities are reflected on transportation or balancing agreements the following month and are not material.

The Company is subject to FERC regulations and, accordingly, certain revenue collected may be subject to refund upon final FERC orders in pending regulated rate proceedings. The Company may record revenue that is subject to refund based on its best estimates of the final outcomes of such proceedings and other third party regulatory proceedings, advice of counsel and estimated total exposure, as well as collection and other risks. Estimates of any refunds are included as provision for rate refunds on the Balance Sheets – Regulatory Basis.

Unamortized Financing Costs

Financing costs incurred for the issuance of long-term debt are included as a component of approved rates and are amortized over the term of the related financing based on the percentage of debt principal retired each year, as prescribed by the FERC. The unamortized balance of debt issuance costs as of December 31, 2012 and 2011 was $7.5 million and $10.3 million, respectively, and is included in other deferred debits on the Balance Sheets – Regulatory Basis.

Income Taxes

Berkshire Hathaway includes MEHC and its subsidiaries in its United States federal income tax return. Consistent with established regulatory practice, the Company's provision for income taxes has been computed for each of the shipper groups comprising the Company as if each were a distinct entity not included as a member of a consolidated tax return. Substantially all of the Company's respective currently payable or receivable income taxes are remitted to or received from MEHC.

Deferred income tax assets and liabilities are based on differences between the financial statement and income tax basis of assets and liabilities by shipper group using estimated income tax rates expected to be in effect for the year in which the differences are expected to reverse. Changes in deferred income tax assets and liabilities that are associated with the components of other comprehensive income are charged or credited directly to other comprehensive income. Other changes in deferred income tax assets and liabilities are included as a component of income tax expense. Valuation allowances are established for certain deferred income tax assets where realization is not likely.

In determining the Company's income taxes, management is required to interpret complex income tax laws and regulations. The Company's income tax returns are subject to continuous examinations by federal, state and local income tax authorities that may give rise to different interpretations of these complex laws and regulations. Due to the nature of the examination process, it generally takes years before these examinations are completed and these matters are resolved. The Company recognizes the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the Financial Statements – Regulatory Basis from such a position are measured based on the largest benefit that is more-likely-than-not of being realized upon ultimate settlement. Although the ultimate resolution of the Company's federal, state and local income tax examinations is uncertain, the Company believes it has made adequate provisions for these income tax positions. The aggregate amount of any additional income tax liabilities that may result from these examinations, if any, is not expected to have a material adverse impact on the Company's financial results. The Company's unrecognized tax benefits are included in income taxes payable on the Balance Sheets – Regulatory Basis. Estimated interest and penalties, if any, related to uncertain tax positions are included as miscellaneous interest expense on the Statements of Income – Regulatory Basis.

New Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-02, which amends FASB Accounting Standards Codification ("ASC") Topic 220, "Comprehensive Income". The amendments in this guidance require an entity to provide information about the amounts reclassified out of AOCI by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required by GAAP that provide additional detail about those amounts. This guidance is effective prospectively for annual reporting periods beginning after December 15, 2013. The Company is currently evaluating the impact of adopting this guidance on its Financial Statements and disclosures included within Notes to Financial Statements – Regulatory Basis.

In June 2011, the FASB issued ASU No. 2011-05, which amends FASB ASC Topic 220, "Comprehensive Income." ASU No. 2011-05 provides an entity with the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Regardless of the option chosen, this guidance also requires presentation of items on the face of the financial statements that are reclassified from other comprehensive income to net income. This guidance does not change the items that must be reported in other comprehensive income, when an item of other comprehensive income must be reclassified to net income or how tax effects of each item of other comprehensive income are presented. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011. In December 2011, the FASB issued ASU No. 2011-12, which also amends FASB ASC Topic 220 to defer indefinitely the ASU No. 2011-05 requirement to present items on the face of the financial statements that are reclassified from other comprehensive income to net income. ASU No. 2011-12 is also effective for interim and annual reporting periods beginning after December 15, 2011. The Company adopted this guidance on January 1, 2012 and elected the two separate but consecutive statements option.

In May 2011, the FASB issued ASU No. 2011-04, which amends FASB ASC Topic 820, "Fair Value Measurements and Disclosures." The amendments in this guidance are not intended to result in a change in current accounting. ASU No. 2011-04 requires additional disclosures relating to fair value measurements categorized within Level 3 of the fair value hierarchy, including quantitative information about unobservable inputs, the valuation process used by the entity and the sensitivity of unobservable input measurements. Additionally, entities are required to disclose the level of the fair value hierarchy for assets and liabilities that are not measured at fair value in the balance sheet, but for which disclosure of the fair value is required. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011. The Company adopted ASU No. 2011-04 on January 1, 2012. The adoption of this guidance did not have a material impact on the Company's disclosures included within Notes to Financial Statements – Regulatory Basis.

(3) Utility Plant, Net

Utility plant, net consists of the following as of December 31 (in thousands):

	Depreciation Rates	2012	2011
Transmission plant – Original and 2002 Expansion (“Rolled-in”) system[1]	1.95%	$ 1,091,519	$ 1,065,815
Transmission plant – 2003 and 2010 Expansion (“Incremental”) system[1]	3.00%	1,205,151	1,209,944
Transmission plant – Apex Expansion system[1]	3.00%	278,238	295,745
Transmission plant – other	4.76% to 6.67%	52,596	32,922
Compressor engines	9.92%	132,160	108,333
Intangible plant[2]	1.95% to 20.00%	25,650	26,417
General plant	4.00% to 33.33%	11,827	10,217
Total operating assets		2,797,141	2,749,393
Accumulated depreciation and amortization		(984,021)	(910,117)
Net operating assets		1,813,120	1,839,276
Construction work-in-progress		645	13,660
Utility plant, net		$ 1,813,765	$ 1,852,936

(1) Includes recoverable line pack gas of $3.6 million, $7.3 million and $0.4 million for the Rolled-in, Incremental and Apex Expansion systems, respectively, as of December 31, 2012 and $3.6 million, $7.3 million and $0.3 million for the Rolled-in, Incremental and Apex Expansion systems, respectively, as of December 31, 2011. Recoverable line pack gas is not depreciated.

(2) Includes costs for capitalized software development, contributions in aid of construction, and leasehold improvements.

The Company had gross costs for capitalized right of use or right of way of $72.0 million and $60.9 million and accumulated amortization of $26.5 million and $24.8 million as of December 31, 2012 and 2011, respectively, which is reflected in utility plant, net on the Balance Sheets - Regulatory Basis. Capitalized right of use or right of way costs are amortized at rates ranging from 1.95% to 6.67%.

For the years ended December 31, 2012 and 2011, depreciation expense of $81.3 million and $68.1 million, respectively, and amortization expense of $3.0 million and $1.8 million, respectively, were included in depreciation and amortization on the Statements of Income - Regulatory Basis. The Company expects amortization expense to be $2.3 million for each of 2013 and 2014, $2.0 million for 2015, and $1.6 million for each of 2016 and 2017.

(4) Regulatory Matters

Regulatory assets represent costs that are expected to be recovered in future regulated rates. The Company’s regulatory assets reflected on the Balance Sheets – Regulatory Basis consist of the following as of December 31 (in thousands):

	Weighted Average Remaining Life	2012	2011
Levelized depreciation on utility plant[1]	27 years	$ 57,806	$ 64,993
Deferred income taxes associated with equity AFUDC	27 years	27,812	28,683
Other	Various	6,371	4,636
Total		$ 91,989	$ 98,312

(1) Levelized depreciation on utility plant is in a net asset position for the Rolled-in, Apex Expansion and High Desert systems.

The Company had regulatory assets not earning a return on investment of $5.7 million and $3.9 million as of December 31, 2012 and 2011, respectively.

Regulatory liabilities represent income to be recognized or amounts to be returned to eligible customers in future periods. The Company's regulatory liabilities reflected on the Balance Sheets – Regulatory Basis consists of the following as of December 31 (in thousands):

	Weighted Average Remaining Life	2012	2011
Levelized depreciation on utility plant[1]	27 years	$ 105,483	$ 81,024
Other	Various	2,533	1,946
Total		$ 108,016	$ 82,970

(1) Levelized depreciation on utility plant is in a net liability position for the Incremental system.

In December 2009, the FERC issued an order establishing revised rates for Period One and required that rates be established based on a levelized rate design for Period Two. The FERC set all other issues related to Period Two for hearing. In November 2010, the FERC issued an order that denied all requests for rehearing related to Period One from the FERC's December 2009 order and established that the Company is entitled to base its Period Two rates on a 100% equity capital structure.

In July 2011, the FERC issued an order requiring, among other things, that Period Two rates be based on a return on equity of 11.55% and a levelization period that coincides with a contract length of 10 or 15 years. The FERC also determined that capital expenditures associated with compressor engines and general plant replacements can be recovered in a future rate case and cannot be incorporated into Period Two rates at this time. The Company, as well as others, requested rehearing and clarification of the FERC's July 2011 order. The Company filed in compliance with the FERC's order in August 2011 and, following an order on compliance, again in September 2011. In late September 2011, the FERC issued a second order on compliance, accepting the Company's filing. In February 2013, the FERC issued an order that denied the requests for rehearing regarding its previous orders on Period Two. In March 2013, the Company requested clarification, or in the alternative a rehearing, on recovery of plant replacements.

(5) Fair Value Measurements

The carrying value of cash, certain cash equivalents, receivables, payables and accrued liabilities approximates fair value because of the short-term maturity of these instruments. The Company uses a three level hierarchy for determining fair value and 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 Company has investments in money market mutual funds that are accounted for as available for sale securities, are stated at fair value and are included in cash and cash equivalents and other property and investments on the Balance Sheets – Regulatory Basis. The fair value of the Company's money market mutual funds, which approximates cost, was $67.3 million and $21.9 million as of December 31, 2012 and 2011, respectively. The Company considers these money market mutual funds to be valued using Level 1 inputs, which are determined by using, when available, a readily observable quoted market price or net asset value of an identical security in an active market.

The Company's long-term notes payable to subsidiary is carried at cost on the Balance Sheets – Regulatory Basis. The fair value of the Company's long-term notes payable to subsidiary is a Level 2 fair value measurement and has been estimated based upon quoted market prices. The following table presents the carrying value and estimated fair value of the Company's long-term notes payable to subsidiary as of December 31 (in thousands):

	2012		2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term notes payable to subsidiary	$ 627,862	$ 712,920	$ 715,705	$ 822,180

(6) Long-Term Notes Payable to Subsidiary

The Company's long-term notes payable to subsidiary, which amortize monthly, consist of the following as of December 31 (in thousands):

	2012	2011
6.676% Senior Notes, due 2016	$ 227,000	$ 257,333
4.893% Senior Notes, due 2018	400,862	458,372
Total long-term notes payable to subsidiary	627,862	715,705
Less - current portion	(79,742)	(87,843)
Long-term portion	$ 548,120	$ 627,862

The Company provides a debt service reserve letter of credit in amounts that approximate the next six months of principal and interest payments due on the loans, which were equal to $59.0 million and $62.0 million as of December 31, 2012 and 2011, respectively.

The annual repayments of the Company's long-term notes payable to subsidiary for the years beginning January 1, 2013 and thereafter are as follows (in thousands):

2013	$ 79,742
2014	81,414
2015	85,340
2016	190,340
2017	61,864
2018	129,162
Total	$ 627,862

Both the 6.676% Senior Notes and the 4.893% Senior Notes are secured equally and ratably by a collateral assignment of the long-term gas transportation agreements of the Company.

The terms of Funding's debt indentures to which the Company is guarantor preclude the issuance of mortgage bonds by Funding and the Company. The indentures contain provisions for the acceleration of repayment under certain conditions. The indentures also contain restrictions which, under certain circumstances, limit Funding and the Company's ability to issue additional debt, pay cash distributions, and dispose of a major portion of the Company's natural gas pipeline system. As of December 31, 2012 and 2011, Funding is in compliance with all debt covenants.

(7) Income Taxes

Income tax expense consists of the following for the years ended December 31 (in thousands):

	2012	2011
Current:		
Federal	$ 35,923	$ 43,939
State	5,845	6,416
	41,768	50,355
Deferred:		
Federal	18,771	14,490
State	5,985	1,377
	24,756	15,867
Total	$ 66,524	$ 66,222

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 for the years ended December 31:

	2012	2011
Federal statutory income tax rate	35.0%	35.0%
State income tax, net of federal income tax benefit	4.5	2.9
Other, net	(0.8)	0.1
Effective income tax rate	38.7%	38.0%

The net deferred income tax liability consists of the following as of December 31 (in thousands):

	2012	2011
Deferred income tax assets:		
Federal and state carryforwards	$ 70,565	$ 92,815
Regulatory liabilities	41,470	31,629
Unamortized deferred debt costs	3,499	3,818
Contribution in aid of construction	3,067	2,461
Other	312	821
Total deferred income tax assets	118,913	131,544
Deferred income tax liabilities:		
Utility plant, net	(460,346)	(448,300)
Regulatory assets	(23,576)	(21,528)
Other	(1,042)	(699)
Total deferred income tax liabilities	(484,964)	(470,527)
Net deferred income tax liability	$ (366,051)	$ (338,983)

As of December 31, 2012, the Company has federal and state carryforwards for net operating losses totaling $70.6 million, which expire between 2026 and 2032. The Company does not consider a valuation allowance on these amounts necessary, as they are expected to be utilized prior to their expiration.

The United States Internal Revenue Service has closed examinations of MEHC's income tax returns through February 2006, including components related to the Company. In addition, state jurisdictions have closed examination of MEHC's income tax returns through at least February 9, 2006.

(8) Employee Benefit Plans

The Company participates in benefit plans sponsored by MidAmerican Energy Company ("MEC"), an indirect wholly owned subsidiary of MEHC. 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. Employees hired on or after January 1, 2008 for the pension plan or after June 30, 2004 for the other postretirement plan are not eligible to participate. Benefit obligations under the pension plan are based on a cash balance arrangement for salaried employees. Under the other postretirement plan, certain employees may become eligible for these benefits if they reach retirement age while working for the Company. Effective January 1, 2012, MEC changed the medical benefits for all Medicare-eligible participants in its other postretirement benefit plan. Medicare-eligible participants now enroll in individual medical plans, rather than company-sponsored plans, under which MEC contributes fixed amounts to the participant's health reimbursement account. Benefit obligations under the pension plan and other postretirement plans are determined for the Company's employees by an independent actuary.

Net Periodic Benefit Cost

For purposes of calculating the expected return on pension plan assets, a market-related value is used. The market-related value of plan assets is calculated by spreading the difference between expected and actual investment returns on equity investments over a five-year period beginning after the first year in which they occur.

Net periodic benefit cost for the plans of MEC and its participating affiliates included the following components for the years ended December 31 (in millions):

	Pension		Other Postretirement	
	2012	2011	2012	2011
Service cost	$ 18	$ 18	$ 4	$ 4
Interest cost	37	39	8	10
Expected return on plan assets	(45)	(43)	(13)	(13)
Net amortization	4	-	(3)	(2)
Net periodic benefit cost (benefit)	$ 14	$ 14	$ (4)	$ (1)

The Company's share of pension cost totaled $0.5 million and $0.7 million for the years ended December 31, 2012 and 2011, respectively. The Company's share of other postretirement cost totaled $- million and $0.1 million for the years ended December 31, 2012 and 2011, respectively.

Funded Status

The following table is a reconciliation of the fair value of plan assets for MEC and its participating affiliates for the years ended December 31 (in millions):

	Pension		Other Postretirement	
	2012	2011	2012	2011
Plan assets at fair value, beginning of year	$ 555	$ 546	$ 213	$ 216
Employer contributions	65	55	1	2
Participant contributions	-	-	2	7
Actual return on plan assets	74	-	25	4
Benefits paid	(51)	(46)	(15)	(16)
Plan assets at fair value, end of year	$ 643	$ 555	$ 226	$ 213

The Company's contributions to the pension plan and the other postretirement plan totaled $1.0 million and $1.1 million for the years ended December 31, 2012 and 2011, respectively. As of December 31, 2012 and 2011, the fair value of plan assets attributable to the Company in the pension plan was $12.3 million and $11.2 million, respectively, and the other postretirement plan was $6.2 million and $5.3 million, respectively. Amounts attributable to the Company were allocated from MEC to the Company in accordance with the intercompany administrative service agreement.

The following table is a reconciliation of the benefit obligations for MEC and its participating affiliates for the years ended December 31 (in millions):

	Pension		Other Postretirement	
	2012	2011	2012	2011
Benefit obligation, beginning of year	$ 799	$ 738	$ 198	$ 189
Service cost	18	18	4	4
Interest cost	37	39	8	10
Participant contributions	-	-	2	7
Plan amendments	-	-	-	(18)
Actuarial loss	43	50	16	22
Benefits paid	(51)	(46)	(15)	(16)
Benefit obligation, end of year	$ 846	$ 799	$ 213	$ 198
Accumulated benefit obligation, end of year	$ 821	$ 771		

MEC paid benefits from the plans to the Company's participants totaling $1.0 million for each of the years ended December 31, 2012 and 2011. As of December 31, 2012 and 2011, the benefit obligation attributable to the Company for the pension plan was $12.0 million and $11.8 million, respectively, and for the other postretirement plan was $5.0 million and $4.4 million, respectively.

The funded status of the plans for MEC and its participating affiliates as of December 31 is as follows (in millions):

	Pension		Other Postretirement	
	2012	2011	2012	2011
Plan assets at fair value, end of year	$ 643	$ 555	$ 226	$ 213
Less - Benefit obligation, end of year	846	799	213	198
Funded status	$ (203)	$ (244)	$ 13	$ 15

As of December 31, 2012, the Company recorded an affiliate company receivable included in other property and investments relating to the over funded status of the pension and other postretirement plans of $1.5 million. As of December 31, 2011, the Company recorded an affiliate company payable included in other non-current liabilities relating to the under funded status of the pension plan of $0.6 million and an affiliate company receivable included in other property and investments relating to the over funded status of the other postretirement plan of $0.9 million. 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.

Unrecognized Amounts

The portion of the funded status of the plans for MEC and its participating affiliates not yet recognized in net periodic benefit cost as of December 31 is as follows (in millions):

	Pension		Other Postretirement	
	2012	2011	2012	2011
Net loss	$ 121	$ 111	$ 51	$ 48
Prior service cost (credit)	4	4	(53)	(58)
Total	$ 125	$ 115	$ (2)	$ (10)

A reconciliation of the amounts not yet recognized as components of net periodic benefit cost for MEC and its participating affiliates for the years ended December 31, 2012 and 2011 is as follows (in millions):

	Regulatory Asset	Regulatory Liability	Receivables (Payables) with Affiliates	Total
Pension				
Balance, December 31, 2010	$ 14	$ (1)	$ 9	$ 22
Net gain arising during the year	85	1	7	93
Balance, December 31, 2011	99	-	16	115
Net loss arising during the year	14	-	-	14
Net amortization	(3)	-	(1)	(4)
Total	11	-	(1)	10
Balance, December 31, 2012	$ 110	$ -	$ 15	$ 125

	Regulatory Asset	Regulatory Liability	Receivables (Payables) with Affiliates	Total
Other Postretirement				
Balance, December 31, 2010	$ -	$ (8)	$ (14)	$ (22)
Net loss arising during the year	16	8	5	29
Prior service credit arising during the year	(15)	-	(4)	(19)
Net amortization	1	-	1	2
Total	2	8	2	12
Balance, December 31, 2011	2	-	(12)	(10)
Net loss (gain) arising during the year	6	-	(2)	4
Net amortization	3	-	1	4
Total	9	-	(1)	8
Balance, December 31, 2012	$ 11	$ -	$ (13)	$ (2)

The net loss and prior service cost (credit) for MEC and its participating affiliates that will be amortized in 2013 into net periodic benefit cost are estimated to be as follows (in millions):

	Net Loss	Prior Service Cost (Credit)	Total
Pension	$ 10	$ 1	$ 11
Other postretirement	3	(6)	(3)
Total	$ 13	$ (5)	$ 8

The net loss and prior service cost amounts expected to be recognized by the Company for the year ended December 31, 2013 for the pension plan and the other postretirement plan are a credit of $0.1 million.

Plan Assumptions

Assumptions used to determine benefit obligations and net periodic benefit cost for MEC and its participating affiliates were as follows:

	Pension		Other Postretirement	
	2012	2011	2012	2011
Benefit obligations as of December 31:				
Discount rate	4.00%	4.75%	3.75%	4.75%
Rate of compensation increase	3.00%	3.50%	N/A	N/A
Net periodic benefit cost for the years ended December 31:				
Discount rate	4.75%	5.50%	4.75%	5.50%
Expected return on plan assets(1)	7.50%	7.50%	7.50%	7.50%
Rate of compensation increase	3.50%	3.50%	N/A	N/A

(1) Amounts reflected are pre-tax values. Assumed after-tax returns for a taxable, non-union other postretirement plan were 5.75% for 2012 and 2011.

	2012	2011
Assumed healthcare cost trend rates as of December 31:		
Healthcare cost trend rate assumed for next year	8.00%	7.40%
Rate that the cost trend rate gradually declines to	5.00%	5.00%
Year that the rate reaches the rate it is assumed to remain at	2018	2016

In establishing MEC's assumption as to the expected return on plan assets, MEC utilizes the expected asset allocation and return assumptions for each asset class based on historical performance and forward-looking views of the financial markets.

A one percentage-point change in assumed healthcare cost trend rates would have the following effects for MEC and its participating affiliates (in millions):

	One Percentage-Point	
Increase (decrease) in:	Increase	Decrease
Total service and interest cost	$ -	$ -
Other postretirement benefit obligation	1	(1)

Contributions and Benefit Payments

MEC's contributions to its pension and other postretirement benefit plans are expected to be $8 million and $- million, respectively, during 2013. Funding to MEC's pension benefit plan trust is based upon the actuarially determined costs of the plan and the requirements of the Internal Revenue Code, the Employee Retirement Income Security Act of 1974 and the Pension Protection Act of 2006, as amended. MEC considers contributing additional amounts from time to time in order to achieve certain funding levels specified under the Pension Protection Act of 2006, as amended. MEC's funding policy for its other postretirement benefit plan is to contribute an amount equal to the sum of the net periodic benefit cost. The Company's contributions to the pension plan and the other postretirement plan are each expected to be $0.5 million during 2013.

Net periodic benefit costs assigned to MEC affiliates are reimbursed currently in accordance with the intercompany administrative service agreement. The expected benefit payments to participants in MEC's pension and other postretirement benefit plans for 2013 through 2017 and for the five years thereafter are summarized below (in millions):

	Projected Benefit Payments	
	Pension	Other Postretirement
2013	$ 53	$ 15
2014	56	15
2015	56	16
2016	58	17
2017	61	18
2018-22	310	92

Plan Assets

Investment Policy and Asset Allocations

MEC's investment policy for its pension and other postretirement benefit plans is to balance risk and return through a diversified portfolio of debt securities, equity securities, and other alternative investments. Maturities for debt securities are managed to targets consistent with prudent risk tolerances. The plans retain outside investment advisors to manage plan investments within the parameters outlined by the MidAmerican Energy Pension and Employee Benefits Plans Administrative Committee. The investment portfolio is managed in line with the investment policy with sufficient liquidity to meet near-term benefit payments. The return on assets assumption for each plan is based on a weighted-average of the expected historical performance for the types of assets in which the plans invest.

The target allocations (percentage of plan assets) for MEC's pension and other postretirement benefit plan assets are as follows as of December 31, 2012:

	Pension	Other Postretirement
Debt securities(1)	20-30%	25-35%
Equity securities(1)	65-75%	60-80%
Real estate funds	2-8%	- %
Other	0-5%	0-5%

(1) For purposes of target allocation percentages and consistent with the plans' investment policy, investment funds have been allocated based on the underlying investments in debt and equity securities.

Fair Value Measurements

A financial asset or liability classification within the three levels of the fair value 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 an entity 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 an entity's judgments about the assumptions market participants would use in pricing the asset or liability since limited market data exists. An entity develops these inputs based on the best information available, including its own data.

The following table presents the fair value of plan assets for MEC and its participating affiliates, by major category, for the defined benefit pension plan (in millions):

	Input Levels for Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
As of December 31, 2012				
Cash equivalents	$ -	$ 7	$ -	$ 7
Debt securities:				
United States government obligations	19	-	-	19
Corporate obligations	-	31	-	31
Municipal obligations	-	5	-	5
Agency, asset and mortgage-backed obligations	-	29	-	29
Equity securities:				
United States companies	137	-	-	137
Investment funds[(1)]	101	288	-	389
Real estate funds	-	-	26	26
Total	$ 257	$ 360	$ 26	$ 643
As of December 31, 2011				
Cash equivalents	$ -	$ 9	$ -	$ 9
Debt securities:				
United States government obligations	6	-	-	6
Corporate obligations	-	29	-	29
Municipal obligations	-	5	-	5
Agency, asset and mortgage-backed obligations	-	35	-	35
Equity securities:				
United States companies	115	-	-	115
Investment funds[(1)]	76	256	-	332
Real estate funds	-	-	24	24
Total	$ 197	$ 334	$ 24	$ 555

(1) Investment funds are comprised of mutual funds and collective trust funds. These funds represent equity and debt securities of approximately 74% and 26%, respectively, for 2012 and 77% and 23%, respectively, for 2011. Additionally, these funds are invested in United States and international securities of approximately 77% and 23%, respectively, for 2012 and 79% and 21%, respectively, for 2011.

The following table presents the fair value of plan assets for MEC and its participating affiliates, by major category, for the defined benefit other postretirement plans (in millions):

	Input Levels for Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
As of December 31, 2012				
Cash equivalents	$ 2	$ -	$ -	$ 2
Debt securities:				
United States government obligations	4	-	-	4
Corporate obligations	-	9	-	9
Municipal obligations	-	32	-	32
Agency, asset and mortgage-backed obligations	-	14	-	14
Equity securities:				
United States companies	102	-	-	102
Investment funds[(1)]	63	-	-	63
Total	$ 171	$ 55	$ -	$ 226
As of December 31, 2011				
Cash equivalents	$ 6	$ -	$ -	$ 6
Debt securities:				
United States government obligations	6	-	-	6
Corporate obligations	-	7	-	7
Municipal obligations	-	30	-	30
Agency, asset and mortgage-backed obligations	-	12	-	12
Equity securities:				
United States companies	88	-	-	88
Investment funds[(1)]	64	-	-	64
Total	$ 164	$ 49	$ -	$ 213

(1) Investment funds are comprised of mutual funds and collective trust funds. These funds represent equity and debt securities of approximately 86% and 14%, respectively, for 2012 and 83% and 17%, respectively, for 2011. Additionally, these funds are invested in United States and international securities of approximately 51% and 49%, respectively, for 2012 and 59% and 41%, respectively, for 2011.

When available, 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. In the absence of a quoted market price or net asset value of an identical security, the fair value is determined using pricing models or net asset values based on observable market inputs and quoted market prices of securities with similar characteristics. When observable market data is not available, the fair value is determined using unobservable inputs, such as estimated future cash flows, purchase multiples paid in other comparable third-party transactions or other information. The real estate funds determine fair value of their underlying assets using independent appraisals given there is no current liquid market for the underlying assets. The following table reconciles the beginning and ending balances of MEC's pension plan assets measured at fair value using significant Level 3 inputs for the years ended December 31 (in millions):

	Real Estate Funds	
	2012	2011
Beginning balance	$ 24	$ 17
Actual return on plan assets still held at period end	2	4
Purchases and sales	-	3
Ending balance	$ 26	$ 24

The Company participates in the MEC sponsored defined contribution plan and contributed $0.5 million for each of the years ended December 31, 2012 and 2011.

(9) Commitments and Contingencies

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 effect on its financial results.

Construction Commitments

The Company has future capital requirements for its ongoing construction program. The Company has approved plans to meet new market opportunities and system reliability objectives. Capital expenditure needs are reviewed regularly by management and may change significantly as a result of such reviews. Estimates may change significantly at any time as a result of, among other factors, changes in rules and regulations, including environmental; changes in income tax laws; general business conditions; load projections; system reliability standards; the cost and efficiency of construction labor, equipment, and materials; and the cost and availability of capital. The Company's firm construction commitments as of December 31, 2012 were $11.4 million for the year ended December 31, 2013.

Operating Leases, Easements and Maintenance Contracts

The Company has non-cancelable operating leases primarily for computer equipment, office space and land. These leases generally require the Company to pay for insurance, taxes and maintenance applicable to the leased property. Certain leases contain renewal options for varying periods and escalation clauses for adjusting rent to reflect changes in price indices. The minimum payments under these leases as of December 31, 2012 were $1.4 million for each of the years 2013 through 2016, $1.5 million for the year 2017, and $2.1 million for the years thereafter. These amounts are not reflected on the Balance Sheets – Regulatory Basis. Rent expense on non-cancelable operating leases totaled $1.2 million and $1.1 million for the years ended December 31, 2012 and 2011, respectively, and was included in operation and maintenance on the Statements of Income – Regulatory Basis.

The Company has a construction, operation and maintenance agreement with Mojave and Mojave Pipeline Operating. Mojave Pipeline Operating serves as operator and agent of the common facilities beginning at Daggett, California. The twenty year term of the construction, operation and maintenance agreement ended on February 15, 2012 and was amended. The amended term expires on December 31, 2013. The agreement automatically renews each year thereafter unless the Company or Mojave provides six months written notice of intent to terminate. Under the terms of this agreement, the Company and Mojave reimburse Mojave Pipeline Operating for their share of the pipeline expenses under a fixed arrangement. In the event that Mojave Pipeline Operating is unwilling or unable to serve as an operator following the expiration of this agreement, the Company believes that it or one of its affiliates could fulfill this role. The expected minimum payments under this agreement total $2.2 million for 2013.

(10) Credit Risk

The Company has a concentration of customers, which includes utilities, marketers and major oil and natural gas companies in California, Nevada, and Utah. This concentration of customers may impact the Company's overall exposure to credit risk in that the customer base may be similarly affected by changes in economic, industry, weather or other conditions.

The following customers accounted for 10% or more of the Company's total revenues for the years ended December 31 or accounts receivable as of December 31:

	Revenue		**Accounts Receivable**	
	2012	**2011**	**2012**	**2011**
NV Energy	17%	14%	16%	17%
Southwest Gas Corporation	8%	6%	12%	12%

As a general policy, collateral is not required for receivables from creditworthy customers. Customers' financial condition and creditworthiness are regularly evaluated, and historical losses have been minimal. In order to provide protection against credit risk, and as permitted by the terms of the Company's tariff, the Company has, among other alternatives, required customers that lack creditworthiness, as defined by the tariff, to provide letters of credit, cash security deposits or to establish separate legally restricted escrow funds to be held until these customers' creditworthiness can be demonstrated. As of December 31, 2012 and 2011, the Company has reflected escrow funds of $2.1 million and $0.1 million, respectively, in other current and accrued assets and $26.2 million and $21.9 million, respectively, in other property and investments. The Company also had offsetting cash security deposit and escrow fund obligations of $28.3 million and $22.0 million as of December 31, 2012 and 2011, respectively, in customer deposits on the Balance Sheets – Regulatory Basis. Letters of credit, not reflected on the Balance Sheets – Regulatory Basis, were $96.6 million and $127.8 million as of December 31, 2012 and 2011, respectively.

(11) Other Related Party Transactions

MEHC provides certain administrative and management services, including executive, financial, legal, and tax, to the Company. Expenses incurred by MEHC and billed to the Company are based on the individual services and expense items provided and were $1.7 million and $2.3 million for the years ended December 31, 2012 and 2011, respectively. Income tax transactions with MEHC resulted in net payments of $36.4 million and $47.2 million for the years ended December 31, 2012 and 2011, 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 $1.1 million and $0.8 million for the years ended December 31, 2012 and 2011, respectively.

As of December 31, 2012 and 2011, the Company had net accounts payable to MEHC and certain subsidiaries for intercompany transactions totaling $0.3 million and $1.3 million, respectively, which is reflected in accounts payable on the Balance Sheets – Regulatory Basis.

Northern Natural Gas Company (“Northern”), an indirect wholly owned subsidiary of MEHC, provides certain administrative and management services, including executive, financial, regulatory, legal, commercial, and tax to the Company. The Company was billed $1.1 million for each of the years ended December 31, 2012 and 2011 for these services.

Northern provides risk management services to the Company, pursuant to a service agreement dated August 1, 2008. The Company assumes all risks, liabilities, losses and profits associated with these risk management services. Northern entered into specific risk management transactions that settled on behalf of the Company totaling $0.6 million for each of the years ended December 31, 2012 and 2011.

The Company provided natural gas transportation and other services to PacifiCorp, an indirect subsidiary of MEHC, of $3.2 million and $3.4 million for the years ended December 31, 2012 and 2011, respectively. PacifiCorp provided electricity and other services to the Company of $0.7 million and $0.6 million for the years ended December 31, 2012 and 2011, respectively. PacifiCorp provides certain administrative and management services, including information technology, legislative and financial, to the Company. Expenses incurred by PacifiCorp and billed to the Company are based on the individual services and expense items provided and were $0.2 million for each of the years ended December 31, 2012 and 2011. As of December 31, 2012 and 2011, the Company had net accounts receivable from PacifiCorp for intercompany transactions totaling $0.3 million, which is reflected in customer accounts receivable on the Balance Sheets – Regulatory Basis.

For the years ended December 31, 2012 and 2011, the Company distributed to its partners $93.5 million and $- million, respectively, and received a contribution from its partners of $- million and $55.0 million, respectively.

(12) Subsequent Events

Subsequent to December 31, 2012, the Company distributed to its Partners $43.0 million on January 31, 2013, $16.0 million on February 28, 2013, and $3.0 million on April 1, 2013.

Kern River Funding Corporation

Financial Statements

As of and for the Years Ended December 31, 2012 and 2011

Deloitte & Touche LLP
First National Tower
1601 Dodge Street, Ste. 3100
Omaha, NE 68102-1649
USA
Tel: +1 402 346 7788
Fax: +1 402 997 7875
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of
Kern River Funding Corporation
Salt Lake City, Utah

We have audited the accompanying financial statements of Kern River Funding Corporation (the "Company"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kern River Funding Corporation as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

April 18, 2013

KERN RIVER FUNDING CORPORATION
BALANCE SHEETS
(Amounts in thousands, except per share data)

	As of December 31,	
	2012	**2011**
ASSETS		
Current assets:		
Receivable due from parent	$ 1	$ 3,302
Current portion of long-term notes receivable from parent	79,742	87,843
Total current assets	79,743	91,145
Long-term notes receivable from parent	548,120	627,862
Total assets	$ 627,863	$ 719,007
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities:		
Accrued interest	$ -	$ 3,301
Current portion of long-term notes payable	79,742	87,843
Total current liabilities	79,742	91,144
Long-term notes payable	548,120	627,862
Total liabilities	627,862	719,006
Shareholder's equity:		
Common stock, $1 par value, 1,000 shares authorized, issued and outstanding	1	1
Total liabilities and shareholder's equity	$ 627,863	$ 719,007

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

KERN RIVER FUNDING CORPORATION
STATEMENTS OF INCOME
(Amounts in thousands)

	Years Ended December 31,	
	2012	2011
Revenues from long-term notes receivable from parent	$ 37,188	$ 41,655
Interest expense on long-term notes payable	37,188	41,655
Net income	$ -	$ -

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

KERN RIVER FUNDING CORPORATION
STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	Years Ended December 31, 2012	2011
Cash flows from operating activities:		
Net income	$ -	$ -
Adjustments to reconcile net income to net cash flows from operating activities:		
Net change in receivable due from parent	3,301	(3,301)
Net change in accrued interest	(3,301)	3,301
Net cash flows from operating activities	-	-
Cash flows from financing activities:		
Proceeds received on long-term notes receivable from parent	$ 87,843	$ 74,329
Repayments of long-term notes payable	(87,843)	(74,329)
Net cash flows from financing activities	-	-
Net change in cash	-	-
Cash at beginning of period	-	-
Cash at end of period	$ -	$ -
Supplemental disclosure - interest paid	$ 40,489	$ 38,354

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

KERN RIVER FUNDING CORPORATION
NOTES TO FINANCIAL STATEMENTS

(1) General

Kern River Funding Corporation ("Funding") is a direct wholly owned subsidiary of Kern River Gas Transmission Company ("Kern River"). Funding was organized to issue and make payments on debt securities for Kern River. There are no other revenues or costs incurred by Funding except for those that are passed from or to Kern River. Funding's Financial Statements were prepared in conformity with accounting principles generally accepted in the United States of America. Funding has evaluated subsequent events through April 18, 2013, which is the date the Financial Statements were available to be issued.

(2) Revenue Recognition

Funding recognizes revenues based on the interest costs that are passed through to Kern River. For the years ended December 31, 2012 and 2011, Funding's reported revenues include $37.2 million and $41.7 million, respectively, of interest income on notes receivable from Kern River.

(3) Fair Value Measurements

The carrying value of receivable due from parent approximates fair value because of the short-term maturity of these instruments. Funding's long-term notes receivable and payable are carried at cost in the Financial Statements. The fair value of Funding's long-term notes receivable and payable are a Level 2 fair value measurement and have been estimated based upon quoted market prices. The following table presents the carrying value and estimated fair value of Funding's long-term notes receivable from parent and long-term notes payable as of December 31 (in thousands):

	2012		2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Long-term notes receivable from parent	$ 627,862	$ 712,920	$ 715,705	$ 822,180
Liabilities:				
Long-term notes payable	$ 627,862	$ 712,920	$ 715,705	$ 822,180

(4) Long-Term Notes Payable

Funding's long-term notes payable, which amortize monthly, consist of the following as of December 31 (in thousands):

	2012	2011
6.676% Senior Notes, due 2016	$ 227,000	$ 257,333
4.893% Senior Notes, due 2018	400,862	458,372
Total long-term notes payable	627,862	715,705
Less - current portion	(79,742)	(87,843)
Long-term portion	$ 548,120	$ 627,862

Kern River provides a debt service reserve letter of credit in amounts that approximate the next six months of principal and interest payments due on the loans, which were equal to $59.0 million and $62.0 million as of December 31, 2012 and 2011, respectively.

The annual repayments of Funding’s long-term notes payable for the years beginning January 1, 2013 and thereafter are as follows (in thousands):

2013	$ 79,742
2014	81,414
2015	85,340
2016	190,340
2017	61,864
2018	129,162
Total	$ 627,862

Both the 6.676% Senior Notes and the 4.893% Senior Notes are secured equally and ratably by a collateral assignment of the long-term gas transportation agreements of Kern River.

The terms of Funding’s debt indentures to which Kern River is guarantor preclude the issuance of mortgage bonds by Funding and Kern River. The indentures contain provisions for the acceleration of repayment under certain conditions. The indentures also contain restrictions which, under certain circumstances, limit Funding and Kern River’s ability to issue additional debt, pay cash distributions, and dispose of a major portion of Kern River’s natural gas pipeline system. As of December 31, 2012 and 2011, Funding is in compliance with all debt covenants.

(5) Income Taxes

Funding is included in Berkshire Hathaway Inc.’s consolidated United States federal income tax return. Funding computes an income tax provision for income taxes payable to represent Funding’s liability as if it filed on a stand-alone basis. For the years ended December 31, 2012 and 2011, there was no current income tax expense and there were no temporary differences.