



**Northern Natural Gas Company**

**Financial Statements (Unaudited) as of and for the  
Quarterly Period Ended September 30, 2016**

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

	As of	
	September 30, 2016	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 103,818	\$ 27,523
Accounts receivable, net	34,522	65,380
Accounts receivable from affiliates	3,543	7,989
Notes receivable from BHE	155,000	155,000
Transportation and exchange gas receivables	2,090	4,813
Inventories	26,608	26,840
Income tax receivable	13,687	43,508
Other current assets	6,432	9,764
Total current assets	345,700	340,817
Property, plant and equipment, net	2,761,867	2,680,579
Regulatory assets	155,701	161,336
Other assets	40,235	41,060
<b>Total assets</b>	<b>\$ 3,303,503</b>	<b>\$ 3,223,792</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 39,979	\$ 30,736
Accounts payable to affiliates	1,095	967
Accrued interest	6,772	12,260
Accrued property, income and other taxes	50,493	50,484
Transportation and exchange gas payables	966	3,669
Derivative contracts	13,661	11,823
Other current liabilities	34,015	29,611
Total current liabilities	146,981	139,550
Regulatory liabilities	23,899	24,202
Derivative contracts	55,107	62,660
Asset retirement obligations	32,426	30,994
Long-term debt	795,362	795,024
Deferred income taxes	797,603	739,717
Other long-term liabilities	20,210	21,606
Total liabilities	1,871,588	1,813,753
Commitments and contingencies (Notes 4 and 6)		
Shareholder's equity:		
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	450,046	428,170
Total shareholder's equity	1,431,915	1,410,039
<b>Total liabilities and shareholder's equity</b>	<b>\$ 3,303,503</b>	<b>\$ 3,223,792</b>

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

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

	<b>Nine-Month Periods Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>Operating revenue:</b>		
Transportation	\$ 381,749	\$ 388,879
Storage	52,038	45,963
Gas, liquids and other sales	8,521	32,369
Total operating revenue	<u>442,308</u>	<u>467,211</u>
<b>Operating costs and expenses:</b>		
Operating and maintenance	134,094	142,219
Cost of gas and liquids sales	12,586	35,126
Depreciation and amortization	55,340	51,913
Taxes, other than income taxes	39,395	42,257
Total operating costs and expenses	<u>241,415</u>	<u>271,515</u>
<b>Operating income</b>	<u>200,893</u>	<u>195,696</u>
<b>Other income (expense):</b>		
Interest expense, net	(29,058)	(30,632)
Interest income	1,277	932
Other, net	4,556	6,733
Total other income (expense)	<u>(23,225)</u>	<u>(22,967)</u>
<b>Income before income tax expense</b>	177,668	172,729
Income tax expense	70,792	68,805
<b>Net income</b>	<u>\$ 106,876</u>	<u>\$ 103,924</u>

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

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

	<b>Nine-Month Periods Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>
Net income	\$ 106,876	\$ 103,924
Other comprehensive loss -		
Unrealized losses on cash flow hedges, net of tax of \$- and \$(125)	—	(189)
Comprehensive income	<u>\$ 106,876</u>	<u>\$ 103,735</u>

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**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>Accumulated Other Comprehensive Income, net</u>	<u>Total</u>
<b>Balance, December 31, 2014</b>	\$ 1	\$ 981,868	\$ 347,717	\$ 496	\$ 1,330,082
Net income	—	—	103,924	—	103,924
Other comprehensive loss - cash flow hedges	—	—	—	(189)	(189)
<b>Balance, September 30, 2015</b>	<u>\$ 1</u>	<u>\$ 981,868</u>	<u>\$ 451,641</u>	<u>\$ 307</u>	<u>\$ 1,433,817</u>
<b>Balance, December 31, 2015</b>	\$ 1	\$ 981,868	\$ 428,170	\$ —	\$ 1,410,039
Net income	—	—	106,876	—	106,876
Dividends on common stock	—	—	(85,000)	—	(85,000)
<b>Balance, September 30, 2016</b>	<u>\$ 1</u>	<u>\$ 981,868</u>	<u>\$ 450,046</u>	<u>\$ —</u>	<u>\$ 1,431,915</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>Nine-Month Periods Ended September 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 106,876	\$ 103,924
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	55,340	51,913
Amortization of debt issuance costs	355	301
Deferred income taxes	57,886	43,427
Other, net	3,958	3,961
Changes in other operating assets and liabilities:		
Accounts receivable and other assets	29,078	36,537
Inventories	413	(7)
Accounts payable and other accrued liabilities	(684)	(11,481)
Gas balancing activities	(202)	(1,394)
Accrued property, income and other taxes	29,829	32,152
Net cash flows from operating activities	282,849	259,333
<b>Cash flows from investing activities:</b>		
Capital expenditures	(119,608)	(147,417)
Purchases of marketable securities	(4,496)	(4,455)
Proceeds from sales of marketable securities	2,550	2,213
Net cash flows from investing activities	(121,554)	(149,659)
<b>Cash flows from financing activities:</b>		
Dividends on common stock	(85,000)	—
Repayment of long-term debt	—	(100,000)
Proceeds from redemption of promissory notes from BHE	—	70,000
Issuance of promissory notes by BHE	—	(50,000)
Net cash flows from financing activities	(85,000)	(80,000)
<b>Net change in cash and cash equivalents</b>	76,295	29,674
<b>Cash and cash equivalents at beginning of period</b>	27,523	46,901
<b>Cash and cash equivalents at end of period</b>	\$ 103,818	\$ 76,575

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 subsidiaries principally engaged in the energy business. 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 southern Texas to Michigan's Upper Peninsula (the "System"). The System, which is interconnected with many interstate and intrastate pipelines in the national grid system, consists of two operationally integrated systems. 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 Company primarily transports and stores natural gas for utilities, municipalities, gas marketing companies, industrial and commercial users and other end-users. 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 5.7 billion cubic feet ("Bcf") per day and a Field Area delivery capacity of 1.7 Bcf per day to the Market Area. Additionally, the Company has three underground natural gas storage facilities and two liquefied natural gas storage peaking units that have a total firm service and operational storage cycle capacity of over 73 Bcf and 2.0 Bcf per day of peak delivery capability. 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 0.9 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 September 30, 2016 and for the nine-month periods ended September 30, 2016 and 2015. The results of operations for the nine-month period ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year. The Company has evaluated subsequent events through November 22, 2016, 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, 2015 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 nine-month period ended September 30, 2016.

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

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-15, which amends FASB Accounting Standards Codification ("ASC") Topic 230, "Statement of Cash Flows." The amendments in this guidance address the classification of eight specific cash flow issues within the statement of cash flows with the objective of reducing the existing diversity in practice. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted, and is required to be adopted retrospectively. The Company is currently evaluating the impact of adopting this guidance on its 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. This guidance is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted, and is required to be adopted using a modified retrospective approach. The Company is currently evaluating the impact of adopting this guidance on its Financial Statements and disclosures included within Notes to Financial Statements.

In May 2014, the FASB issued ASU No. 2014-09, which creates FASB ASC Topic 606, "Revenue from Contracts with Customers" and supersedes ASC Topic 605, "Revenue Recognition." The guidance replaces industry-specific guidance and establishes a single five-step model to identify and recognize 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. Additionally, the guidance requires the entity to disclose further quantitative and qualitative information regarding the nature and amount of revenues arising from contracts with customers, as well as other information about the significant judgments and estimates used in recognizing revenues from contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, which defers the effective date of ASU No. 2014-09 one year to interim and annual reporting periods beginning after December 15, 2017. During 2016, the FASB issued several ASUs that clarify the implementation guidance for ASU No. 2014-09 but do not change the core principle of the guidance. This guidance may be adopted retrospectively or under a modified retrospective method where the cumulative effect is recognized at the date of initial application. The Company is currently evaluating the impact of adopting this guidance on its Financial Statements and disclosures included within Notes to Financial Statements.

## **(3) 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 \$0.7 million and \$0.6 million for the nine-month periods ended September 30, 2016 and 2015, respectively. As of September 30, 2016, 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 \$5.1 million and \$23.9 million, respectively. As of December 31, 2015, 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 \$5.1 million and \$23.0 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.

#### **(4) 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, monitor, report, manage and mitigate 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.

For certain designated markets, certain customers pay a fixed price of \$0.09 per decatherm ("dth") of volumes delivered to purchase compressor fuel and system use gas from the Company. The Company estimates it will be required to purchase an annual average of 0.9 Bcf of natural gas through October 2022 to meet these requirements based on an average system requirements factor of 0.9% of volumes delivered. The Company's contracts with these customers provide service through October 2019, with annual renewal options for one customer to continue service through October 2022. As of September 30, 2016, the Company had entered into swap agreements covering the expected contractual requirements through October 2022.

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 5 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, on a gross basis, and reconciles those amounts to the amounts presented on a net basis on the Balance Sheets (in thousands):

	<u>Derivative Assets</u>		<u>Derivative Liabilities</u>		<u>Total</u>
	<u>Current</u>	<u>Noncurrent</u>	<u>Current</u>	<u>Noncurrent</u>	
<b><u>As of September 30, 2016</u></b>					
<b>Not designated as hedging contracts<sup>(1)</sup>:</b>					
Commodity assets	\$ 6	\$ —	\$ 136	\$ 1	\$ 143
Commodity liabilities	—	—	(13,797)	(55,108)	(68,905)
Total	<u>6</u>	<u>—</u>	<u>(13,661)</u>	<u>(55,107)</u>	<u>(68,762)</u>
<b>Total derivatives - net basis<sup>(2)</sup></b>	<u>\$ 6</u>	<u>\$ —</u>	<u>\$ (13,661)</u>	<u>\$ (55,107)</u>	<u>\$ (68,762)</u>
<b><u>As of December 31, 2015</u></b>					
<b>Not designated as hedging contracts<sup>(1)</sup>:</b>					
Commodity liabilities	\$ —	\$ —	\$ (12,303)	\$ (62,660)	\$ (74,963)
Total	<u>—</u>	<u>—</u>	<u>(12,303)</u>	<u>(62,660)</u>	<u>(74,963)</u>
<b>Total derivatives</b>	<u>—</u>	<u>—</u>	<u>(12,303)</u>	<u>(62,660)</u>	<u>(74,963)</u>
Cash collateral receivable	—	—	480	—	480
<b>Total derivatives - net basis<sup>(2)</sup></b>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (11,823)</u>	<u>\$ (62,660)</u>	<u>\$ (74,483)</u>

- (1) The Company's commodity derivatives not designated as hedging contracts are generally included in regulated rates, and as of September 30, 2016 and December 31, 2015, a regulatory asset of \$68.8 million and \$75.0 million, respectively, was recorded related to the net derivative liability of \$68.8 million and \$74.5 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 11 million and 14 million dth of natural gas purchases as of September 30, 2016 and December 31, 2015, 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 commodity derivative contracts recognized in regulatory assets, as well as amounts reclassified to earnings for the nine-month periods ended September 30 (in thousands):

	<u>2016</u>	<u>2015</u>
<b>Beginning balance</b>	\$ 74,963	\$ 68,753
Changes in fair value recognized in regulatory assets	3,723	15,120
Net (losses) gains reclassified to operating revenue	(152)	1,380
Net losses reclassified to cost of gas and liquids sales	(9,772)	(8,431)
<b>Ending balance</b>	<u>\$ 68,762</u>	<u>\$ 76,822</u>

### *Designated as Hedging Contracts*

The following table reconciles the beginning and ending balances of the Company's accumulated other comprehensive (income) loss (pre-tax) and summarizes pre-tax gains and losses on commodity derivative contracts designated and qualifying as cash flow hedges recognized in other comprehensive income ("OCI"), as well as amounts reclassified to earnings for the nine-month periods ended September 30 (in thousands):

	<u>2016</u>	<u>2015</u>
<b>Beginning balance</b>	\$ —	\$ (822)
Changes in fair value recognized in OCI	(51)	(1,117)
Net gains reclassified to operating revenue	51	1,142
<b>Ending balance</b>	<u>\$ —</u>	<u>\$ (797)</u>

Realized gains and losses on hedges and hedge ineffectiveness are recognized on the Statements of Income as operating revenue or cost of gas and liquids sales depending upon the nature of the item being hedged. For each of the nine-month periods ended September 30, 2016 and 2015, hedge ineffectiveness was insignificant.

### *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 September 30, 2016, 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 \$68.8 million and \$75.0 million as of September 30, 2016 and December 31, 2015, respectively, for which the Company had posted collateral of \$- million and \$0.5 million, respectively, in the form of cash deposits. If all credit-risk-related contingent features for derivative contracts in liability positions had been triggered as of September 30, 2016 and December 31, 2015, the Company would have been required to post \$68.8 million and \$74.5 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.

### **(5) 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):

	Input Levels for Fair Value Measurements			Other <sup>(1)</sup>	Total
	Level 1	Level 2	Level 3		
<b>As of September 30, 2016</b>					
<b>Assets:</b>					
Commodity derivatives	\$ —	\$ 143	\$ —	\$ (137)	\$ 6
Money market mutual funds <sup>(2)</sup>	119,843	—	—	—	119,843
Investment funds	4,294	—	—	—	4,294
	<u>\$ 124,137</u>	<u>\$ 143</u>	<u>\$ —</u>	<u>\$ (137)</u>	<u>\$ 124,143</u>
<b>Liabilities - commodity derivatives</b>	<u>\$ —</u>	<u>\$ (68,905)</u>	<u>\$ —</u>	<u>\$ 137</u>	<u>\$ (68,768)</u>
<b>As of December 31, 2015</b>					
<b>Assets:</b>					
Money market mutual funds <sup>(2)</sup>	\$ 44,112	\$ —	\$ —	\$ —	\$ 44,112
Investment funds	2,124	—	—	—	2,124
	<u>\$ 46,236</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 46,236</u>
<b>Liabilities - commodity derivatives</b>	<u>\$ —</u>	<u>\$ (74,483)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (74,483)</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 4 for further discussion regarding the Company's risk management and hedging activities.

The Company's investments in money market mutual funds are accounted for as available-for-sale securities and are stated at fair value. Investment funds are accounted for as trading securities and are stated at fair value. Trading securities are carried 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.

## **(6) 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 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 established a three-person compensation commission in September 2012, to determine the value of the interests to be taken. In March 2014, the federal district court found that the Company must compensate the defendants for all gas in the extension area, including storage gas. The condemnation panel issued a report in August 2014, recommending a total award of \$7.3 million. The federal district court issued a decision in February 2015, adopting the condemnation panel's recommendations. The Company filed its appeal of the final condemnation order to the Tenth Circuit Court of Appeals in November 2015. All of the defendants have cross-appealed. The Company and the defendants have filed briefs and oral argument is set for November 2016.
- 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 have been dismissed, but the nuisance claim remains. Discovery has been stayed pending the conclusion of the condemnation action discussed above. In May 2016, the court issued an order lifting the stay that had been in place since August 2011. A scheduling conference with the magistrate was held in July 2016. The magistrate established dates for amending pleadings and discovery; however, a trial date was not set.
- 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 filed a motion to modify the summary judgment ruling which was heard in October 2014. In June 2015, the court indicated an order would be entered denying the Company's motion, but no order has been issued. 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 Supreme Court. 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.

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

The Company provided gas transportation, storage and other services to MEC totaling \$44.4 million and \$41.6 million for the nine-month periods ended September 30, 2016 and 2015, 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 \$4.2 million and \$3.9 million for the nine-month periods ended September 30, 2016 and 2015, respectively. MEC also provided electricity and other services to the Company of \$0.5 million and \$0.6 million for the nine-month periods ended September 30, 2016 and 2015, respectively. The Company reimbursed MEC \$44.2 million and \$41.7 million for the nine-month periods ended September 30, 2016 and 2015, 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 \$1.9 million and \$1.7 million for the nine-month periods ended September 30, 2016 and 2015, respectively. Income tax transactions with BHE resulted in net receipts of \$16.9 million and \$5.0 million for the nine-month periods ended September 30, 2016 and 2015, respectively.

As of September 30, 2016 and December 31, 2015, the Company had accounts payable to BHE and certain subsidiaries for intercompany transactions totaling \$1.1 million and \$1.0 million, respectively. The Company also had accounts receivable from affiliates of \$3.5 million and \$8.0 million as of September 30, 2016 and December 31, 2015, 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 \$1.1 million and \$0.9 million for the nine-month periods ended September 30, 2016 and 2015, respectively, for these services.

The Company possesses demand promissory notes from BHE. The balance of the demand promissory notes as of September 30, 2016 and December 31, 2015 was \$155.0 million. The notes contain variable interest

rates based on 30-day LIBOR plus a fixed spread per annum. Interest income of \$1.0 million and \$0.8 million was recorded for the nine-month periods ended September 30, 2016 and 2015, respectively.