Northern Natural Gas Company

Financial Statements and Independent Auditors' Report
as of and for the
Years Ended December 31, 2017 and 2016

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder
of Northern Natural Gas Company
Omaha, Nebraska

We have audited the accompanying financial statements of Northern Natural Gas Company (the "Company"), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of income, changes in shareholder's equity, 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 Northern Natural Gas Company as of December 31, 2017 and 2016, 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

Omaha, Nebraska
March 29, 2018

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

	As of December 31,	
	2017	**2016**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,005	$ 48,398
Accounts receivable, net	82,748	75,147
Accounts receivable from affiliates	8,953	8,708
Notes receivable from BHE	175,000	155,000
Transportation and exchange gas receivables	14,098	12,028
Inventories	30,038	28,314
Income tax receivable	9,998	—
Other current assets	18,059	10,057
Total current assets	359,899	337,652
Property, plant and equipment, net	3,015,628	2,812,523
Regulatory assets	128,723	150,436
Other assets	45,003	40,969
Total assets	$ 3,549,253	$ 3,341,580
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities:		
Accounts payable	$ 54,779	$ 44,312
Accounts payable to affiliates	1,401	1,253
Accrued interest	12,260	12,260
Accrued property, income and other taxes	52,030	55,501
Transportation and exchange gas payables	11,167	10,630
Derivative contracts	12,224	14,025
Current portion of long-term debt	199,871	—
Other current liabilities	24,614	35,446
Total current liabilities	368,346	173,427
Regulatory liabilities	455,299	25,393
Derivative contracts	—	50,507
Asset retirement obligations	32,367	32,676
Long-term debt	595,922	795,478
Deferred income taxes	495,073	832,758
Other long-term liabilities	22,208	21,923
Total liabilities	1,969,215	1,932,162
Commitments and contingencies (Notes 9 and 12)		
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	598,169	427,549
Total shareholder's equity	1,580,038	1,409,418
Total liabilities and shareholder's equity	$ 3,549,253	$ 3,341,580

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

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

	Years Ended December 31, 2017	Years Ended December 31, 2016
Operating revenue:		
Transportation	$ 590,115	$ 556,768
Storage	70,774	68,701
Gas, liquids and other sales	30,331	10,950
Total operating revenue	691,220	636,419
Operating costs and expenses:		
Operating and maintenance	217,647	196,499
Cost of gas and liquids sales	34,330	16,577
Depreciation and amortization	76,909	74,360
Taxes, other than income taxes	51,972	52,342
Total operating costs and expenses	380,858	339,778
Operating income	310,362	296,641
Other income (expense):		
Interest expense, net	(38,213)	(38,721)
Interest income	4,439	1,779
Other, net	12,862	6,423
Total other income (expense)	(20,912)	(30,519)
Income before income tax expense	289,450	266,122
Income tax expense	118,830	106,743
Net income	$ 170,620	$ 159,379

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

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

	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balance, December 31, 2015	$ 1	$ 981,868	$ 428,170	$ 1,410,039
Net income	—	—	159,379	159,379
Dividends on common stock	—	—	(160,000)	(160,000)
Balance, December 31, 2016	1	981,868	427,549	1,409,418
Net income	—	—	170,620	170,620
Balance, December 31, 2017	$ 1	$ 981,868	$ 598,169	$ 1,580,038

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

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

	Years Ended December 31,	
	2017	**2016**
Cash flows from operating activities:		
Net income	$ 170,620	$ 159,379
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	76,909	74,360
Amortization of debt issuance costs	456	475
Deferred income taxes	84,262	93,041
Other, net	(2,428)	5,029
Changes in other operating assets and liabilities:		
Accounts receivable and other assets	(11,294)	(17,911)
Inventories	126	(951)
Accounts payable and other accrued liabilities	2,798	5,696
Gas balancing activities	(48,365)	(595)
Accrued property, income and other taxes	(13,469)	48,525
Net cash flows from operating activities	259,615	367,048
Cash flows from investing activities:		
Capital expenditures	(264,422)	(184,403)
Proceeds from sale of assets	(13)	204
Purchases of marketable securities	(4,943)	(4,524)
Proceeds from sales of marketable securities	2,370	2,550
Net cash flows from investing activities	(267,008)	(186,173)
Cash flows from financing activities:		
Dividends on common stock	—	(160,000)
Proceeds from redemption of promissory notes from BHE	220,000	—
Issuance of promissory notes by BHE	(240,000)	—
Net cash flows from financing activities	(20,000)	(160,000)
Net change in cash and cash equivalents	(27,393)	20,875
Cash and cash equivalents at beginning of period	48,398	27,523
Cash and cash equivalents at end of period	$ 21,005	$ 48,398
Supplemental Disclosure:		
Interest paid, net of amounts capitalized	$ 37,630	$ 38,180
Income taxes (paid) received	$ (47,470)	$ 32,710
Non-cash investing transactions-		
Accruals related to property, plant and equipment additions	$ 42,397	$ 39,375

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

Northern Natural Gas Company
Notes to Financial Statements

(1) Organization and Operations

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

(2) Summary of Significant Accounting Policies

Basis of Presentation

The Company has no subsidiaries and does not hold a controlling financial interest in any other entity. The Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

Use of Estimates in Preparation of Financial Statements

The preparation of the 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 financial statements and the reported amounts of revenue and expenses during the period. These estimates include, but are not limited to, the effects of regulation; unbilled revenue; income taxes; valuation of certain financial assets and liabilities, including derivative contracts; long-lived asset recovery; asset retirement obligations ("AROs"); and accounting for contingencies. Actual results may differ from the estimates used in preparing the Financial Statements. The Company has evaluated subsequent events through March 29, 2018, which is the date the audited Financial Statements were available to be issued.

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.

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 income ("AOCI").

Fair Value Measurements

As defined under GAAP, fair value is the price that would be received to sell an asset or paid to transfer a liability between market participants in the principal market or in the most advantageous market when no principal market exists. Adjustments to transaction prices or quoted market prices may be required in illiquid or disorderly markets in order to estimate fair value. Different valuation techniques may be appropriate under the circumstances to determine the value that would be received to sell an asset or paid to transfer a liability in an orderly transaction. Market participants are assumed to be independent, knowledgeable, able and willing to transact an exchange and not under duress. Nonperformance or credit risk is considered in determining fair value. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. Accordingly, estimates of fair value presented herein are not necessarily indicative of the amounts that could be realized in a current or future market exchange.

Cash Equivalents and Restricted Cash

Cash equivalents consist of funds invested in securities with a maturity of three months or less when purchased. Cash and cash equivalents exclude amounts where availability is restricted by legal requirements or other contractual provisions. Restricted amounts are included in other current assets and other assets on the Balance Sheets.

Allowance for Doubtful Accounts

Accounts receivable 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 collectibility 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, 2017 and 2016, the allowance for doubtful accounts totaled $0.3 million and $0.4 million, respectively, and is included in accounts receivable, net on the Balance Sheets.

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 gas service contracts also result in imbalances. Such imbalances are valued at contractual or market rates and recorded as transportation and exchange gas receivables or payables on the Balance Sheets with offsetting entries to cost of gas and liquids sales on the Statements of Income. The imbalances cause offsetting changes in the volumes of system balancing gas, which are priced at contractual or market rates, and are recorded as adjustments to system gas balances in property, plant and equipment, net on the Balance Sheets and to cost of gas and liquids sales on the Statements of Income. Settlement of imbalances occurs in accordance with the contractual terms of the agreements and timing of delivery of gas based on operational conditions.

Inventories

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

Derivatives

The Company employs a number of different derivative contracts, which may include forward gas purchase and gas sale contracts and gas price commodity and basis swaps to manage price risk for natural gas. 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. Derivative balances reflect offsetting permitted under master netting agreements with counterparties.

Commodity derivatives used in normal business operations that are settled by physical delivery, among other criteria, are eligible for and may be designated as normal purchases or sales. Normal purchases or normal sales contracts are not marked-to-market and settled amounts are recognized as operating revenue or cost of gas and liquids sales on the Statements of Income.

For the Company's derivatives not designated as hedging contracts, the settled amount is generally includable in regulated rates. Accordingly, the net unrealized gains and losses associated with interim price movements on contracts that are accounted for as derivatives and probable of inclusion in regulated rates are recorded as regulatory assets and liabilities. For the Company's derivatives not designated as hedging contracts and for which changes in fair value are not recorded as regulatory assets and liabilities, unrealized gains and losses are recognized on the Statements of Income as operating revenue for sales contracts and cost of gas and liquids sales and operating and maintenance for purchase contracts and natural gas and fuel swap contracts.

For the Company's derivatives designated as hedging contracts, the Company formally assesses, at inception and thereafter, whether the hedging contract is highly effective in offsetting changes in the hedged item. The Company formally documents hedging activity by transaction type and risk management strategy.

Changes in the estimated fair value of a derivative contract designated and qualified as a cash flow hedge, to the extent effective, are included on the Statements of Changes in Shareholder's Equity as AOCI, net of tax, until the contract settles and the hedged item is recognized in earnings. The Company discontinues hedge accounting prospectively when it has determined that a derivative contract no longer qualifies as an effective hedge, or when it is no longer probable that the hedged forecasted transaction will occur. When hedge accounting is discontinued because the derivative contract no longer qualifies as an effective hedge, future changes in the estimated fair value of the derivative contract are charged to earnings. Gains and losses related to discontinued hedges that were previously recorded in AOCI will remain in AOCI until the contract settles and the hedged item is recognized in earnings, unless it becomes probable that the hedged forecasted transaction will not occur at which time associated deferred amounts in AOCI are immediately recognized in earnings.

Property, Plant and Equipment, Net

General

Additions to property, plant and equipment 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 computed by applying the composite or straight-line method based on either estimated useful lives or mandated recovery periods as prescribed by the Federal Energy Regulatory Commission ("FERC"). Depreciation studies are completed by the Company to determine the appropriate group lives, net salvage and group depreciation rates. These studies are reviewed and rates are ultimately approved by the FERC. Under the composite method when property, plant and equipment 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 debt and equity AFUDC, which represents the cost of debt and equity funds necessary to finance the construction of regulated facilities, as a component of property, plant and equipment, with offsetting credits to the Statements of Income. AFUDC is computed based on guidelines set forth by the FERC.

AFUDC on borrowed funds totaled $1.3 million and $0.8 million for the years ended December 31, 2017 and 2016, respectively, and is included in interest expense, net on the Statements of Income. AFUDC on equity funds totaled $5.6 million and $3.3 million for the years ended December 31, 2017 and 2016, respectively, and is included in other, net on the Statements of Income.

System Gas

Storage base gas and system balancing gas are accounted for utilizing the fixed asset accounting method as prescribed by the FERC. Under this approach, system gas volumes are classified as property, plant and equipment, net and valued at cost. Temporary encroachments upon system gas are valued at contractual or current market prices.

Asset Retirement Obligations

The Company recognizes AROs when it has a legal obligation to remove or abandon-in-place an asset upon retirement. The Company's AROs are related to the decommissioning of all offshore Gulf Coast facilities. 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. Subsequent to the initial recognition, the ARO liability is adjusted for any revisions to the original estimate of undiscounted cash flows (with corresponding adjustments to property, plant and equipment) and for accretion of the ARO liability due to the passage of time. The difference between the ARO liability, the corresponding ARO asset included in property, plant and equipment, net and amounts recovered in regulated rates to satisfy such liabilities is recorded as a regulatory asset or liability.

Impairment

The Company evaluates long-lived assets for impairment, including property, plant and equipment, 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 and any resulting impairment loss is reflected on the Statements of Income. The impacts of regulation are considered when evaluating the carrying value of rate base assets.

Revenue Recognition

Revenue from customers is recognized as natural gas is delivered or services are provided. Revenue recognized includes billed and unbilled amounts. As of December 31, 2017 and 2016, unbilled revenue was $8.1 million and $7.7 million, respectively, and is included in accounts receivable, net on the Balance Sheets. The Company’s transportation and storage revenue is primarily derived from fixed reservation charges based on contractual quantities and regulated rates. The remaining revenue, consisting primarily of commodity charges, is based on contractual rates and estimated usage based on scheduled quantities. Differences between scheduled quantities and actual measured quantities are reflected in revenue during the following month and historically have been immaterial.

The Company is subject to FERC regulations and, accordingly, certain revenue collected may be subject to possible refunds 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. The Company had no earned revenue subject to refund for the years ended December 31, 2017 and 2016.

Income Taxes

Berkshire Hathaway includes BHE and its subsidiaries in its United States federal income tax return. Consistent with established regulatory practice, the Company’s provision for income tax expense has been computed on a stand-alone basis, and substantially all of its respective currently payable or receivable income taxes are remitted to or received from BHE.

Deferred income tax assets and liabilities are based on differences between the financial statement and income tax basis of assets and liabilities 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 components of other comprehensive income ("OCI") are charged or credited directly to OCI. On December 22, 2017, the Tax Cuts and Jobs Act ("2017 Tax Reform") was signed into law which, among other items, reduces the federal corporate tax rate from 35% to 21%. Changes in deferred income tax assets and liabilities that are associated with property-related basis differences and other various differences that the Company deems probable of being reflected in future regulatory rates, are charged or credited directly to a regulatory asset or liability. Other changes in deferred income tax assets and liabilities are included as a component of income tax expense. Changes in deferred income tax assets and liabilities attributable to changes in enacted income tax rates are charged or credited to income tax expense or a regulatory asset or liability in the period of enactment. Valuation allowances are established when necessary to reduce certain deferred income tax assets to the amount that is more-likely-than-not to be realized.

In determining the Company's income taxes, management is required to interpret complex income tax laws and regulations, which includes consideration of regulatory implications imposed by the FERC. 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 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 other current assets and other long-term liabilities on the Balance Sheets. Estimated interest and penalties, if any, related to uncertain tax positions are included as a component of income tax expense on the Statements of Income.

New Accounting Pronouncements

In March 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-05, which amends FASB Accounting Standards Codification ("ASC") Topic 740, Income Taxes. This amendment adds various Securities and Exchange Commission ("SEC") paragraphs pursuant to the issuance of SEC Staff Accounting Bulletin ("SAB") No. 118 to assist in the implementation process of the 2017 Tax Reform by allowing calculations to be classified as provisional and subject to remeasurement. There are three different classifications for the accounting: (1) completed, (2) not complete but reasonably estimable or (3) not complete and amounts are not reasonably estimable. This guidance is effective immediately for all companies. The Company has adopted this guidance.

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

In March 2017, the FASB issued ASU No. 2017-07, which amends FASB ASC Topic 715, "Compensation - Retirement Benefits." The amendments in this guidance require that an employer disaggregate the service cost component from the other components of net benefit cost and report the service cost component in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the statement of operations separately from the service cost component and outside the subtotal of operating income. Additionally, the guidance only allows the service cost component to be eligible for capitalization when applicable. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017 for public entities. For nonpublic entities, this guidance is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods within annual reporting periods beginning after December 15, 2019. This guidance must be adopted retrospectively for the presentation of the service cost component and the other components of net benefit cost in the statement of operations and prospectively for the capitalization of the service cost component in the balance sheet, with early adoption permitted. The Company adopted this guidance effective January 1, 2018 and the adoption will not have a material impact on its Financial Statements and disclosures included within Notes to Financial Statements.

In November 2016, the FASB issued ASU No. 2016-18, which amends FASB ASC Subtopic 230-10, "Statement of Cash Flows - Overall." The amendments in this guidance require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017 for public entities. For nonpublic entities, this guidance is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods within annual reporting periods beginning after December 15, 2019. This guidance is required to be adopted retrospectively, with early adoption permitted. The Company adopted this guidance effective January 1, 2018 and the adoption will not have a material impact on its Financial Statements and disclosures included within Notes to Financial Statements.

In August 2016, the FASB issued ASU No. 2016-15, which amends FASB 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 for public entities. For nonpublic entities, this guidance is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods within annual reporting periods beginning after December 15, 2019. This guidance is required to be adopted retrospectively, with early adoption permitted. The Company adopted this guidance effective January 1, 2018 and the adoption will not have a material impact 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. In January 2018, the FASB issued ASU No. 2018-01 that provides for an optional transition practical expedient allowing companies to not have to evaluate existing land easements if they were not previously accounted for under ASC Topic 840, "Leases." This guidance is effective for interim and annual reporting periods beginning after December 15, 2018 for public entities. For nonpublic entities, this guidance is effective for annual reporting periods beginning after December 15, 2019 and interim reporting periods within annual reporting periods beginning after December 15, 2020. This guidance is required to be adopted using a modified retrospective approach, with early adoption permitted. The Company plans to adopt this guidance effective January 1, 2019 and is currently evaluating the impact on its Financial Statements and disclosures included within Notes to Financial Statements.

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. This guidance is effective for interim and annual reporting periods beginning after December 15, 2017 for public entities. For nonpublic entities, this guidance is effective for annual reporting periods beginning after December 15, 2018 and interim reporting periods within annual reporting periods beginning after December 15, 2019, with early adoption permitted. During 2016 and 2017, 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 adopted this guidance effective January 1, 2018 under the modified retrospective method and the adoption will not have an impact on its Financial Statements but will increase the disclosures included within Notes to Financial Statements. The timing and amount of revenue recognized after adoption of the new guidance will not be different than before as a majority of revenue is recognized when the Company has the right to invoice as it corresponds directly with the value to the customer of the Company’s performance to date.

(3) Property, Plant and Equipment, Net

Property, plant and equipment, net consists of the following as of December 31 (in thousands):

	Depreciation Rates	2017	2016
Transmission and other plant	1.5% to 10.0%	$ 3,384,832	$ 3,185,138
Storage plant[(1)]	1.25% to 2.34%	666,005	647,970
Intangible plant[(2)]	4.4% to 20.0%	152,573	147,023
General plant and buildings	2.75% to 10.0%	94,353	92,796
Total operating assets		4,297,763	4,072,927
Accumulated depreciation and amortization		(1,354,505)	(1,319,224)
Net operating assets		2,943,258	2,753,703
Construction work-in-progress		72,370	58,820
Property, plant and equipment, net		$ 3,015,628	$ 2,812,523

(1) Includes system-gas and market-based underground storage facilities. Recoverable system gas is not depreciated.

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

The Company had gross costs for capitalized software development of $131.4 million and $126.7 million and accumulated amortization of $60.8 million and $55.1 million as of December 31, 2017 and 2016, respectively, which is included in intangible plant and reflected in property, plant and equipment, net on the Balance Sheets. Capitalized software development costs are amortized at a rate of 4.4%.

The Company had gross costs for capitalized right of use or right of way of $112.2 million and $109.6 million and accumulated amortization of $38.8 million and $36.9 million as of December 31, 2017 and 2016, respectively, which is included in transmission and other plant and storage plant and reflected in property, plant and equipment, net on the Balance Sheets. Capitalized right of use or right of way costs are amortized at rates ranging from 1.25% to 10.0%.

For the years ended December 31, 2017 and 2016, depreciation expense of $68.4 million and $66.2 million, respectively, and amortization expense of $8.5 million and $8.2 million, respectively, were included in depreciation and amortization on the Statements of Income. The Company expects amortization expense to be $8.3 million for 2018, $8.3 million for 2019, $8.0 million for 2020, $7.6 million for 2021 and $7.3 million for 2022.

(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 consist of the following as of December 31 (in thousands):

	Weighted Average Remaining Life	2017	2016
Deferred unamortized loss on derivative contract value	5 years	$ 54,848	$ 64,532
Smart pigging and hydrostatic testing costs	7 years	27,461	28,386
Deferred income taxes associated with equity AFUDC[1]	67 years	22,552	22,276
AROs	6 years	16,428	28,092
Employee benefit plan[2]	12 years	7,063	6,439
Fuel trackers periodic rate adjustments	Various	6,730	—
Other	Various	1,249	1,432
Total regulatory assets		$ 136,331	$ 151,157
Reflected as:			
Current assets		$ 7,608	$ 721
Noncurrent assets		128,723	150,436
Total regulatory assets		$ 136,331	$ 151,157

(1) Amortized at the same rate as onshore transmission plant.

(2) Represents amounts not yet recognized as a component of net periodic benefit cost that are expected to be included in regulated rates when recognized.

The Company had regulatory assets not earning a return on investment of $61.5 million and $117.2 million as of December 31, 2017 and 2016, respectively.

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

	Weighted Average Remaining Life	2017	2016
Excess deferred income taxes[1]	Various	$ 418,909	$ —
Employee benefit plan [2]	12 years	30,231	24,911
Encroachment revaluation	1 year	3,632	483
Fuel trackers periodic rate adjustments	Various	—	9,295
Other	Various	5,317	1,704
Total regulatory liabilities		$ 458,089	$ 36,393
Reflected as:			
Current liabilities		$ 2,790	$ 11,000
Noncurrent liabilities		455,299	25,393
Total regulatory liabilities		$ 458,089	$ 36,393

(1) Amounts represent income tax liabilities related to the federal tax rate change from 35% to 21% on deferred income tax assets and liabilities that the Company deems probable of being reflected in future regulatory rates. See Note 6 for further discussion of 2017 Tax Reform impacts.

(2) Represents amounts not yet recognized as a component of net periodic benefit cost that are to be returned to customers in future periods when recognized.

(5) Long-Term Debt

Long-term debt consists of the following, including unamortized premiums and discounts, as of December 31 (dollars in thousands):

	Par Value	2017	2016
Long-term debt:			
5.75% Senior Notes, due 2018	$ 200,000	$ 199,871	$ 199,642
4.25% Senior Notes, due 2021	200,000	199,199	199,192
5.8% Senior Bonds, due 2037	150,000	149,091	149,066
4.1% Senior Bonds, due 2042	250,000	247,632	247,578
Total long-term debt	$ 800,000	$ 795,793	$ 795,478
Reflected as:			
Current liabilities		$ 199,871	$ —
Noncurrent liabilities		595,922	795,478
		$ 795,793	$ 795,478

All of the Company's senior notes and bonds are due and payable on their respective maturity dates and none have mandatory prepayment terms.

The Company is prohibited from making distributions in respect of the shares of its capital stock unless, on the date of any such distribution, none of certain specified events of default exist under its senior unsecured debt and either (1) at the time and as a result of such distribution, the ratio of its debt to its total capital does not exceed 0.65 to 1.0 and the ratio of its earnings before interest, taxes, depreciation and amortization, to its interest expense is not less than 2.5 to 1.0, or (2) if the Company is not in compliance with such ratios, its senior unsecured long-term debt rating is at least BBB (or its then equivalent) from Standard and Poor’s and Baa2 (or its then equivalent) from Moody's Investors Service, Inc.

(6) Income Taxes

Tax Cuts and Jobs Act

The 2017 Tax Reform impacts many areas of income tax law. The most material item included the reduction of the federal corporate tax rate from 35% to 21% effective January 1, 2018 and limitations on bonus depreciation for utility property. GAAP requires the effect on deferred tax assets and liabilities of a change in tax rates be recognized in the period the tax rate change was enacted. As a result of the 2017 Tax Reform, the Company reduced deferred income tax liabilities by $308.7 million. As it is probable the change in deferred taxes on property-related basis differences and other various differences will be reflected in future regulated rates, the Company established a regulatory liability of $418.9 million, which includes an income tax gross-up. The reduction in deferred income taxes related to items that will not be included in future regulated rates yielded an increase in deferred income tax expense of $2.7 million.

The Company has recorded the impacts of the 2017 Tax Reform in accordance with ASU 2018-05 and believes all the impacts to be complete with the exception of the interpretations of the bonus depreciation rules. The Company has determined the amounts recorded and the interpretations relating to bonus depreciation to be provisional and subject to remeasurement during the measurement period upon obtaining the necessary additional information to complete the accounting. The Company believes its interpretations for bonus depreciation to be reasonable, however, as the guidance is clarified estimates may change. The accounting is estimated to be completed by December 2018.

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

	2017	2016
Current:		
Federal	$ 27,584	$ 6,083
State	6,984	7,619
	34,568	13,702
Deferred:		
Federal	69,691	80,043
State	14,571	12,998
	84,262	93,041
Total	$ 118,830	$ 106,743

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:

	2017	2016
Federal statutory income tax rate	35.0%	35.0%
State income tax, net of federal income tax benefit	5.1	5.1
Effects of tax rate change	0.9	—
Effective income tax rate	41.0%	40.1%

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

	2017	2016
Deferred income tax assets:		
Regulatory liabilities	$ 120,767	$ 10,004
AROs	8,700	12,971
State carryforwards	6,729	6,101
Net unrealized losses on derivative contracts	3,286	25,616
Acquired goodwill	—	2,262
Other	16,954	21,842
Total deferred income tax assets	156,436	78,796
Valuation allowance	(2,028)	(667)
Total deferred income tax assets, net	154,408	78,129
Deferred income tax liabilities:		
Property, plant and equipment, net	(606,453)	(840,150)
Regulatory assets	(33,196)	(59,923)
Employee benefits	(8,126)	(9,888)
Other	(1,706)	(926)
Total deferred income tax liabilities	(649,481)	(910,887)
Net deferred income tax liability	$ (495,073)	$ (832,758)

The Company did not have federal net operating loss or credit carryforwards as of December 31, 2017. The following table provides the Company's state net operating loss and credit carryforwards and expiration dates as of December 31, 2017 (in thousands):

Net operating loss carryforwards	$ 100,636
Deferred income taxes on net operating loss carryforwards	$ 6,720
Expiration dates	2018-2035
Other tax credits	$ 9
Expiration dates	2018-2027

Acquired goodwill resulted from the income tax treatment by the Company's predecessor owners of their January 2002 acquisition of the Company. Acquired goodwill was amortized for tax purposes through January 2017 and was fully amortized as of December 31, 2017.

The valuation allowance primarily relates to Iowa state credit carryforwards that are not expected to be realized.

The United States Internal Revenue Service has effectively settled examination of BHE's income tax returns through December 31, 2009, including components related to the Company. State tax agencies have closed their examinations of, or the statute of limitations has expired for, BHE's income tax returns through December 31, 2007 for Kansas and Minnesota, through December 31, 2008 for Illinois, through December 31, 2009 for Nebraska and through December 31, 2013 for Iowa. The closure of examinations, or the expiration of the statute of limitations, for state filings may not preclude the state from adjusting the state net operating loss carryforward utilized in a year for which the examination is not closed.

(7) 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 $0.8 million and $0.9 million for the years ended December 31, 2017 and 2016, respectively. As of December 31, 2017, the Company recorded in other long-term liabilities its portion of the under funded status of the pension plan and in other assets its portion of the over funded status of the other postretirement plan of $7.1 million and $30.2 million, respectively. As of December 31, 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 $6.4 million and $24.9 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.

(8) Asset Retirement Obligations

The Company estimates its ARO liabilities based upon detailed engineering calculations of the amount and timing of the future cash spending for a third party to perform the required work. Spending estimates are escalated for inflation and then discounted at a credit-adjusted, risk-free rate. Changes in estimates could occur for a number of reasons, including plan revisions, inflation and changes in the amount and timing of the expected work.

The Company has concluded that it is legally obligated to remove, or abandon-in-place, its onshore 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. The Company has also identified AROs related to asbestos siding on some of its buildings. Because both the methods of settlement and the timing of the retirements are unknown, the amounts of these obligations cannot be reasonably estimated to determine the fair value of these obligations.

The following table reconciles the beginning and ending balances of the Company’s ARO liabilities for the years ended December 31(in thousands):

	2017	2016
Beginning balance	$ 32,676	$ 30,994
Change in estimated costs	(1,365)	556
Accretion	1,056	1,126
Ending balance	$ 32,367	$ 32,676

The Company's ARO liability relates to the abandonment of pipeline assets located in offshore waters. The change in estimated costs did not impact earnings in 2017 or 2016.

(9) Risk Management and Hedging Activities

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

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

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. These contracts, which will terminate in October 2018, have an estimated remaining purchase obligation of 0.5 Bcf. The Company has entered into swap agreements to hedge against the related price exposure.

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 Notes 2 and 10 for additional information on derivative contracts.

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

	Derivative Liabilities		
	Current	**Noncurrent**	**Total**
As of December 31, 2017			
Commodity assets[1]	$ 982	$ —	$ 982
Commodity liabilities[1]	(13,206)	—	(13,206)
Total derivatives - net basis[2]	$ (12,224)	$ —	$ (12,224)
As of December 31, 2016			
Commodity assets[1]	$ 502	$ 59	$ 561
Commodity liabilities[1]	(14,527)	(50,566)	(65,093)
Total derivatives - net basis[2]	$ (14,025)	$ (50,507)	$ (64,532)

(1) The Company's commodity derivatives not designated as hedging contracts are included in regulated rates, and as of December 31, 2017 and 2016, a regulatory asset of $12.2 million and $64.5 million, respectively, was recorded related to the net derivative liability of $12.2 million and $64.5 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 is 0.4 million and 9 million dth of natural gas purchases, net, as of December 31, 2017 and 2016, respectively.

Not Designated as Hedging Contracts

The following table reconciles the beginning and ending balances of the Company's regulatory assets and summarizes the pre-tax gains and losses on open commodity derivative contracts recognized in regulatory assets, as well as amounts reclassified to earnings for the years ended December 31 (in thousands):

	2017	2016
Beginning balance	$ 64,532	$ 74,963
Changes in fair value recognized in regulatory assets	1,365	2,349
Net gains (losses) reclassified to operating revenue	191	(152)
Termination of remaining contract value	(42,624)	—
Net losses reclassified to cost of gas and liquids sales	(11,240)	(12,628)
Ending balance	$ 12,224	$ 64,532

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 December 31, 2017, 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 $13.2 million and $64.5 million as of December 31, 2017 and 2016, respectively. As a result of customer contract renewal, the Company issued cash payments of $42.6 million during 2017 to terminate derivative contracts that were purchased to hedge price exposure on anticipated fuel purchases. If all credit-risk-related contingent features for derivative contracts in liability positions had been triggered as of December 31, 2017 and 2016, the Company would have been required to post $12.2 million and $64.5 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.

(10) 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				
	Level 1	Level 2	Level 3	Other(1)	Total
As of December 31, 2017					
Assets:					
Commodity derivatives	$ —	$ 982	$ —	$ (982)	$ —
Money market mutual funds(2)	30,876	—	—	—	30,876
Investment funds	8,298	—	—	—	8,298
	$ 39,174	$ 982	$ —	$ (982)	$ 39,174
Liabilities - commodity derivatives	$ —	$ (13,206)	$ —	$ 982	$ (12,224)
As of December 31, 2016					
Assets:					
Commodity derivatives	$ —	$ 561	$ —	$ (561)	$ —
Money market mutual funds(2)	67,046	—	—	—	67,046
Investment funds	4,433	—	—	—	$ 4,433
	$ 71,479	$ 561	$ —	$ (561)	$ 71,479
Liabilities - commodity derivatives	$ —	$ (65,093)	$ —	$ 561	$ (64,532)

(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 9 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.

The Company's long-term debt is carried at cost on the Financial Statements. The fair value of the Company's long-term debt is a Level 2 fair value measurement and has been estimated based upon quoted market prices, where available, or at the present value of future cash flows discounted at rates consistent with comparable maturities with similar credit risks. The following table presents the carrying value and estimated fair value of the Company's long-term debt as of December 31 (in thousands):

	2017		2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt	$ 795,793	$ 850,493	$ 795,478	$ 817,625

(11) Credit Risk

The Company has a concentration of customers in the electric and gas utility industries, principally in the upper Midwestern states. 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 Company's ten largest customers accounted for 65% of its system-wide transportation and storage revenue in 2017.

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

	Revenue		Accounts Receivable	
	2017	2016	2017	2016
Xcel Energy, Inc.(1)	13%	14%	11%	13%
CenterPoint Energy Resources Corporation(2)	11	11	13	15
MEC	10	11	9	9

(1) The Company's agreements are with Northern States Power-Minnesota, Northern States Power-Wisconsin, Northern States Power-Generation and Southwestern Public Service Company, subsidiaries of Xcel Energy, Inc.

(2) The Company's agreements are with CenterPoint Energy Minnesota Gas, CenterPoint Energy Services and CenterPoint Energy Gas Transmission, subsidiaries of CenterPoint Energy Resources Corporation.

For shippers that have withdrawn gas prior to injection under the Company's deferred delivery services, the Company is exposed to credit risk with respect to those counterparties based upon the value of the gas withdrawn. The balances in transportation and exchange gas receivables were $14.1 million and $12.0 million as of December 31, 2017 and 2016, respectively. Included in these amounts were balances owed of $9.2 million and $9.6 million as of December 31, 2017 and 2016, respectively, which were related to the Company's deferred delivery services.

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, 2017 and 2016, the Company has reflected on the Balance Sheets escrow funds of $2.9 million and $3.0 million, respectively, in other current assets and $5.8 million and $8.8 million, respectively, in other assets with offsetting amounts in other current liabilities and long-term liabilities, respectively.

(12) 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 condemnation panel which 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. In July 2017, the Tenth Circuit Court of Appeals reversed the federal district court award requiring the Company to pay for the value of storage gas remaining in the extension area and rejected the appeals of the defendants for additional compensation for storage rights and wells that were converted to observation wells. The Tenth Circuit Court of Appeals also rejected the defendants' request for attorney's fees. The decision reduces the condemnation award by approximately $6.0 million. The landowner and producer defendants filed requests for rehearing of the Tenth Circuit Court of Appeals decision. In August 2017, the requests for rehearing were not granted and the case was remanded to the federal district court for final disposition.

- The Company filed a lawsuit in December 2008 against Nash, LD Drilling and Val Energy in the United States District Court for the District of Kansas ("District Court") for nuisance, conversion and unjust enrichment related to the storage gas losses from the June 2010 FERC order through February 2011 after which the third-party wells in the extension area were shut-in. The conversion and unjust enrichment claims related to production of storage gas before the date of the certificate expansion order have been dismissed. In May 2016, the court issued an order lifting the stay that had been in place since August 2011. The trial set for June 2018 has been indefinitely postponed because of the retirement of the presiding judge.

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

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

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

Purchase Obligations

The Company expects to incur significant future capital expenditures to meet increased customer growth and system reliability objectives. As of December 31, 2017, the Company had firm construction commitments of $43.3 million, primarily related to branch line and compressor replacements. 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. Additionally, the Company has commitments to two of its largest customers to meet minimum levels of incremental capacity requests through 2027 and 2034.

Operating Leases, Easements and Maintenance Contracts

The Company has non-cancelable operating leases primarily for office space and rights-of-way. The minimum payments under these leases as of December 31, 2017 were $1.3 million, $1.2 million, $1.1 million, $1.0 million and $1.0 million for the years 2018 through 2022, respectively, and $4.9 million for the total of the years thereafter. These amounts are not reflected on the Balance Sheets. Rent expense on non-cancelable operating leases totaled $4.0 million for each of the years ended December 31, 2017 and 2016, and was included in operating and maintenance on the Statements of Income.

(13) Other Related Party Transactions

The Company provided gas transportation, storage and other services to MEC totaling $64.8 million and $64.5 million for the years ended December 31, 2017 and 2016, 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 $7.0 million and $5.8 million for the years ended December 31, 2017 and 2016, respectively. MEC also provided electricity and other services to the Company of $0.6 million for each of the years ended December 31, 2017 and 2016. The Company reimbursed MEC $67.6 million and $64.1 million for the years ended December 31, 2017 and 2016, 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 $3.3 million and $2.7 million for the years ended December 31, 2017 and 2016, respectively. Income tax transactions with BHE resulted in net payments of $47.5 million and net receipts of $32.7 million for the years ended December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016, the Company had net accounts payable to BHE and certain subsidiaries for intercompany transactions totaling $1.4 million and $1.3 million, respectively. The Company also had accounts receivable from affiliates of $9.0 million and $8.7 million as of December 31, 2017 and 2016, 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 $2.2 million and $1.8 million for the years ended December 31, 2017 and 2016, respectively, for these services.

The Company possesses demand promissory notes from BHE. The balance of the demand promissory notes as of December 31, 2017 and 2016 was $175.0 million and $155.0 million, respectively. The notes contain variable interest rates based on 30-day LIBOR plus a fixed spread per annum. Interest income of $4.0 million and $1.4 million was recorded for the years ended December 31, 2017 and 2016, respectively.

(14) Subsequent Events

In January 2018, the Company distributed dividends on common stock of $30.0 million. In February 2018, BHE issued a promissory note to the Company for $30.0 million.