Northern Illinois Gas Company

(doing business as Nicor Gas Company)

Condensed Consolidated Financial Statements as of June 30, 2017 and December 31, 2016
and for the Three and Six Months Ended June 30, 2017 and 2016 (Unaudited)

INDEX TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Certification of Senior Financial Officer

In connection with the unaudited condensed consolidated financial statements of Northern Illinois Gas Company (the Corporation) for the three and six months ended June 30, 2017 (the Financial Statements), the undersigned, the Senior Vice President, Accounting for the Corporation, hereby certifies that, to the best of her knowledge and belief on the date hereof, the unaudited condensed consolidated financial statements fairly present, in all material respects, the financial position of the Corporation and its results of operations and cash flows, prepared in accordance with accounting principles generally accepted in the United States.

Date: August 11, 2017

/s/ Grace A. Kolvereid
Grace A. Kolvereid
Senior Vice President, Accounting

NICOR GAS COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	**2017**	2016
	(in millions)		*(in millions)*	
Operating Revenues:				
Natural gas revenues (includes revenue taxes of $19, $17, $67, and $57 for the periods presented, respectively)	**$ 303**	$ 270	**$ 1,003**	$ 840
Operating Expenses:				
Cost of natural gas	**128**	99	**572**	420
Other operations and maintenance	**68**	66	**163**	160
Depreciation and amortization	**45**	41	**88**	82
Taxes other than income taxes	**26**	22	**79**	66
Total operating expenses	**267**	228	**902**	728
Operating Income	**36**	42	**101**	112
Interest expense, net of amounts capitalized	**9**	8	**18**	16
Earnings Before Income Taxes	**27**	34	**83**	96
Income taxes	**10**	12	**32**	36
Consolidated Net Income	**$ 17**	$ 22	**$ 51**	$ 60

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	**2017**	2016
	(in millions)		*(in millions)*	
Consolidated Net Income	**$ 17**	$ 22	**$ 51**	$ 60
Other comprehensive loss, net of tax				
Qualifying hedges:				
Changes in fair value, net of tax of $-, $(1), $-, and $(1), respectively	**(1)**	(1)	**(1)**	(1)
Consolidated Comprehensive Income	**$ 16**	$ 21	**$ 50**	$ 59

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

NICOR GAS COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	For the Six Months Ended June 30,	
	2017	2016
	(in millions)	
Operating Activities:		
Consolidated net income	**$ 51**	$ 60
Adjustments to reconcile consolidated net income to net cash provided from operating activities —		
Depreciation and amortization, total	**88**	82
Deferred income taxes	**14**	(27)
Market-to-Market Adjustments	**6**	(5)
Pension, postretirement, and other employee benefits	**(2)**	(3)
Other, net	**1**	6
Changes in certain current assets and liabilities —		
—Receivables	**147**	58
—Prepaid taxes	**(2)**	80
—Natural gas for sale, net of temporary LIFO liquidation	**211**	189
—Other current assets	**3**	14
—Accrued taxes	**1**	85
—Accounts payable	**(16)**	6
—Natural gas over recovery	**40**	(9)
—Other current liabilities	**(11)**	(14)
Net cash provided from operating activities	**531**	522
Investing Activities:		
Property additions	**(223)**	(204)
Cost of removal, net of salvage	**(18)**	(21)
Change in construction payables, net	**19**	(1)
Other investing activities	**1**	1
Net cash used for investing activities	**(221)**	(225)
Financing Activities:		
Decrease in notes payable, net	**(478)**	(445)
Proceeds —		
Capital contributions from parent company	**170**	25
First mortgage bonds	**—**	250
Redemptions and repurchases — First mortgage bonds	**—**	(125)
Other financing activities	**(1)**	(2)
Net cash used for financing activities	**(309)**	(297)
Net Change in Cash and Cash Equivalents	1	—
Cash and Cash Equivalents at Beginning of Period	**—**	—
Cash and Cash Equivalents at End of Period	**$ 1**	$ —
Supplemental Cash Flow Information:		
Cash paid (received) during the period for —		
Interest (net of less than $1 capitalized for each 2017 and 2016)	$ 16	$ 16
Income taxes, net	$ (1)	$ (15)
Noncash transactions — Accrued property additions at end of period	$ 27	$ 8

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

NICOR GAS COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

Assets	**At June 30, 2017**	At December 31, 2016
	(in millions)	
Current Assets:		
Cash and cash equivalents	**$ 1**	$ —
Receivables —		
Customer accounts receivable	**157**	203
Unbilled revenues	**28**	118
Other accounts and notes receivable	**14**	24
Accumulated provision for uncollectible accounts	**(22)**	(16)
Materials and supplies	**12**	14
Natural gas for sale	**6**	148
Assets from risk management activities, net of collateral	**3**	9
Prepaid expenses	**13**	9
Regulatory assets	**45**	46
Total current assets	**257**	555
Property, Plant, and Equipment:		
In service	**6,115**	6,007
Less: Accumulated depreciation	**2,234**	2,215
Plant in service, net of depreciation	**3,881**	3,792
Construction work in progress	**145**	66
Total property, plant, and equipment	**4,026**	3,858
Other Property and Investments:		
Miscellaneous property and investments	**6**	6
Deferred Charges and Other Assets:		
Regulatory assets	**358**	351
Other deferred charges and assets	**64**	59
Total deferred charges and other assets	**422**	410
Total Assets	**$ 4,711**	$ 4,829

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

NICOR GAS COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

Liabilities and Stockholder's Equity	**At June 30, 2017**	At December 31, 2016
	(in millions)	
Current Liabilities:		
Notes payable	**$ 45**	$ 523
Accounts payable	**178**	172
Customer deposits	**72**	83
Accrued Taxes —		
Accrued income taxes	**20**	7
Other accrued taxes	**14**	26
Accrued compensation	**8**	7
Regulatory liabilities	**120**	80
Accrued environmental remediation	**25**	26
Temporary LIFO liquidation	**69**	—
Other current liabilities	**26**	27
Total current liabilities	**577**	951
Long-term Debt	**619**	620
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	**573**	556
Employee benefit obligations	**196**	198
Other cost of removal obligations	**1,245**	1,230
Accrued environmental remediation	**235**	227
Other regulatory liabilities	**38**	39
Other deferred credits and liabilities	**17**	17
Total deferred credits and other liabilities	**2,304**	2,267
Total Liabilities	**3,500**	3,838
Common Stockholder's Equity:		
Common stock, par value $5 per share —		
Authorized — 25,000,000 shares		
Outstanding — June 30, 2017: 15,264,779 shares		
— December 31, 2016: 15,232,414 shares		
Par Value	**76**	76
Paid in capital	**414**	243
Retained earnings	**723**	672
Accumulated other comprehensive loss	**(2)**	(1)
Total Common Stockholder's Equity	**1,211**	990
Preferred Stock	**—**	1
Total Stockholder's Equity	**1,211**	991
Total Liabilities and Stockholder's Equity	**$ 4,711**	$ 4,829

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

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(A) INTRODUCTION

Northern Illinois Gas Company, doing business as Nicor Gas Company (Nicor Gas), is a natural gas distribution company that serves 2.2 million customers in a service territory that encompasses most of the northern third of Illinois, excluding the city of Chicago, and is a wholly-owned subsidiary of Southern Company Gas. Southern Company Gas is a wholly-owned, direct subsidiary of The Southern Company.

Nicor Gas is subject to regulation by the Illinois Commerce Commission (Illinois Commission). As such, Nicor Gas' financial statements reflect the effects of rate regulation in accordance with accounting principles generally accepted in the United States of America (GAAP) and comply with the accounting policies and practices prescribed by the Illinois Commission. The preparation of financial statements in conformity with GAAP requires the use of estimates, and the actual results may differ from those estimates.

These condensed consolidated financial statements reflect Nicor Gas' wholly-owned subsidiary on a consolidated basis. Intercompany profits and transactions have been eliminated in consolidation.

These condensed consolidated financial statements have been prepared without audit. The Condensed Balance Sheet as of December 31, 2016 has been derived from the audited financial statements of Nicor Gas (2016 Financial Statements). In the opinion of management, the information furnished herein reflects all adjustments, which, except as otherwise disclosed, are of a normal recurring nature, necessary to present fairly the results of operations for the periods ended June 30, 2017 and 2016. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations, although Nicor Gas believes that the disclosures are adequate to make the information presented not misleading. Disclosures which would substantially duplicate the disclosures in the 2016 Financial Statements and details which have not changed significantly in amount or composition since the issuance of the 2016 Financial Statements are generally omitted from these condensed consolidated financial statements unless specifically required by GAAP. Therefore, these condensed consolidated financial statements should be read in conjunction with the financial statements and the notes thereto included in the 2016 Financial Statements. Due to the seasonal variations in the demand for natural gas, operating results for the periods presented are not necessarily indicative of the operating results to be expected for the full year.

Certain prior year data in these condensed consolidated financial statements has been reclassified to conform to current year presentation. Changes to the consolidated statements of cash flows include revised financial statement line item descriptions to align with the new balance sheet descriptions and expanded line items within each type of cash flow activity. Such changes did not have a significant impact on the results of operations, financial position, or cash flows of Nicor Gas.

Recently Issued Accounting Standards

In 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers,* replacing the existing accounting standard and industry specific guidance for revenue recognition with a five-step model for recognizing and measuring revenue from contracts with customers. The underlying principle of the standard is to recognize revenue to depict the transfer of goods or services to customers at the amount expected to be collected. The new standard also requires enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue and the related cash flows arising from contracts with customers.

While Nicor Gas expects most of its revenue to be included in the scope of ASC 606, it has not fully completed its evaluation of all revenue arrangements. The majority of Nicor Gas' revenue, including energy provided to customers, is from tariff offerings that provide natural gas without a defined contractual term. Nicor Gas expects that the adoption of ASC 606 will not result in a significant shift in the timing of revenue recognition for such sales.

The power and utilities industry continues to evaluate other specific industry issues, including the applicability of ASC 606 to contributions in aid of construction (CIAC). Although final implementation guidance has not been issued, Nicor Gas expects CIAC to be out of the scope of ASC 606.

The new standard is effective for interim and annual reporting periods beginning after December 15, 2017. Nicor Gas intends to use the modified retrospective method of adoption effective January 1, 2018. Nicor Gas has also elected to utilize practical expedients which allows it to apply the standard to open contracts at the date of adoption and to reflect the aggregate effect of all modifications when identifying performance obligations and allocating the transaction price for contracts modified before the effective date. Under the modified retrospective method of adoption, prior year reported results are not restated; however, a cumulative effect adjustment to retained earnings at January 1, 2018 is recorded. In addition, disclosures will include comparative information on 2018 financial statement line items under current guidance. While the adoption of ASC 606, including the cumulative-effect adjustment, is not expected to have a material impact on either the timing or amount of revenues, recognized in Nicor Gas' financial statements, Nicor Gas will continue to evaluate the requirements, as well as any additional clarifying guidance that may be issued.

On March 10, 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (ASU 2017-07). ASU 2017-07 requires that an employer report the service cost component in the same line item or items as other compensation costs and requires the other components of net periodic pension and postretirement benefit costs to be separately presented in the income statement outside income from operations. Additionally, only the service cost component is eligible for capitalization, when applicable. However, all cost components remain eligible for capitalization under Federal Energy Regulatory Commission (FERC) regulations. ASU 2017-07 will be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension and postretirement benefit costs in the income statement. The capitalization of the service cost component of net periodic pension and postretirement benefit costs in assets will be applied on a prospective basis. ASU 2017-07 is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Nicor Gas is currently evaluating the new standard. The presentation changes required for net periodic pension and postretirement benefit costs will result in a decrease in Nicor Gas' operating income and an increase in other income for 2016 and 2017 and is expected to result in a decrease in operating income and an increase in other income for 2018. The adoption of ASU 2017-07 is not expected to have a material impact on Nicor Gas' financial statements.

Natural Gas for Sale

Nicor Gas' natural gas inventory is carried at cost on a last-in, first-out (LIFO) basis. Inventory decrements occurring during the year that are restored prior to year-end are charged to cost of natural gas at the estimated annual replacement cost. Inventory decrements that are not restored prior to year-end are charged to cost of natural gas at the actual LIFO cost of the inventory layers liquidated. Nicor Gas' inventory decrement at June 30, 2017 is expected to be restored prior to year-end. The cost of natural gas, including inventory costs, is recovered from customers under a purchased gas recovery mechanism adjusted for differences between actual costs and amounts billed; therefore, LIFO liquidations have no impact on Nicor Gas' net income.

Revenue Taxes

Nicor Gas charges customers for gas revenue taxes imposed on Nicor Gas and remits amounts owed to various governmental authorities. Gas revenue taxes are recorded at the amount charged to customers, which may include a small administrative fee, as operating revenues, and the related taxes imposed on Nicor Gas are recorded as operating expenses on the statements of income. Gas use taxes are excluded from revenue and expense with the related administrative fee included in operating revenues when the tax is imposed on the customer. Revenue taxes included in operating expenses were $18 million and $65 million for the three and six months ended June 30, 2017, respectively, and $17 million and $56 million for the three and six months ended June 30, 2016, respectively.

Income Taxes

Nicor Gas was included in Southern Company Gas' 2014 consolidated United States federal income tax return, which is currently under audit by the Internal Revenue Service. In addition, Southern Company Gas' 2013 and 2014 consolidated Illinois income tax returns are currently under audit by the Illinois Department of Revenue.

On July 6, 2017, the State of Illinois enacted tax legislation that increased the effective corporate income tax rate from 5.25% to 7.0% (making the total corporate tax rate 9.5% when combined with the 2.5% personal property replacement tax) effective July 1, 2017. In addition to increasing taxes on future earnings, this legislation will require Nicor Gas to adjust existing accumulated deferred income tax liabilities to reflect an increased tax rate, and any portion recoverable through rates will be recorded as a regulatory asset. Nicor Gas is currently evaluating these changes. The ultimate impact of this legislation cannot be determined at this time, but it is not expected to have a material impact on Nicor Gas' financial statements.

(B) CONTINGENCIES AND REGULATORY MATTERS

See Note 3 to the 2016 Financial Statements for information relating to various lawsuits, other contingencies, and regulatory matters.

General Litigation Matters

Nicor Gas is subject to certain claims and legal actions arising in the ordinary course of business. The ultimate outcome of such pending or potential litigation against Nicor Gas cannot be predicted at this time; however, for current proceedings not specifically reported herein, management does not anticipate that the ultimate liabilities, if any, arising from such current proceedings would have a material effect on Nicor Gas' financial statements.

Nicor Gas and Nicor Energy Services Company, wholly-owned subsidiaries of Southern Company Gas, and Nicor Inc. were defendants in a putative class action initially filed in 2011 in the state court in Cook County, Illinois. The plaintiffs purported to represent a class of the customers who purchased the Gas Line Comfort Guard product from Nicor Energy Services Company and variously alleged that the marketing, sale, and billing of the Gas Line Comfort Guard product violated the Illinois Consumer Fraud and Deceptive Business Practices Act, constituting common law fraud and resulting in unjust enrichment of these entities. The plaintiffs sought, on behalf of the classes they purported to represent, actual and punitive damages, interest, costs, attorney fees, and injunctive relief. On February 8, 2017, the judge denied the plaintiffs' motion for class certification and Nicor Gas' motion for summary judgment. On March 7, 2017, the parties reached a settlement, which was finalized and effective on April 3, 2017. The settlement had no impact on Nicor Gas' financial statements.

Environmental Remediation

Nicor Gas must comply with environmental laws and regulations that cover the handling and disposal of waste and releases of hazardous substances. Under these various laws and regulations, Nicor Gas could incur substantial costs to clean up affected sites. Nicor Gas has received authority from the Illinois Commission to recover approved

environmental compliance costs through regulatory mechanisms. These regulatory mechanisms are adjusted annually or as necessary within limits approved by the Illinois Commission.

Nicor Gas' environmental remediation liability was $260 million and $253 million as of June 30, 2017 and December 31, 2016, respectively, based on the estimated cost of environmental investigation and remediation associated with known current and former manufactured gas plant operating sites. These environmental remediation expenditures are recoverable from customers through rate mechanisms approved by the Illinois Commission.

The final outcome of these matters cannot be determined at this time. However, the final disposition of these matters is not expected to have a material impact on Nicor Gas' financial statements.

Regulatory Matters

See Note 3 to the 2016 Financial Statements under "Regulatory Matters" for additional information.

Riders

Nicor Gas has established a variable tax cost adjustment rider, which was approved by the Illinois Commission effective July 16, 2017. This rider provides for recovery of the invested capital tax imposed on Nicor Gas through an annual true-up and reconciliation mechanism. Accordingly, this rider will not have a significant effect on Nicor Gas' net income.

Natural Gas Cost Recovery

Nicor Gas has established natural gas cost recovery rates approved by the Illinois Commission. Natural gas cost recovery revenues are adjusted for differences in actual recoverable natural gas costs and amounts billed in current regulated rates. Changes in the billing factor will not have a significant effect on Nicor Gas' operating income or net income, but will affect cash flows.

Base Rate Case

On March 10, 2017, Nicor Gas filed a general base rate case with the Illinois Commission requesting a $208 million increase in annual base rate revenues. The requested increase is based on a 2018 projected test year and a return on equity of 10.7%. The Illinois Commission is expected to rule on the requested increase within the 11-month statutory time limit, after which rate adjustments will be effective. The ultimate outcome of this matter cannot be determined at this time.

Regulatory Infrastructure Program

In 2014, the Illinois Commission approved Nicor Gas' nine-year regulatory infrastructure program, Investing in Illinois. Under this program, Nicor Gas placed into service $75 million of qualifying assets during the first six months of 2017.

(C) FAIR VALUE MEASUREMENTS

As of June 30, 2017, assets and liabilities measured at fair value on a recurring basis during the period, together with their associated level of the fair value hierarchy, were as follows:

	Fair Value Measurements Using (*)				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Asset Value as a Practical Expedient (NAV)	Total
			(in millions)		
Assets:					
Energy-related derivatives	$ 1	$ 2	$ —	$ —	$ 3
Liabilities:					
Energy-related derivatives	$ 1	$ 2	$ —	$ —	$ 3

(*) Energy-related derivatives excludes cash collateral of $1 million.

Valuation Methodologies

The energy-related derivatives primarily consist of exchange-traded and non-exchange-traded derivatives such as over-the-counter forwards and options. These are standard products used within the energy industry and are valued using the market approach. The inputs used are mainly from observable market sources, such as forward natural gas prices and implied volatility. See Note (G) for additional information on how these derivatives are used.

Long-term Debt

As of June 30, 2017, other financial instruments for which the carrying amount did not equal fair value were as follows:

	Carrying Amount	Fair Value
	(in millions)	
Long-term debt	$ 619	$ 687

The fair value is determined using Level 2 measurements and is based on quoted market prices for the same or similar issues or on the current rates available to Nicor Gas.

(D) STOCKHOLDER'S EQUITY

Changes in Stockholder's Equity

The following table presents year-to-date changes in stockholder's equity of Nicor Gas:

	Number of Common Shares Issued	Common Stockholder's Equity	Preferred Stock	Total Stockholder's Equity
	(in thousands)		*(in millions)*	
Balance at December 31, 2016	15,232	$ 990	$ 1	$ 991
Consolidated net income	—	51	—	51
Other comprehensive loss	—	(1)	—	(1)
Preferred stock conversion	33	1	(1)	—
Capital contributions from parent company	—	170	—	170
Balance at June 30, 2017	**15,265**	**$ 1,211**	**$ —**	**$ 1,211**
Balance at December 31, 2015	15,232	822	1	823
Consolidated net income	—	60	—	60
Other comprehensive loss	—	(1)	—	(1)
Capital contributions from parent company	—	25	—	25
Balance at June 30, 2016	15,232	$ 906	$ 1	$ 907

At December 31, 2016, Nicor Gas had 800,000 shares authorized, $100 par value non-redeemable preferred stock. Nicor Gas had 8,750 shares outstanding of 4.6% convertible preferred stock and 5,258 shares outstanding of 5.0% convertible preferred stock at December 31, 2016 included within equity on the consolidated balance sheets. On February 28, 2017, all shares of convertible preferred stock were converted to 32,365 shares of common stock.

(E) FINANCING

See Note 5 to the 2016 Financial Statements under "Long-Term Debt" and "Bank Credit Arrangements" for additional information.

Bank Credit Arrangements

Bank credit arrangements under Nicor Gas' credit facility provide liquidity support to Nicor Gas' commercial paper borrowings and are restricted for the working capital needs of Nicor Gas. The following table outlines the committed credit arrangements as of June 30, 2017:

	Expires 2022	Unused
	(in millions)	
Nicor Gas Credit Facility	$ 700	$ 700

In May 2017, Nicor Gas terminated its existing credit arrangement for $700 million, which was to mature in 2017 and 2018, and entered into a new multi-year credit arrangement currently allocated for $700 million with a maturity date of 2022.

Subject to applicable market conditions, Nicor Gas expects to renew or replace its bank credit arrangements as needed, prior to expiration. In connection therewith, Nicor Gas may extend the maturity dates and/or increase or decrease the lending commitments thereunder.

Financing Activities

Subsequent to June 30, 2017, Nicor Gas agreed to issue $400 million aggregate principal amount of First Mortgage Bonds in a private placement, $200 million of which was issued in August 2017 and $200 million of which is expected to be issued in November 2017.

(F) RETIREMENT BENEFITS

Nicor Gas participates in the Southern Company Gas qualified defined benefit, trusteed, pension plan - AGL Resources Inc. Retirement Plan (AGL Plan) - that covers certain eligible Nicor Gas employees. The AGL Plan is funded in accordance with requirements of the Employee Retirement Income Security Act of 1974, as amended. No mandatory contributions to the AGL Plan are anticipated for the year ending December 31, 2017. Nicor Gas also participates in the Southern Company Gas postretirement benefit plan - AGL Welfare Plan - that provides certain medical care and life insurance benefits for eligible retired employees. See Note 2 to the 2016 Financial Statements for additional information.

Nicor Gas' pro rata components of Southern Company Gas' net periodic pension costs for the periods presented were as follows:

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2017	2016	**2017**	2016
	(in millions)		*(in millions)*	
Service cost	**$ 2**	$ 2	**$ 4**	$ 4
Interest cost	**3**	3	**6**	6
Expected return on plan assets	**(6)**	(7)	**(13)**	(14)
Amortization:				
Net loss	**2**	2	**4**	4
Net periodic pension cost	**$ 1**	$ —	**$ 1**	$ —

Nicor Gas' pro rata components of Southern Company Gas' other postretirement benefit plans' net periodic cost for the periods presented were as follows:

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2017	2016	**2017**	2016
	(in millions)		*(in millions)*	
Service cost	**$ 1**	$ 1	**$ 1**	$ 1
Interest cost	**1**	2	**3**	4
Amortization:				
Prior service costs	**—**	—	**(1)**	(1)
Net loss	**—**	—	**1**	1
Net periodic pension cost	**$ 2**	$ 3	**$ 4**	$ 5

(G) DERIVATIVES

Nicor Gas is exposed to market risks, primarily commodity price risk, interest rate risk, and weather risk. To manage the volatility attributable to these exposures, Nicor Gas nets its exposures, where possible, to take advantage of natural offsets and enters into various derivative transactions for the remaining exposures pursuant to Nicor Gas' policies in areas such as counterparty exposure and risk management practices. Nicor Gas' policy is that derivatives are to be used primarily for hedging purposes and mandates strict adherence to all applicable risk management policies. Derivative positions are monitored using techniques including, but not limited to, market valuation, value at risk, stress testing, and sensitivity analysis. Derivative instruments are recognized at fair value in

the balance sheets as either assets or liabilities and are presented on a net basis. See Note (C) herein for additional information on fair value measurements. In the statements of cash flows, the cash impacts of settled energy-related and interest rate derivatives are recorded as operating activities.

Energy-Related Derivatives

Nicor Gas enters into energy-related derivatives to hedge exposures to natural gas and other fuel price changes. However, due to cost-based rate regulations and other various cost recovery mechanisms, Nicor Gas has limited exposure to market volatility in prices of natural gas. Nicor Gas manages energy-related hedging programs, implemented per Illinois Commission guidelines, through the use of financial derivative contracts, which is expected to continue to mitigate price volatility.

Energy-related derivative contracts are accounted for under one of three methods:

- *Regulatory Hedges* - Energy-related derivative contracts which are designated as regulatory hedges relate primarily to Nicor Gas' energy-related hedging programs, where gains and losses are initially recorded as regulatory liabilities and assets, respectively, and then are included in the cost of natural gas as the underlying natural gas is used in operations and ultimately recovered through cost recovery clauses.
- *Cash Flow Hedges* - Gains and losses on energy-related derivatives designated as cash flow hedges (which are mainly used to hedge anticipated purchases and sales) are initially deferred in other comprehensive income (OCI) before being recognized in the statements of income in the same period as the hedged transactions are reflected in earnings.
- *Not Designated* - Gains and losses on energy-related derivative contracts that are not designated or fail to qualify as hedges are recognized in the statements of income as incurred.

At June 30, 2017, the net volume of energy-related derivative contracts for natural gas positions totaled 43 billion cubic feet for Nicor Gas, together with the longest hedge date of 2018 over which Nicor Gas is hedging its exposure to the variability in future cash flows for forecasted transactions and the longest non-hedge date of 2018 for derivatives not designated as hedges.

For cash flow hedges, the amount expected to be reclassified from accumulated OCI to earnings for the next 12-month period ending June 30, 2018 is immaterial.

Derivative Financial Statement Presentation and Amounts

The derivative contracts of Nicor Gas are subject to master netting arrangements or similar agreements and are reported net on its financial statements. Some of these energy-related and interest rate derivative contracts may contain certain provisions that permit intra-contract netting of derivative receivables and payables for routine billing and offsets related to events of default and settlements. The fair value of energy-related derivatives was reflected in the balance sheets as follows:

		As of June 30, 2017		As of December 31, 2016	
Derivative Category	**Balance Sheet Location**	**Assets**	**Liabilities**	**Assets**	**Liabilities**
		(in millions)		*(in millions)*	
Derivatives designated as hedging instruments for regulatory purposes					
Energy-related derivatives:					
	Assets from risk management activities/Liabilities from risk management activities – current	**$ 3**	**$ 3**	$ 17	$ 2
Total derivatives designated as hedging instruments for regulatory purposes		**$ 3**	**$ 3**	$ 17	$ 2
Derivatives designated as hedging instruments in cash flow and fair value hedges					
Energy-related derivatives:					
	Assets from risk management activities/Liabilities from risk management activities – current	**$ —**	**$ —**	$ 1	$ —
Total derivatives designated as hedging instruments in cash flow and fair value hedges		**$ —**	**$ —**	$ 1	$ —
Gross amounts recognized		**$ 3**	**$ 3**	$ 18	$ 2
Gross amounts offset(*)		**$ —**	**$ (2)**	$ (9)	$ (1)
Net amounts recognized in the Balance Sheet		**$ 3**	**$ 1**	$ 9	$ 1

(*) Gross amounts offset include cash collateral held on deposit in broker margin accounts of $1 million and $8 million as of June 30, 2017 and December 31, 2016, respectively.

At June 30, 2017 and December 31, 2016, the pre-tax effects of unrealized derivative gains (losses) arising from energy-related derivative instruments designated as regulatory hedging instruments and deferred were as follows:

	Unrealized Losses			Unrealized Gains		
Derivative Category	**Balance Sheet Location**	**June 30, 2017**	December 31, 2016	**Balance Sheet Location**	**June 30, 2017**	December 31, 2016
		(in millions)			*(in millions)*	
Energy-related derivatives:						
	Other regulatory assets, current(*)	**$ (1)**	$ (1)	Other regulatory liabilities, current	**$ 3**	$ 9

(*) Fair value gains and losses recorded in regulatory assets and liabilities include cash collateral held on deposit in broker margin accounts of $1 million at June 30, 2017 and $8 million at December 31, 2016.

For the three and six months ended June 30, 2017 and 2016, the pre-tax effect of energy related derivatives designated as cash flow hedging instruments recognized in OCI and those reclassified from accumulated OCI into earnings were immaterial.

For the three and six months ended June 30, 2017 and 2016, the pre-tax effects of energy-related derivatives not designated as hedging instruments were immaterial.

Contingent Features

Nicor Gas does not have any credit arrangements that would require material changes in payment schedules or terminations as a result of a credit rating downgrade. There are certain derivatives that could require collateral, but not accelerated payment, in the event of a credit rating change below BBB- and/or Baa3. At June 30, 2017, Nicor Gas had no collateral posted with derivative counterparties to satisfy these arrangements.

At June 30, 2017, the fair value of derivative liabilities with contingent features and the maximum potential collateral requirements arising from the credit-risk-related contingent features were immaterial.

Generally, collateral may be provided by a guaranty, letter of credit, or cash. If collateral is required, fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral are not offset against fair value amounts recognized for derivatives executed with the same counterparty.

Nicor Gas is exposed to losses related to financial instruments in the event of counterparties' nonperformance. Nicor Gas only enters into agreements and material transactions with counterparties that have investment grade credit ratings by Moody's Investors Service, Inc. and S&P Global Ratings, a division of S&P Global Inc. or with counterparties who have posted collateral to cover potential credit exposure. Nicor Gas has also established risk management policies and controls to determine and monitor the creditworthiness of counterparties in order to mitigate Nicor Gas' exposure to counterparty credit risk.

Nicor Gas also utilizes master netting agreements whenever possible to mitigate exposure to counterparty credit risk. When Nicor Gas is engaged in more than one outstanding derivative transaction with the same counterparty and it also has a legally enforceable netting agreement with that counterparty, the "net" mark-to-market exposure represents the netting of the positive and negative exposures with that counterparty and a reasonable measure of Nicor Gas' credit risk. Nicor Gas also uses other netting agreements with certain counterparties with whom it conducts significant transactions. Master netting agreements enable Nicor Gas to net certain assets and liabilities by counterparty. Nicor Gas also nets across product lines and against cash collateral, provided the master netting and cash collateral agreements include such provisions.

Nicor Gas may require counterparties to pledge additional collateral when deemed necessary. Nicor Gas does not anticipate a material adverse effect on its financial statements as a result of counterparty nonperformance.

(H) AFFILIATE TRANSACTIONS

In the ordinary course of business, in accordance with the terms authorized under the Public Utilities Act, Nicor Gas enters into transactions with its affiliates. The charges for these transactions are cost-based, market-based, or at a prevailing price.

Facilities and Services

Nicor Gas enters into transactions with its affiliates for the use of facilities and services. Nicor Gas had net charges from affiliates of $37 million and $77 million for the three and six months ended June 30, 2017, respectively, and $41 million and $76 million for the three and six months ended June 30, 2016, respectively. Certain operating costs are paid on behalf of Nicor Gas by AGL Services Company, a service company that was established to provide certain centralized shared services to the operating subsidiaries of Southern Company Gas, and then charged to Nicor Gas.

Loans

Nicor Gas is prohibited by regulations of the Illinois Commission from loaning money to affiliates. However, it is permitted under these regulations to receive cash advances from Southern Company Gas. The balance of any such advances may not exceed the balance of funds available to Nicor Gas under the Nicor Gas existing credit agreements or commercial paper facility with unaffiliated third parties. Interest is charged on such loans at the lower of Nicor Gas' commercial paper rate or Southern Company Gas' actual interest cost for the funds obtained or used to provide the cash advance to Nicor Gas. Nicor Gas received no cash advances from Southern Company Gas during the first six months of 2017 and 2016.

Natural Gas Related Transactions

Nicor Solutions, LLC (Nicor Solutions) and Prairie Point Energy, LLC (doing business as Nicor Advanced Energy) are gas marketing services subsidiaries of Southern Company Gas that conduct non-utility business in Illinois.

Nicor Solutions offers residential and small commercial customers energy-related products that provide for natural gas cost stability and management of their utility bill. Under these products, Nicor Solutions pays Nicor Gas for the utility bills issued to the utility-bill management customers. Nicor Gas recorded revenues of $5 million and $14 million for the three and six months ended June 30, 2017, respectively, and $4 million and $12 million for the three and six months ended June 30, 2016, respectively, associated with these payments.

Nicor Advanced Energy provides natural gas and related services on an unregulated basis to residential and small commercial customers. As a natural gas supplier, Nicor Advanced Energy pays Nicor Gas for delivery charges, administrative charges, and applicable taxes. Nicor Advanced Energy paid Nicor Gas $1 million and $2 million for three and six months ended June 30, 2017, respectively, and $1 million and $2 million for the three and six months ended June 30, 2016, respectively. Additionally, Nicor Advanced Energy may pay or receive inventory imbalance adjustments. The amount Nicor Advanced Energy paid to Nicor Gas was less than $1 million and $3 million for three and six months ended June 30, 2017, respectively, and less than $1 million and $1 million for the three and six months ended June 30, 2016, respectively.

Nicor Gas enters into natural gas purchases and sales with Sequent Energy Management, L.P. (Sequent) as authorized by terms of an Illinois Commission order. Net purchases with Sequent were $3 million and $4 million for three and six months ended June 30, 2017, respectively, and $2 million and $5 million for the three and six months ended June 30, 2016, respectively. Additionally, Nicor Gas recorded gas supply related charges to Sequent of less than $1 million and $1 million for three and six months ended June 30, 2017, respectively, and less than $1 million for each of the three and six months ended June 30, 2016.

Horizon Pipeline Company, LLC, a 50-percent-owned joint venture of Southern Company Gas, which operates an interstate regulated natural gas pipeline of approximately 70 miles stretching from Joliet, Illinois to near the Wisconsin/Illinois border, charged Nicor Gas $2 million and $4 million for three and six months ended June 30, 2017, respectively, and $3 million and $5 million for the three and six months ended June 30, 2016, respectively, for natural gas transportation under rates that have been accepted by the FERC.

In addition, certain related parties may acquire regulated utility services at rates approved by the Illinois Commission.

(I) SUBSEQUENT EVENTS

Management evaluated subsequent events for potential recognition and disclosure through June 30, 2017, and through August 11, 2017, the date these condensed consolidated financial statements and related notes were available to be issued, and determined that no significant events, other than the tax legislation enacted in the State of Illinois discussed in Note (A), the variable tax cost adjustment rider discussed in Note (B), and the pricing and subsequent sale of First Mortgage Bonds discussed in Note (E) herein, have occurred subsequent to period end.