Northern Illinois Gas Company
(doing business as Nicor Gas Company)

Condensed Consolidated Financial Statements as of September 30, 2016 and December 31, 2015 and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

INDEX TO QUARTERLY REPORT (UNAUDITED)
September 30, 2016

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 nine months ended September 30, 2016 (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: November 29, 2016

/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 September 30,		For the Nine Months Ended September 30,	
	2016	2015	**2016**	2015
	(in millions)			
Operating Revenues:				
Natural gas revenues (includes revenue taxes of $9, $9, $66 and $83 for the periods presented, respectively)	**$ 201**	$ 204	**$ 1,041**	$ 1,282
Total operating revenues	**201**	204	**1,041**	1,282
Operating Expenses:				
Cost of natural gas	**58**	58	**478**	711
Other operations and maintenance	**63**	64	**223**	220
Depreciation and amortization	**42**	39	**124**	116
Taxes other than income taxes	**13**	13	**79**	96
Total operating expenses	**176**	174	**904**	1,143
Operating Income	**25**	30	**137**	139
Other Income and (Expense):				
Interest expense, net of amounts capitalized	**(8)**	(8)	**(24)**	(23)
Total other income and (expense)	**(8)**	(8)	**(24)**	(23)
Earnings Before Income Taxes	**17**	22	**113**	116
Income taxes	**6**	9	**42**	46
Consolidated Net Income	**$ 11**	$ 13	**$ 71**	$ 70

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	**2016**	2015
	(in millions)			
Consolidated Net Income	**$ 11**	$ 13	**$ 71**	$ 70
Other comprehensive income (loss):				
Qualifying hedges:				
Changes in fair value, net of tax of less than $(1) for the three and nine months ended September 30, 2016	**(1)**	—	**(2)**	—
Reclassification adjustment for amounts included in net income, net of tax of less than $1 for the three and nine months ended September 30, 2016	**1**	—	**1**	—
Consolidated Comprehensive Income	**$ 11**	$ 13	**$ 70**	$ 70

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 Nine Months Ended September 30,	
	2016	2015
	(in millions)	
Operating Activities:		
Consolidated net income	**$ 71**	$ 70
Adjustments to reconcile consolidated net income to net cash provided from operating activities —		
Depreciation and amortization, total	**124**	116
Deferred income taxes	**(22)**	21
Pension, postretirement, and other employee benefits	**(3)**	(2)
Other, net	**(1)**	3
Changes in certain current assets and liabilities —		
-Receivables	**121**	256
-Prepaid taxes	**80**	45
-Natural gas for sale	**6**	(13)
-Materials and supplies	**2**	(6)
-Other current assets	**15**	20
-Accounts payable	**34**	(31)
-Accrued taxes	**(1)**	(12)
-Natural gas over recovery	**(25)**	25
-Other current liabilities	**(6)**	(16)
Net cash provided from operating activities	**395**	476
Investing Activities:		
Property additions	**(337)**	(302)
Cost of removal, net of salvage	**(35)**	(36)
Change in construction payables, net	**13**	12
Net cash used for investing activities	**(359)**	(326)
Financing Activities:		
Decrease in notes payable, net	**(183)**	(150)
Proceeds —		
First mortgage bonds	**250**	—
Capital contributions from parent company	**25**	—
Redemptions and repurchases — First mortgage bonds	**(125)**	—
Other financing activities	**(3)**	—
Net cash used for financing activities	**(36)**	(150)
Net Change in Cash and Cash Equivalents	**—**	—
Cash and Cash Equivalents at Beginning of Period	**—**	—
Cash and Cash Equivalents at End of Period	**$ —**	$ —

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

NICOR GAS COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

Assets	**At September 30, 2016**	At December 31, 2015
	(in millions)	
Current Assets:		
Receivables —		
Customer accounts receivable	**$ 106**	$ 173
Unbilled revenues	**29**	68
Other accounts and notes receivable	**11**	25
Accumulated provision for uncollectible accounts	**(16)**	(18)
Materials and supplies	**15**	17
Natural gas for sale	**139**	145
Assets from risk management activities, net of collateral	**3**	7
Prepaid expenses	**10**	90
Regulatory assets, current	**41**	47
Total current assets	**338**	554
Property, Plant, and Equipment:		
In service	**5,882**	5,632
Less accumulated depreciation	**2,203**	2,170
Plant in service, net of depreciation	**3,679**	3,462
Construction work in progress	**95**	53
Total property, plant, and equipment	**3,774**	3,515
Other Property and Investments:		
Miscellaneous property and investments	**6**	6
Total other property and investments	**6**	6
Deferred Charges and Other Assets:		
Regulatory assets, deferred	**405**	335
Other deferred charges and assets	**24**	70
Total deferred charges and other assets	**429**	405
Total Assets	**$ 4,547**	$ 4,480

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

NICOR GAS COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

Liabilities and Stockholders' Equity	**At September 30, 2016**	At December 31, 2015
	(in millions)	
Current Liabilities:		
Securities due within one year	**$ —**	$ 125
Notes payable	**356**	539
Accounts payable	**146**	93
Due to affiliates	**11**	16
Customer deposits	**96**	88
Accrued Taxes —		
Other accrued taxes	**15**	16
Accrued compensation	**6**	6
Other regulatory liabilities, current	**50**	66
Accrued environmental remediation liabilities, current	**27**	32
Other current liabilities	**34**	43
Total current liabilities	**741**	1,024
Long-term Debt	**620**	372
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	**545**	562
Employee benefit obligations	**218**	200
Other cost of removal obligations	**1,227**	1,218
Accrued environmental remediation liabilities, deferred	**221**	218
Other deferred credits and liabilities	**57**	63
Total deferred credits and other liabilities	**2,268**	2,261
Total Liabilities	**3,629**	3,657
Common Stockholders' Equity:		
Common stock, par value $5 per share —		
Authorized — 25,000,000 shares		
Outstanding — 15,232,414 shares		
Par Value	**76**	76
Paid-in capital	**193**	168
Retained earnings	**650**	579
Accumulated other comprehensive loss	**(2)**	(1)
Total Common Stockholders' Equity	**917**	822
Preferred Stock	**1**	1
Total Stockholders' Equity	**918**	823
Total Liabilities and Stockholders' Equity	**$ 4,547**	$ 4,480

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 (formerly known as AGL Resources Inc.). On July 1, 2016, Southern Company Gas completed its previously announced merger with The Southern Company (Southern Company). In accordance with the Agreement and Plan of Merger, a wholly-owned subsidiary of Southern Company merged with and into Southern Company Gas, with Southern Company Gas continuing as the surviving corporation and a wholly-owned, direct subsidiary of Southern Company (Merger).

The Merger was approved by the Illinois Commerce Commission (Illinois Commission) on June 7, 2016. In connection with this approval, among other things, Nicor Gas is prohibited from recovering Merger-related expenses, Nicor Gas must maintain a minimum number of employees for a set period of time, and Nicor Gas must maintain its pre-Merger level of support for various social and charitable programs. In addition, the use of the Nicor name or logo must be phased out by Southern Company Gas' gas marketing services businesses in conducting non-utility business in Illinois. There are no restrictions on Nicor Gas' ability to file future base rate cases as a result of this approval.

The impact of the acquisition method of accounting was not pushed down to Nicor Gas and is not reflected in the condensed consolidated quarterly financial statements included herein, which have been prepared, without audit, in accordance with accounting principles generally accepted in the United States of America (GAAP). The condensed consolidated balance sheet as of December 31, 2015 has been derived from the audited consolidated financial statements of Nicor Gas (2015 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 September 30, 2016 and 2015. 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 2015 Financial Statements and details which have not changed significantly in amount or composition since the filing of the 2015 Financial Statements are generally omitted from this quarterly report 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 2015 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 the financial statements have been modified or reclassified to conform to the 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. Changes to the consolidated statements of income and the consolidated balance sheets include changing certain captions to conform to the current year presentation. Such changes did not have a significant impact on the results of operations, financial position, or cash flows of Nicor Gas.

Inventories

Nicor Gas' natural gas inventory is carried at cost on a last-in, first-out (LIFO) basis. Under the LIFO method, inventory decrements occurring during the year that are expected to be restored prior to year-end are charged to cost of goods sold at the estimated annual replacement cost, and the difference between this cost and the actual liquidated LIFO layer cost is recorded as a temporary LIFO liquidation on the unaudited Condensed Consolidated Balance Sheets. There was an immaterial temporary LIFO liquidation balance as of September 30, 2016. Interim inventory decrements that are not expected to be restored prior to year-end are charged to cost of goods sold at the actual LIFO cost of the layers liquidated. The inventory decrement as of September 30, 2016 of $5 million is expected to be restored prior to year-end. There was no inventory decrement as of December 31, 2015.

Revenue Taxes

Nicor Gas charges customers for gas revenue and gas use taxes imposed on Nicor Gas and remits amounts owed to various governmental authorities. Revenue taxes included in operating expenses were $8 million and $64 million for the three and nine months ended September 30, 2016, respectively, and $8 million and $81 million for the three and nine months ended September 30, 2015, respectively.

Equity

Due to the increased working capital requirements associated with Nicor Gas' Investing in Illinois infrastructure replacement program, Nicor Gas has temporarily ceased distributing dividends to Southern Company Gas. The $25 million increase in

additional paid-in-capital was attributable to a cash contribution from Southern Company Gas to provide capital for Nicor Gas' increased financing needs. Any cash that was not used for working capital requirements was used to pay down Nicor Gas' commercial paper borrowings during the period.

Recently Issued Accounting Standards

On November 20, 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes* (ASU 2015-17), which simplifies the presentation of deferred income taxes. ASU 2015-17 requires deferred tax assets and liabilities to be presented as non-current in a classified balance sheet and is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. As permitted, Nicor Gas elected to early adopt the guidance as of September 30, 2016 and applied its provisions retrospectively for comparative purposes. Prior to the adoption of ASU 2015-17, all deferred income tax assets and liabilities were required to be separated into current and non-current amounts. The new guidance resulted in a reclassification of $47 million deferred income taxes, current to non-current accumulated deferred income taxes in Nicor Gas' December 31, 2015 balance sheet. Other than the reclassification, the adoption of ASU 2015-17 did not have an impact on the results of operations, financial position, or cash flows of Nicor Gas.

On February 25, 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (ASU 2016-02). ASU 2016-02 requires lessees to recognize on the balance sheet a lease liability and a right-of-use asset for all leases. ASU 2016-02 also changes the recognition, measurement, and presentation of expense associated with leases and provides clarification regarding the identification of certain components of contracts that would represent a lease. The accounting required by lessors is relatively unchanged. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. Nicor Gas is currently evaluating the new standard and has not yet determined its ultimate impact; however, adoption of ASU 2016-02 is expected to have a significant impact on Nicor Gas' balance sheet.

(B) CONTINGENCIES AND REGULATORY MATTERS

See Note 10 to the consolidated financial statements of Nicor Gas in the 2015 Financial Statements for additional information relating to various lawsuits, other contingencies, and regulatory matters. Also, see Notes 3 and 4 to the consolidated financial statements of Nicor Gas in the 2015 Financial Statements for additional information relating to 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 or in Note 10 to the consolidated financial statements of Nicor Gas in the 2015 Financial Statements, 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, along with Nicor Energy Services Company, a wholly-owned subsidiary of Southern Company Gas, and Nicor Inc., is a defendant in a putative class action initially filed in September 2011 in state court in Cook County, Illinois. The plaintiffs purport to represent a class of the customers who purchased the Gas Line Comfort Guard product from Nicor Energy Services Company and variously allege 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 seek, on behalf of the classes they purport to represent, actual and punitive damages, interest, costs, attorney fees, and injunctive relief. On October 26, 2016, the court held a hearing on the plaintiffs' motion for class certification and the defendants' motion for summary judgment on all of the plaintiffs' claims. The ultimate outcome of this matter cannot be determined at this time.

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 remediation costs through a rate rider mechanism that authorizes dollar-for-dollar recovery.

Nicor Gas is subject to environmental remediation liabilities associated with former manufactured gas plant sites in the state of Illinois. Accrued environmental remediation costs of $248 million have been recorded in the consolidated balance sheets, $27 million of which is expected to be incurred over the next 12 months. These environmental remediation expenditures are recoverable from customers through a rate rider mechanism approved by the Illinois Commission. The ultimate outcome of these matters cannot be determined at this time; however, these matters are not expected to have a material impact on Nicor Gas' financial statements.

In September 2015, the Environmental Protection Agency (EPA) filed an administrative complaint and notice of opportunity for hearing against Nicor Gas. The complaint alleges violation of the regulatory requirements applicable to polychlorinated biphenyls in the Nicor Gas distribution system and the EPA seeks a total civil penalty of approximately $0.3 million. The ultimate outcome of this matter cannot be predicted at this time; however, the final disposition of this matter is not expected to have a material impact on the results of operations, financial position, or cash flows of Nicor Gas.

Regulatory Matters

See Note 4 to the consolidated financial statements of Nicor Gas in the 2015 Financial Statements for additional information regarding Nicor Gas' recovery of costs through various regulatory clauses and accounting orders.

Regulatory Infrastructure Programs In 2014, the Illinois Commission approved Nicor Gas' nine-year regulatory infrastructure program, Investing in Illinois. As of September 30, 2016, Nicor Gas has placed into service $457 million of qualifying assets under this program, $207 million of which was related to the first nine months of 2016. Nicor Gas filed its annual update under the program with the Illinois Commission on April 1, 2016.

Gas Cost Prudence Review Dispute

In 2014, the Illinois Commission Staff and the Citizens Utility Board (CUB) filed testimony in the Nicor Gas 2003 gas cost prudence review disputing certain gas loan transactions offered by Nicor Gas under its Chicago Hub services and requesting refunds of $18 million and $22 million, respectively. Nicor Gas filed surrebuttal testimony later in 2014 disputing that any refund was due, as Nicor Gas was authorized to enter into these transactions and revenues associated with such transactions reduced ratepayers' costs as either credits to the purchase gas adjustment or reductions to base rates consistent with then-current Illinois Commission orders governing these activities. In July 2015, the administrative law judge issued a proposed order concluding that Nicor Gas' supply costs and purchases in 2003 were prudent, its reconciliation of the related costs was proper, and the propositions by the the Illinois Commission Staff and the CUB were based on hindsight speculation, which is expressly prohibited in a prudence review examination. In November 2015, the Illinois Commission granted the CUB's petition for a rehearing on this matter. On February 10, 2016, the administrative law judge issued a proposed order on the rehearing affirming the original order by the Illinois Commission, which was approved by the Illinois Commission on March 23, 2016 and concluded this matter.

The Illinois Commission approved the purchase gas adjustments for the years 2004 through 2007 on August 9, 2016, and years 2008 and 2009 on August 24, 2016. As a condition of these approvals, Nicor Gas agreed to revise the way in which interest is reflected in the calculations beginning in 2013. Nicor Gas does not expect this to have material impact on its consolidated financial statements. The gas cost prudence reviews for years 2010 through 2015 are underway. The ultimate outcome of these matters cannot be determined at this time.

(C) FAIR VALUE MEASUREMENTS

As of September 30, 2016, 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 [a]				
As of September 30, 2016	**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	$ 3	$ 4	$ —	$ —	$ 7
Total	$ 3	$ 4	$ —	$ —	$ 7
Liabilities:					
Energy-related derivatives	$ —	$ 5	$ —	$ —	$ 5
Total	$ —	$ 5	$ —	$ —	$ 5

(a) Excludes cash collateral of $2 million at September 30, 2016.

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.

As of September 30, 2016, 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	$ 620	$ 730

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

(D) STOCKHOLDERS' EQUITY

Changes in Stockholders' Equity

	Number of Common Shares Issued	Common Stockholders' Equity	Preferred Stock	Total Stockholders' Equity
	(in thousands)	*(in millions)*		
Balance at December 31, 2015	15,232	$ 822	$ 1	$ 823
Consolidated net income	—	71	—	71
Other comprehensive income (loss)	—	(1)	—	(1)
Capital contributions from parent company	—	25	—	25
Balance at September 30, 2016	**15,232**	**$ 917**	**$ 1**	**$ 918**
Balance at December 31, 2014	15,232	$ 675	$ 1	$ 676
Consolidated net income	—	70	—	70
Balance at September 30, 2015	15,232	$ 745	$ 1	$ 746

(E) FINANCING

Bank Credit Arrangements

Bank credit arrangements under Nicor Gas' credit facility provide liquidity support to Nicor Gas' commercial paper borrowings and is restricted for working capital needs of Nicor Gas. See Note 8 to the consolidated financial statements of Nicor Gas under "Credit Facility" in the 2015 Financial Statements and "Financing Activities" herein for additional information.

The following table outlines the committed credit arrangement of Nicor Gas as of September 30, 2016:

	Expires			
	2017	2018	Total	Unused
	(in millions)		*(in millions)*	
Nicor Gas	$ 26	$ 674	$ 700	$ 700

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

Substantially all of Nicor Gas' properties are subject to the lien of the indenture securing its first mortgage bonds.

In February and May 2016, $75 million and $50 million, respectively, of Nicor Gas' first mortgage bonds matured and were repaid using the proceeds from commercial paper borrowings. In June 2016, Nicor Gas issued $250 million aggregate principal amount of first mortgage bonds with the following terms: $100 million at 2.66% due June 20, 2026, $100 million at 2.91% due June 20, 2031, and $50 million at 3.27% due June 20, 2036. The proceeds were used to repay short-term indebtedness incurred under the Nicor Gas commercial paper program and for other working capital needs.

(F) RETIREMENT BENEFITS

Pension Benefits

Effective July 1, 2016, in connection with the Merger, Southern Company Services, Inc. became the sponsor of Southern Company Gas' pension and other postretirement benefit plans. Nicor Gas participates in the Southern Company Gas defined benefit, trusteed, pension plan – AGL Resources Inc. Retirement Plan – that covers eligible Nicor Gas employees. The qualified pension plan is funded in accordance with requirements of the Employee Retirement Income Security Act of 1974, as amended. Nicor Gas also participates in the Southern Company Gas postretirement benefit plan – AGL Welfare Plan – which provides medical care and life insurance benefits for eligible retired employees. See Notes 3 and 7 to the consolidated financial statements of Nicor Gas in the 2015 Financial Statements for additional information on these retirement benefit plans.

In connection with the Merger, Southern Company Gas performed updated valuations of its pension and other postretirement benefit plan assets and obligations to reflect actual census data at the new measurement date of July 1, 2016. This valuation resulted in increases to the projected benefit obligations for the pension and other postretirement benefit plans of approximately $48 million and $20 million, respectively, and an increase in the fair value of pension plan assets of $1 million. Nicor Gas has a related regulatory asset of $182 million as of September 30, 2016, an increase of $68 million as a result of the new measurement on July 1, 2016, related to unrecognized prior service cost and actuarial gain/loss, as it is probable that this amount will be recovered through future rates for Nicor Gas.

Actuarial Assumptions

The weighted average rates assumed in the actuarial calculations used to determine the net periodic costs for the pension and other postretirement benefit plans for the period ended September 30, 2016 and the benefit obligations as of the new measurement date, July 1, 2016, are presented below.

Assumptions used to determine net periodic costs:	July 1, 2016 through September 30, 2016	January 1, 2016 through June 30, 2016	For the Three and Nine Months Ended September 30, 2015
Pension plans			
Discount rate – interest costs [(a)]	**3.2%**	4.0%	4.2%
Discount rate – service costs [(a)]	**4.1**	4.8	4.2
Expected long-term return on plan assets	**7.8**	7.8	7.8
Annual salary increase	**3.5**	3.7	3.7
Pension band increase [(b)]	**2.0**	2.0	2.0
Other postretirement benefit plans			
Discount rate – interest costs [(a)]	**2.8**	3.6	4.0
Discount rate – service costs [(a)]	**4.0**	4.7	4.0
Annual salary increase	**3.5**	3.7	3.7

(a) Rates are presented on a weighted average basis for the three and nine months ended September 30, 2015.

(b) Only applicable to the Nicor Gas union employees. The pension bands for the former Nicor Inc. plan have been updated to reflect the new negotiated rates for 2016 and 2017 of 2.0%, as indicated in the union agreement dated March 2014.

Assumptions used to determine benefit obligations:	July 1, 2016	December 31, 2015
Pension plans		
Discount rate	**3.9%**	4.6%
Annual salary increase	**3.5**	3.7
Pension band increase [(*)]	**2.0**	2.0
Other postretirement benefit plans		
Discount rate	**3.6**	4.4
Annual salary increase	**3.5**	3.7

(*) Only applicable to the Nicor Gas union employees. The pension bands for the former Nicor Inc. plan have been updated to reflect the new negotiated rates for 2016 and 2017 of 2.0%, respectively, as indicated in the union agreement dated March 2014.

An additional assumption used in measuring the accumulated other postretirement benefit obligations (APBO) is the weighted average medical care cost trend rate. The weighted average medical care cost trend rates used in measuring the APBO for the three month period ended September 30, 2016 as of the new measurement date, July 1, 2016, and for the period ended December 31, 2015 were as follows:

	Initial Cost Trend Rate	Ultimate Cost Trend Rate	Year That Ultimate Rate is Reached
July 1, 2016			
Pre-65	**6.8%**	**4.5%**	**2038**
Post-65 medical	**8.8**	**4.5**	**2038**
Post-65 prescription	**8.8**	**4.5**	**2038**
December 31, 2015			
Pre-65	6.8	4.5	2038
Post-65 medical	8.8	4.5	2038
Post-65 prescription	8.8	4.5	2038

Components of the net periodic benefit costs for the periods presented were as follows:

Pension Plan

		(in millions)
Three Months Ended September 30, 2016		
Service cost (*)	$	2
Interest cost (*)		3
Expected return on plan assets		(7)
Amortization:		
Net (gain)/loss		3
Net periodic pension cost	$	1
Nine Months Ended September 30, 2016		
Service cost (*)	$	6
Interest cost (*)		8
Expected return on plan assets		(21)
Amortization:		
Net (gain)/loss		8
Net periodic pension cost	$	1
Three Months Ended September 30, 2015		
Service cost (*)	$	2
Interest cost (*)		3
Expected return on plan assets		(7)
Amortization:		
Net (gain)/loss		3
Net periodic pension cost	$	1
Nine Months Ended September 30, 2015		
Service cost (*)	$	6
Interest cost (*)		9
Expected return on plan assets		(21)
Amortization:		
Net (gain)/loss		9
Net periodic pension cost	$	3

(*) Effective January 1, 2016, Nicor Gas uses a spot rate approach to estimate the service cost and interest cost components. Historically, Nicor Gas estimated these components using a single weighted-average discount rate.

Postretirement Benefits

		(in millions)
Three Months Ended September 30, 2016		
Service cost (*)	$	—
Interest cost (*)		2
Amortization:		
Prior service costs		(1)
Net (gain)/loss		1
Net periodic postretirement benefit cost	$	2
Nine Months Ended September 30, 2016		
Service cost (*)	$	1
Interest cost (*)		5
Amortization:		
Prior service costs		(2)
Net (gain)/loss		2
Net periodic postretirement benefit cost	$	6
Three Months Ended September 30, 2015		
Service cost (*)	$	1
Interest cost (*)		2
Amortization:		
Prior service costs		(1)
Net (gain)/loss		1
Net periodic postretirement benefit cost	$	3
Nine Months Ended September 30, 2015		
Service cost (*)	$	2
Interest cost (*)		6
Amortization:		
Prior service costs		(3)
Net (gain)/loss		3
Net periodic postretirement benefit cost	$	8

(*) Effective January 1, 2016, Nicor Gas use a spot rate approach to estimate the service cost and interest cost components. Historically, Nicor Gas estimated these components using a single weighted-average discount rate.

(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) for additional information. 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 fuel-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' fuel-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 in the period of change.

At September 30, 2016, the net volume of energy-related derivative contracts for natural gas positions for Nicor Gas, together with the longest hedge date over which it is hedging its exposure to the variability in future cash flows for forecasted transactions and the longest non-hedge date for derivatives not designated as hedges, were as follows:

Net Purchased/(Sold) mmBtu	Longest Hedge Date	Longest Non-hedge Date
(in millions)		
46	**2017**	**2017**

Nicor Gas' derivative instruments at September 30, 2016 are comprised of long natural gas positions, which are contracts to purchase natural gas.

For cash flow hedges, the amount expected to be reclassified from accumulated OCI to earnings for the next 12-month period ending September 30, 2017 is immaterial.

Interest Rate Derivatives

In conjunction with the issuance of first mortgage bonds in June 2016, Southern Company Gas settled certain 10-year fixed rate forward-starting interest rate swaps that were executed in January 2015 to hedge potential interest rate volatility. Southern Company Gas designated the interest rate swaps as cash flow hedges. Nicor Gas received $3 million of the settlement loss, which represented the loss associated with Nicor Gas' debt issuance, and recorded it within other comprehensive income. This loss will be amortized to interest expense through 2026 and is immaterial on an annual basis. See Note (E) for additional information.

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. At September 30, 2016 and December 31, 2015, the fair value of energy-related derivatives and interest rate derivatives was reflected in the balance sheets as follows:

Derivative Category	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location	September 30, 2016	December 31, 2015	Balance Sheet Location	September 30, 2016	December 31, 2015
		(in millions)			(in millions)	
Derivatives designated as hedging instruments for regulatory purposes						
Energy-related derivatives						
	Assets from risk management activities – current	**$ 7**	$ 2	Liabilities from risk management activities – current	**$ (5)**	$ (16)
Total derivatives designated as hedging instruments for regulatory purposes		**$ 7**	$ 2		**$ (5)**	$ (16)
Derivatives designated as hedging instruments in cash flow and fair value hedges						
Energy-related derivatives						
	Assets from risk management activities – current	**$ —**	$ —	Liabilities from risk management activities – current	**$ —**	$ (1)
Total derivatives designated as hedging instruments in cash flow and fair value hedges		**$ —**	$ —		**$ —**	$ (1)
Gross amount of recognized assets and liabilities [(a) (b)]		**$ 7**	$ 2		**$ (5)**	$ (17)
Gross amounts offset in the balance sheet [(b)]		**(4)**	5		**2**	14
Net amounts of derivatives assets and liabilities, presented in the balance sheet [(c)]		**$ 3**	$ 7		**$ (3)**	$ (3)

(a) The gross amounts of recognized assets and liabilities are netted on the consolidated balance sheets to the extent that there were netting arrangements with the counterparties.

(b) The gross amounts of recognized assets and liabilities do not include cash collateral held on deposit in broker margin accounts of $2 million as of September 30, 2016 and $19 million as of December 31, 2015.

(c) As of September 30, 2016 and December 31, 2015, letters of credit from counterparties offset an immaterial portion of these assets under master netting arrangements.

At September 30, 2016 and December 31, 2015, 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:

Derivative Category	Unrealized Losses			Unrealized Gains		
	Balance Sheet Location	September 30, 2016	December 31, 2015	Balance Sheet Location	September 30, 2016	December 31, 2015
		(in millions)			(in millions)	
Energy-related derivatives:						
	Other regulatory assets, current	**$ (3)**	$ (3)	Other regulatory liabilities, current	**$ 3**	$ 7
Total energy-related derivative gains (losses)		**$ (3)**	$ (3)		**$ 3**	$ 7

For the three months ended September 30, 2016 and 2015, the pre-tax effects of energy-related derivatives and interest rate derivatives designated as cash flow hedging instruments recognized in OCI and those reclassified from accumulated OCI into earnings were immaterial.

For the nine months ended September 30, 2016 and 2015, the pre-tax effects of energy-related derivatives and interest rate derivatives designated as cash flow hedging instruments recognized in OCI and those reclassified from accumulated OCI into earnings were as follows:

Derivatives in Cash Flow Hedging Relationships	Gain (Loss) Recognized in OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		
			Statements of Income Location	Amount	
	2016	2015		**2016**	2015
	(in millions)			*(in millions)*	
Energy-related derivatives	$ —	$ (1)	Cost of natural gas	$ —	$ —
	—	—	Other operations and maintenance	(1)	(1)
Total	$ —	$ (1)		$ (1)	$ (1)

For the three and nine months ended September 30, 2016 and 2015, the pre-tax effects of energy-related derivatives and interest rate derivatives not designated as hedging instruments were less than $1 million.

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 September 30, 2016, Nicor Gas had $2 million of collateral posted with derivative counterparties.

At September 30, 2016, 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 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 and S&P 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. Therefore, Nicor Gas does not anticipate a material adverse effect on the 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 $36 million and $112 million for the three and nine months ended September 30, 2016, respectively, and $35 million and $105 million for the three and nine months ended September 30, 2015, respectively. Certain operating costs are paid on Nicor Gas' behalf 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 Nicor Gas the cash advance. Nicor Gas received no cash advances from Southern Company Gas during the first nine months of 2016 or 2015.

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 $2 million and $14 million for three and nine months ended September 30, 2016, respectively, and $2 million and $19 million for the three and nine months ended September 30, 2015, 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 $3 million for three and nine months ended September 30, 2016, respectively, and less than $1 million and $3 million for the three and nine months ended September 30, 2015, respectively. Additionally, Nicor Advanced Energy may pay or receive inventory imbalance adjustments. Nicor Advanced Energy paid to Nicor Gas $2 million and $3 million for the three and nine months ended September 30, 2016, respectively, and $2 million and $4 million for the three and nine months ended September 30, 2015, respectively.

Sequent Energy Management, LP (Sequent) is a wholly-owned subsidiary of Southern Company Gas that engages in wholesale marketing of natural gas supply services. Nicor Gas enters into natural gas purchases and sales with Sequent as authorized by terms of an Illinois Commission order. There were no net purchases with Sequent for the three months ended September 30, 2016. Net purchases with Sequent were $5 million for the nine months ended September 30, 2016, and $3 million and $4 million for the three and nine months ended September 30, 2015, respectively. Additionally, Nicor Gas charged Sequent less than $1 million for the three and nine months ended September 30, 2016 and 2015 in gas supply related charges.

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 $7 million for each of the three and nine months ended September 30, 2016 and 2015, respectively, for natural gas transportation under rates that have been accepted by the Federal Energy Regulatory Commission.

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

(I) SUBSEQUENT EVENTS

Nicor Gas' management evaluated subsequent events for potential recognition and disclosure through September 30, 2016 and through November 29, 2016, the date that these unaudited condensed consolidated financial statements and related notes were available to be issued, and determined that no significant events have occurred subsequent to period end.