DOCKET NO. 20180166-GU
FILED 9/7/2018
DOCUMENT NO. 05872-2018
FPSC - COMMISSION CLERK

GUNSTER
FLORIDA'S LAW FIRM FOR BUSINESS

Writer's Direct Dial Number: (850) 521-1706
Writer's E-Mail Address: bkeating@gunster.com

September 7, 2018

BY HAND DELIVERY

Ms. Carlotta Stauffer
Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

RECEIVED-FPSC
2018 SEP -7 PM 12:10
COMMISSION CLERK

Re: [New Filing] - **Application for authority to issue debt security, pursuant to Section 366.04, F.S., and Chapter 25-8, F.A.C., by Florida City Gas.**

Dear Ms. Stauffer:

Enclosed for filing, please find the original and three copies of the Application of Florida City Gas for Authority to Issue Debt Security During Calendar Year 2019, along with its Consolidated Financial Statements for 2017 and 2016. A copy of the pleading is also provided on the enclosed CD.

Also enclosed to assist in processing this Application is a proposed Notice for the Florida Administrative Register. A copy of the proposed Notice in Word format is also provided on the enclosed CD. The date of the final Commission action has been left blank in the proposed Notice. It is the hope of Florida City Gas that the Application can be addressed at the Agenda Conference on October 9, 2018. A copy of this filing has been provided via email to the Office of Public Counsel.

Thank you for your assistance with this filing. As always, please do not hesitate to contact me if you have any questions whatsoever.

COM ___
AFD 3 + CD
APA ___
ECO ___
ENG ___
GCL ___
IDM ___
CLK ___

Sincerely,

Beth Keating

Beth Keating
Gunster, Yoakley & Stewart, P.A.
215 South Monroe St., Suite 601
Tallahassee, FL 32301
(850) 521-1706

NOTICE OF SECURITIES APPLICATION

The Florida Public Service Commission will consider at its ____________ 2018, Commission Conference, Docket No. _______-GU, the application of Florida City Gas for authority to issue securities pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code. The Company seeks PSC approval pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code, to issue (a) short-term debt securities in an aggregate amount not to exceed $50 million in principal at any one time in calendar year 2019 and (b) long-term debt securities in an aggregate amount not to exceed $250 million in principal at any one time in calendar year 2019.

DATE AND TIME: ______, _______, 2018. The Commission Conference begins at 9:30 a.m., although the time at which this item will be heard cannot be determined at this time.

PLACE: Commission Hearing Room 148, Betty Easley Conference Center, 4075 Esplanade Way, Tallahassee, Florida 32399-0850.

PURPOSE: To take final action in Docket No. ______-GU

Emergency Cancellation of Meeting: If a named storm or other disaster requires cancellation of the meeting, Commission staff will attempt to give timely direct notice to the parties. Notice of cancellation of the meeting will also be provided on the Commission's website (http://www.psc.state.fl.us/) under the Hot Topics link found on the home page. Cancellation can also be confirmed by calling the Office of the General Counsel at (850) 413-6199. In accordance with the American with Disabilities Act, persons needing a special accommodation to participate at this proceeding should contact the Office of Commission Clerk no later than five days prior to the conference at 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, via 1-800-955-8770 (Voice) or 1-800-955-8771 (TDD), Florida Relay Service. For more information, please contact____________________, Office of the General Counsel, (850) 413-6218.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In RE: Application by Florida City Gas For Authority to Issue Debt Securities Pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code	)))))	Docket No.______________ Filed: September 7, 2018

APPLICATION OF FLORIDA CITY GAS
FOR AUTHORITY TO ISSUE DEBT SECURITIES

Pivotal Utility Holdings, Inc. d/b/a Florida City Gas ("Applicant"), pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code, hereby files this application for authority to issue (a) short-term debt securities in an aggregate amount not to exceed $50 million in principal at any one time in calendar year 2019 and (b) long-term debt securities in an aggregate amount not to exceed $250 million in principal at any one time in calendar year 2019, in each case pursuant to borrowings from Applicant's parent company, Florida Power & Light Company ("FPL").

In support, Applicant states:

1. **Applicant Information:** The name of Applicant is Pivotal Utility Holdings. Inc., and its principal business address is 700 Universe Boulevard, P.O. Box 14000, Juno Beach, Florida 33408. Applicant is the direct, wholly-owned subsidiary of FPL, a rate-regulated electric utility engaged primarily in the generation, transmission, distribution, and sale of electric energy in Florida. Through its Florida City Gas ("FCG") division, Applicant supplies natural gas to customers in Miami-Dade, Broward, Palm Beach, St. Lucie, Indian River, Martin, Brevard, Hendry and Glades Counties, Florida. Accordingly, Applicant is regulated as a "public utility" by the Florida Public Service Commission ("Commission") under Chapter 366, Florida Statutes. Exhibit A provides the Applicant's most recent audited financial statements.

2. **Incorporation and Domestication:** Applicant was incorporated under the laws of state of New Jersey on January 29, 1969. As noted above. Applicant is qualified to do business in the state of Florida.

3. **Persons Authorized To Receive Notices and Communications:** The names and addresses of the persons authorized to receive notices and communications with respect to this application are as follows:

Beth Keating
Gunster, Yoakley & Stewart, P.A.
215 South Monroe St., Suite 601
Tallahassee, FL 32301
Telephone (850) 521-1706

Carolyn Bermudez
Vice President & General Manager
Florida City Gas
4045 NW 97th Avenue
Doral, Florida 33178
Telephone (305) 835-3606

Paul I. Cutler
Treasurer
Florida Power & Light Company
700 Universe Boulevard
P.O. Box 14000
Juno Beach, Florida 33408
Telephone (561) 694-6204

Kenneth Hoffman
Vice President, Regulatory Affairs
Florida Power & Light Company
215 S. Monroe St.
Suite 810
Tallahassee, Florida 32301
Telephone (850) 521-3900

R. Wade Litchfield
Vice President & General Counsel
Florida Power & Light Company
Florida City Gas
700 Universe Boulevard
P.O Box 14000
Juno Beach, Florida 33408
Telephone (561) 691-7101

4. **Capital Stock and Funded Debt:** The following additional information regarding the financial condition of Applicant is submitted for the Commission's consideration:

a. Applicant has authorized Common Stock, no par value ("Common Stock"), and Preferred Stock, no par value ("Preferred Stock"), under its Articles of Incorporation ("Articles") as set forth below.

b. Applicant's Articles authorize Thirty Million (30,000,000) shares of Common Stock, of which Twelve Million Eight Hundred Seven Thousand One Hundred Eleven (12,807,111) shares were issued and outstanding as of July 31,

2018.

c. Applicant's Articles authorize Five Million (5,000,000) shares of Preferred Stock, of which no shares were issued and outstanding as of July 31, 2018.

d. The amount of capital stock held as reacquired securities by Applicant: As of July 31, 2018, none.

e. The amount of capital stock pledged by Applicant or FPL: As of July 31, 2018, none.

f. The amount of Applicant's capital stock held by affiliated corporations: As of July 31, 2018, all Common Stock is owned by FPL. FPL is a direct, wholly-owned subsidiary of NextEra Energy, Inc.

g. The amount of capital stock held in any fund by Applicant or FPL: As of July 31, 2018, none. As of July 31, 2018, Applicant had no outstanding funded debt.

5. **Proposed Transactions:**

a. **Nature of Transactions:** Applicant requests authorization to finance its working capital and capital expenditure requirements through short-term and long-term borrowings from FPL. The timing of any borrowings made by Applicant from FPL will depend on Applicant's cash flow projections and other factors impacting Applicant's cash and working capital requirements. Applicant's 2019 capital expenditures are forecasted to total approximately $100 million. Any borrowings made by Applicant from FPL will be unsecured and may be subordinated or unsubordinated.

b. **Maximum Principal Amount:** The amount of short-term borrowings by Applicant from FPL will be an aggregate amount not to exceed $50 million in principal at any one time. In addition, the amount of long-term borrowings by Applicant from FPL will be an aggregate amount not to exceed $250 million in principal at any one time.

c. **Present Estimate of Interest Rate:** The interest rate on any short-term or long-term borrowings from FPL is expected to be a pass-through of FPL's average weighted cost for borrowing these funds and will vary depending on the term of the debt and whether the debt is secured or unsecured and subordinated or unsubordinated, as well as market conditions.

d. **Maturity Date(s):** Short-term borrowings from FPL will have maturities not to exceed one year. Long-term borrowings from FPL will have maturities ranging from more than one year to one hundred years.

6. **Purpose For Which the Debt Will Be Incurred:** Applicant will cause the proceeds from any borrowings made by Applicant to be used for capital expenditures, working capital requirements, and general corporate purposes related to FCG's regulated utility operations.

Although it does not require a certificate of need, the proceeds from the loans made by FPL will be used, in part, for the anticipated construction of a new Liquefied Natural Gas ("LNG") Facility in southern Florida in the 2019 period. As approved by the Commission in Order No. PSC-2018-0190-FOF-GU issued April 20, 2018, the new LNG Facility will be capable of providing an additional 10,000 Dth/day of capacity and will include the following: (i) truck loading facilities; (ii) three storage tanks holding a total of 270,000 gallons of LNG; (iii) vaporization equipment; and (iv) other related facilities. The estimated construction cost for the new LNG Facility is $58 million. As of June 30, 2018, development, design and construction costs expended on the new LNG Facility were approximately $3.0 million.

In connection with this application, FCG confirms that the capital raised pursuant to this application will be used in connection with its regulated activities, and not the nonregulated activities of its affiliates.

7. **Lawful Object and Purpose:** Applicant is authorized to borrow funds under the terms of its Articles of Incorporation. Borrowings by Applicant are consistent with the proper performance by Applicant of service as a public utility and reasonably necessary and appropriate

for such purposes.

8. **Name and Address of Counsel Passing upon the Legality of the Proposed Issues:** It is expected that one or more of the following counsel will pass upon the legality of the proposed issues:

Hogan Lovells U.S. LLP
555 Thirteenth Street, NW
Washington, District of Columbia 20004
Attention: Richard J. Parrino, Esq.

Squire Patton Boggs (US) LLP
200 South Biscayne Boulevard
Suite 4700
Miami, Florida 33131
Attention: James E. Morgan III, Esq.

Morgan, Lewis & Bockius LLP
101 Park Avenue
New York, New York 10178
Attention: Thomas P. Giblin, Jr., Esq.

9. **Control or Ownership:** Applicant is a direct, wholly-owned subsidiary of FPL, a rate-regulated electric utility engaged primarily in the generation, transmission, distribution and sale of electric energy in Florida. FPL is a direct, wholly-owned subsidiary of NextEra Energy, Inc., which is a holding company as defined in the Public Utility Holding Company Act of 2005.

WHEREFORE, Pivotal Utility Holdings, Inc. d/ b/a Florida City Gas, doing business in Florida respectfully requests that the Commission:

(a) Publish notice of intent to consider the application pursuant to Section 366.04(1), Florida Statutes, as soon as possible;

(b) Schedule this matter for agenda as early as possible;

(c) Authorize Applicant to make (1) short-term borrowings from FPL in an aggregate amount not to exceed $50 million in principal at any one time in calendar year 2019 and (2) long-term borrowings from FPL in an aggregate amount not to exceed $250 million in

principal at any one time in calendar year 2019, for the purposes and in the manner described herein; and

(d) Grant such other relief as the Commission deems appropriate.

Respectfully submitted this 7th day of September, 2018.

Pivotal Utility Holdings, Inc.,
d/b/a Florida City Gas

By:
Beth Keating
Gunster, Yoakley & Stewart, P.A.
215 South Monroe St., Suite 601
Tallahassee, FL 32301
Telephone (850) 521-1706

Exhibit A

Pivotal Utility Holdings, Inc. Audited Financial Statements

Pivotal Utility Holdings, Inc.

(a wholly-owned subsidiary of Southern Company Gas)

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

Index to the Notes to Financial Statements

	Page
Independent Auditor's Report	3
Financial Statements	
Statements of Income	4
Statements of Comprehensive Income	4
Statements of Cash Flows	5
Balance Sheets	6
Statements of Equity	8
Notes to Financial Statements	
1. Summary of Significant Accounting Policies	9
2. Retirement Benefits	15
3. Contingencies and Regulatory Matters	24
4. Income Taxes	26
5. Financing	28
6. Commitments	28
7. Fair Value Measurements	29
8. Derivatives	30
9. Dispositions	32
10. Affiliate Transactions	32
11. Subsequent Events	33

Deloitte & Touche LLP
Suite 2000
191 Peachtree Street NE
Atlanta, GA 30303-1924
USA

Tel: +1 404 220 1500
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

**To the Board of Directors and Stockholder of
Pivotal Utility Holdings, Inc.**

We have audited the accompanying financial statements of Pivotal Utility Holdings, Inc. (the "Company"), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, cash flows, and equity 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 audit. 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 audits 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 Pivotal Utility Holdings, Inc. 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

March 29, 2018

STATEMENTS OF INCOME
Pivotal Utility Holdings, Inc.
For the Years Ended December 31, 2017 and 2016

	2017	2016
	(in thousands)	
Operating Revenues	$ **398,718**	$ 382,480
Operating Expenses:		
Cost of natural gas	**171,083**	164,130
Other operations and maintenance	**88,555**	107,260
Depreciation and amortization	**44,252**	41,462
Taxes other than income taxes	**8,723**	6,141
Total operating expenses	**312,613**	318,993
Operating Income	**86,105**	63,487
Other Income and (Expense):		
Interest expense, net of amounts capitalized	**(18,660)**	(14,432)
Other income (expense), net	**1,406**	1,885
Total other income and (expense)	**(17,254)**	(12,547)
Earnings Before Income Taxes	**68,851**	50,940
Income taxes	**26,707**	20,476
Net Income	$ **42,144**	$ 30,464

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

STATEMENTS OF COMPREHENSIVE INCOME
Pivotal Utility Holdings, Inc.
For the Years Ended December 31, 2017 and 2016

	2017	2016
	(in thousands)	
Net Income	$ **42,144**	$ 30,464
Other comprehensive income (loss):		
Pension and other postretirement benefit plans:		
Benefit plan net gain (loss), net of tax of $319 and $(7,585), respectively	**541**	(11,114)
Reclassification adjustment for amounts included in net income, net of tax of $(484) and $702, respectively	**659**	1,016
Total Other Comprehensive Income (Loss)	**1,200**	(10,098)
Comprehensive Income	$ **43,344**	$ 20,366

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

STATEMENTS OF CASH FLOWS
Pivotal Utility Holdings, Inc.
For the Years Ended December 31, 2017 and 2016

		2017		2016
		(in thousands)		
Operating Activities:				
Net income	$	42,144	$	30,464
Adjustments to reconcile net income to net cash provided from operating activities —				
Depreciation and amortization, total		44,252		41,462
Deferred income taxes		41,339		16,865
Pension, postretirement, and other employee benefits		1,979		(16,016)
Mark-to-market adjustments		10,391		(22,243)
Other, net		(28,915)		631
Changes in certain current assets and liabilities —				
—Receivables		(24,855)		(16,035)
—Inventories		(489)		2,995
—Other current assets		5,687		(3,977)
—Accrued taxes		(22,228)		(2,782)
—Accounts payable		57,863		(5,448)
—Accrued compensation		2,148		(1,258)
—Other current liabilities		(31,858)		14,208
Net cash provided from operating activities		97,458		38,866
Investing Activities:				
Property additions		(199,362)		(150,318)
Cost of removal, net of salvage		(3,641)		(9,155)
Change in construction payables, net		(1,358)		5,031
Other investing activities		254		2,711
Net cash used for investing activities		(204,107)		(151,731)
Financing Activities:				
Net borrowings from parent		72,490		77,565
Capital contributions from parent company		64,802		64,854
Dividends to parent		(30,643)		(29,554)
Net cash provided from financing activities		106,649		112,865
Net Change in Cash and Cash Equivalents		—		—
Cash and Cash Equivalents at Beginning of Period		—		—
Cash and Cash Equivalents at End of Period	$	—	$	—
Supplemental Cash Flow Information:				
Cash paid during the period for —				
Interest, net of amounts capitalized	$	16,742	$	13,145
Income taxes		7,685		849
Noncash transactions — Accrued property additions at end of period		9,928		11,286

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

BALANCE SHEETS
Pivotal Utility Holdings, Inc.
At December 31, 2017 and 2016

Assets		2017		2016
		(in thousands)		
Current Assets:				
Receivables —				
Customer accounts receivable	$	36,277	$	29,336
Unbilled revenues		39,138		27,925
Other accounts and notes receivable		7,376		1,560
Accumulated provision for uncollectible accounts		(5,896)		(4,789)
Materials and supplies		348		368
Natural gas for sale		21,307		20,818
Prepaid taxes		33,662		6,799
Prepaid expenses		8,306		9,732
Assets from risk management activities, net of collateral		—		7,473
Regulatory assets, current		8,257		10,562
Other current assets		665		96
Total current assets		149,440		109,880
Property, Plant, and Equipment:				
In service		1,713,035		1,529,536
Less: Accumulated depreciation		411,893		418,136
Plant in service, net of depreciation		1,301,142		1,111,400
Construction work in progress		45,183		69,999
Total property, plant, and equipment		1,346,325		1,181,399
Other Property and Investments:				
Goodwill		176,560		176,560
Deferred Charges and Other Assets:				
Regulatory assets, deferred		154,709		137,866
Other deferred charges and assets		4,413		5,690
Total deferred charges and other assets		159,122		143,556
Total Assets	$	1,831,447	$	1,611,395

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

BALANCE SHEETS
Pivotal Utility Holdings, Inc.
At December 31, 2017 and 2016

Liabilities and Stockholder's Equity		2017		2016
		(in thousands)		
Current Liabilities:				
Due to affiliates	$	**118,629**	$	62,640
Accounts payable		**16,502**		16,873
Customer deposits		**10,941**		13,788
Accrued taxes —				
Accrued income taxes		—		2,142
Other accrued taxes		**6,683**		5,798
Accrued compensation		**4,638**		2,393
Liabilities from risk management activities, net of collateral		**1,694**		—
Regulatory liabilities, current		**11,621**		17,254
Accrued environmental remediation, current		**9,882**		29,225
Other current liabilities		**2,455**		2,384
Total current liabilities		**183,045**		152,497
Long-term Debt (See notes)		**577,055**		504,482
Deferred Credits and Other Liabilities:				
Accumulated deferred income taxes		**151,468**		250,072
Deferred credits related to income tax		**146,429**		673
Other cost of removal obligations		**93,262**		90,833
Accrued environmental remediation, deferred		**77,253**		81,988
Employee benefit obligations		**25,050**		28,179
Other regulatory liabilities, deferred		**2,375**		3,012
Other deferred credits and liabilities		**10,908**		12,560
Total deferred credits and other liabilities		**506,745**		467,317
Total Liabilities		**1,266,845**		1,124,296
Stockholder's Equity:				
Common stock, no par value; 12,807,111 shares authorized, issued, and outstanding		—		—
Paid-in capital		**281,283**		216,481
Retained earnings		**284,461**		272,960
Accumulated other comprehensive loss		**(1,142)**		(2,342)
Total Stockholder's Equity		**564,602**		487,099
Total Liabilities and Stockholder's Equity	$	**1,831,447**	$	1,611,395
Commitments and Contingent Matters (See Notes)				

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

STATEMENTS OF EQUITY
Pivotal Utility Holdings, Inc.
For the Years Ended December 31, 2017 and 2016

(In thousands)	Number of Common Shares	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2015	12,807	$ 151,728	$ 272,050	$ (25,377)	$ 398,401
Net income	—	—	30,464	—	30,464
Other comprehensive loss	—	—	—	(10,098)	(10,098)
Reclassification of accumulated other comprehensive loss to regulatory assets	—	—	—	33,133	33,133
Dividends to parent	—	—	(29,554)	—	(29,554)
Capital contributions from parent company	—	64,753	—	—	64,753
Balance at December 31, 2016	12,807	$ 216,481	$ 272,960	$ (2,342)	$ 487,099
Net income	—	—	**42,144**	—	**42,144**
Other comprehensive income	—	—	—	**1,200**	**1,200**
Dividends to parent	—	—	**(30,643)**	—	**(30,643)**
Capital contributions from parent company	—	**64,802**	—	—	**64,802**
Balance at December 31, 2017	**12,807**	**$ 281,283**	**$ 284,461**	**$ (1,142)**	**$ 564,602**

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

Pivotal Utility Holdings, Inc.
Notes to Financial Statements
December 31, 2017 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Pivotal Utility Holdings, Inc. (the Company) engages in the sale and distribution of natural gas to approximately 408 thousand customers in three states through its utility operating divisions that include Elizabethtown Gas in New Jersey, Florida City Gas in Florida, and Elkton Gas in Maryland. The Company is a wholly-owned subsidiary of Southern Company Gas. On July 1, 2016, Southern Company Gas completed its previously announced merger (Merger) with The Southern Company (Southern Company) and became a wholly-owned, direct subsidiary of Southern Company.

The Company is subject to regulation by the regulatory agencies of each state in which it operates. As such, the Company's 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 its regulatory commissions. The preparation of financial statements in conformity with GAAP requires the use of estimates, and the actual results may differ from those estimates.

The impact of the acquisition method of accounting was not pushed down to the Company and is not reflected in the financial statements included herein.

Certain prior year data presented in the financial statements has been reclassified to conform to the current year presentation used by Southern Company Gas.

Recently Issued Accounting Standards

Revenue

In 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers* (ASC 606), 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 new 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.

Most of the Company's revenue, including energy provided to customers, is from tariff offerings that provide natural gas without a defined contractual term.

The Company has completed the evaluation of all revenue streams and determined that the adoption of ASC 606 will not change the current timing of revenue recognition for such transactions. Some revenue arrangements, such as alternative revenue programs, are excluded from the scope of ASC 606 and, therefore, will be accounted for and disclosed or presented separately from revenues under ASC 606 on the Company's financial statements. The Company has concluded contributions in aid of construction are not in scope for ASC 606 and will continue to be accounted for as an offset to property, plant, and equipment.

The new standard is effective for reporting periods beginning after December 15, 2017. The Company applied the modified retrospective method of adoption effective January 1, 2018. The Company also utilized practical expedients which allowed 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. The adoption of ASC 606 did not result in a cumulative-effect adjustment.

Leases

In February 2016, the FASB issued Accounting Standards Update (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 and the Company will adopt the new standard effective January 1, 2019.

The Company is currently implementing an information technology system along with the related changes to internal controls and accounting policies that will support the accounting for leases under ASU 2016-02. In addition, the Company has substantially completed a detailed inventory and analysis of its leases. In terms of rental charges and duration of contracts, the most significant leases relate to fleet vehicles and real estate and where the Company is the lessee and there are no material leases where the Company is the lessor. While the Company has not yet determined the ultimate impact, adoption of ASU 2016-02 is not expected to have a significant impact on the Company's balance sheet.

Other

On January 26, 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* (ASU 2017-04). ASU 2017-04 removes the requirement to compare the implied fair value of goodwill with the carrying amount as part of Step 2 of the goodwill impairment test. Under the new standard, the goodwill impairment loss will be measured as the excess of a reporting unit's carrying amount over its fair value, not exceeding the total amount of goodwill allocated to that reporting unit, which may increase the frequency of goodwill impairment charges if a future goodwill impairment test does not pass the Step 1 evaluation. ASU 2017-04 is effective prospectively for periods beginning on or after December 15, 2019, with early adoption permitted. The Company adopted ASU 2017-04 effective January 1, 2018 with no impact on its financial statements.

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 of 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 only 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 periods beginning after December 15, 2017. The presentation changes required for net periodic pension and postretirement benefit costs will not result in a material impact on the Company's operating income or other income for 2016 and 2017. The Company adopted ASU 2017-07 effective January 1, 2018 with no material impact on its financial statements.

On August 28, 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* (ASU 2017-12), amending the hedge accounting recognition and presentation requirements. ASU 2017-12 makes more financial and non-financial hedging strategies eligible for hedge accounting, amends the related presentation and disclosure requirements, and simplifies hedge effectiveness assessment requirements. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company adopted ASU 2017-12 effective January 1, 2018 with no material impact on its financial statements.

Regulatory Assets and Liabilities

The Company is subject to accounting requirements for the effects of rate regulation. Regulatory assets represent probable future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be credited to customers through the ratemaking process.

Regulatory assets and (liabilities) reflected in the balance sheets at December 31, relate to:

		2017		2016	
		(in thousands)			
Environmental remediation	$	**87,792**	$	72,481	(a,b)
Retiree benefit plans		**37,280**		41,366	(a,c)
Area extension program		**14,158**		14,217	(d)
Recoverable weather normalization adjustment		**12,604**		10,439	(e)
Other regulatory assets		**11,132**		9,925	(f)
Deferred income tax credits		**(146,429)**		(673)	(g,h)
Other cost of removal obligations		**(93,262)**		(90,833)	(g)
Over recovered regulatory clause revenues		**(11,507)**		(8,107)	(i)
Other regulatory liabilities		**(2,489)**		(12,159)	(j)
Total regulatory assets (liabilities), net	$	**(90,721)**	$	36,656	

Note: The recovery and amortization periods for these regulatory assets and (liabilities) are as follows:

(a) Not earning a return as offset in rate base by a corresponding asset or liability.

(b) Recovered through environmental cost recovery mechanisms when the remediation is performed or the work is performed.

(c) Recovered and amortized over the average remaining service period which range up to 15 years.

(d) Recovered over 10 years through a tariff approved by the Florida Public Service Commission (PSC) that allows Florida City Gas to complete various area extension projects.

(e) These mechanisms partially mitigate the impact of unusually cold or warm weather on customer billings and are generally recovered within one year.

(f) Comprised of several components including loss on reacquired debt, rate case expenses, regulatory infrastructure expenses, energy efficiency programs, and financial instrument-hedging assets, which are recovered or amortized over periods generally not exceeding 15 years, except for financial hedging-instruments. Financial instrument-hedging assets are recorded over the life of the underlying hedged purchase contracts, which do not exceed two years. Upon final settlement, actual costs incurred are recovered and actual income earned is refunded through the energy cost recovery clause.

(g) Other cost of removal obligations are recorded and deferred income tax liabilities are amortized over the related property lives, which may range up to 75 years. Cost of removal liabilities will be settle and trued up following completion of the related activities.

(h) Includes excess deferred income tax assets/liabilities resulting from the Tax Cuts and Jobs Act that was signed into law on December 22, 2017 and became effective January 1, 2018 (Tax Reform Legislation), the recovery and amortization of which will be determined by the applicable state regulatory agencies. See Note 3 under "Regulatory Matters and Note 4 for additional details.

(i) Recorded and recovered or amortized generally within one year.

(j) Comprised of several components including energy assistance programs, residential home appliance rebates, and gain on sale of property, which are recovered or amortized over periods generally not exceeding 5 years.

In the event that the Company's operations are no longer subject to applicable accounting rules for rate regulation, the Company would be required to write off to income related regulatory assets and liabilities that are not specifically recoverable through regulated rates. In addition, the Company would be required to determine if any impairment to other assets, including plant, exists and write down the assets, if impaired, to their fair values. All regulatory assets and liabilities are to be reflected in rates. See Note 3 under "Regulatory Matters" for additional information.

Revenues

The Company records revenues when goods or services are provided to customers. Those revenues are based on rates approved by the state regulatory agencies of the Company's utilities. The Company's utilities have rate structures that include volumetric rate designs that allow the opportunity to recover certain costs based on gas usage. Revenues from sales and transportation services are recognized in the same period in which the related volumes are delivered to customers. Revenues from residential and certain commercial and industrial customers are recognized on the basis of scheduled meter readings. Additionally, unbilled revenues are recognized for estimated deliveries of natural gas not yet billed to these customers, from the last bill date to the end of the accounting period. For other commercial and industrial customers, revenues are based on actual deliveries to the end of the period.

The tariffs for the Company include provisions that allow for the recognition of certain revenues prior to the time such revenues are billed to customers. These provisions, referred to as alternative revenue programs, allow for the recognition of certain revenues prior the time such revenues are billed to customers, so long as the amounts recognized will be collected from customers within 24 months of recognition. These programs are as follows:

- *Weather normalization adjustments* - reduce customer bills when winter weather is colder than normal and increase customer bills when weather is warmer than normal and are included in the tariffs for Elizabethtown Gas; and
- *Revenue normalization mechanisms* - mitigate the impact of conservation and declining customer usage and are contained in the tariffs for Elkton Gas.

Concentration of Revenue

The Company has a diversified base of customers. No single customer or industry comprises 10% or more of revenues. For all periods presented, uncollectible accounts averaged less than 2% of revenues.

Cost of Natural Gas

The Company charges its customers for natural gas consumed using natural gas cost recovery mechanisms set by the applicable state regulatory agencies. Under these mechanisms, all prudently-incurred natural gas costs are passed through to customers without markup, subject to regulatory review. The Company defers or accrues the difference between the actual cost of natural gas and the amount of commodity revenue earned in a given period such that no operating income is recognized related to these costs. The deferred or accrued amount is either billed or refunded to customers prospectively through adjustments to the commodity rate. Deferred and accrued natural gas costs are included in the balance sheets as regulatory assets and regulatory liabilities, respectively.

Income and Other Taxes

The Company uses the liability method of accounting for deferred income taxes and provides deferred income taxes for all significant income tax temporary differences. Federal investment tax credits (ITCs) utilized are deferred and amortized to income over the average life of the related property. Taxes that are collected from customers on behalf of governmental agencies to be remitted to these agencies are presented on the balance sheet.

The Company recognizes tax positions that are "more likely than not" of being sustained upon examination by the appropriate taxing authorities. See Note 4 under "Unrecognized Tax Benefits" for additional information.

Property, Plant, and Equipment

Property, plant, and equipment is stated at original cost less any regulatory disallowances and impairments. Original cost includes: materials; labor; minor items of property; appropriate administrative and general costs; payroll-related costs such as taxes, pensions, and other benefits; and the interest capitalized and cost of equity funds used during construction.

The Company's property, plant, and equipment in service consisted of the following at December 31:

	2017	2016
	(in thousands)	
Utility plant in service	$ **1,550,758**	$ 1,407,789
Information technology equipment and software	**63,311**	51,702
Storage facilities	**27,888**	7,193
Other	**71,078**	62,852
Total other plant in service	**162,277**	121,747
Total plant in service	$ **1,713,035**	$ 1,529,536

The cost of replacements of property, exclusive of minor items of property, is capitalized. The cost of maintenance, repairs, and replacement of minor items of property is charged to other operations and maintenance expenses as incurred or performed.

Depreciation

Depreciation of the original cost of utility plant in service is provided using composite straight-line rates. Following are the composite rates for the years ending December 31:

	2017	2016
Elizabethtown Gas	**2.6%**	2.3%
Elkton Gas	**3.0**	2.6
Florida City Gas	**4.7**	4.3

Depreciation studies are conducted periodically to update the composite rates that are approved by the respective state regulatory agency. When property subject to composite depreciation is retired or otherwise disposed of in the normal course of business, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation. As such, gains or losses are not recognized, they are ultimately refunded to, or recovered from, customers through future rate

adjustments. Minor items of property included in the original cost of the asset are retired when the related property unit is retired.

Allowance for Funds Used During Construction (AFUDC)

The Company records AFUDC for Elizabethtown Gas, which represents the estimated debt and equity costs of capital funds that are necessary to finance the construction of new regulated facilities. While cash is not realized currently, AFUDC increases the revenue requirement and is recovered over the service life of the asset through a higher rate base and higher depreciation. All current construction costs are included in rates. The capital expenditures of the other two utilities do not qualify for AFUDC treatment. The AFUDC composite rate for Elizabethtown Gas was 1.56% and 1.68% for the years ended December 31, 2017 and 2016, respectively. The Company recorded $0.5 million and $0.3 million of AFUDC for the years ended December 31, 2017 and 2016, respectively.

Goodwill

Goodwill is not amortized, but is subject to an annual impairment test during the fourth quarter of each year, or more frequently if impairment indicators arise. In assessing goodwill for impairment, the Company has the option of first performing a qualitative assessment to determine that it is more likely than not that fair value of its reporting unit exceeds its carrying value (commonly referred to as Step 0). If the Company chooses not to perform a qualitative assessment, or the result of Step 0 indicates a probable decrease in fair value of its reporting unit below its carrying value, a quantitative two-step test is performed (commonly referred to as Step 1 and Step 2). Step 1 compares the fair value of the reporting unit to its carrying value including goodwill. If the carrying value exceeds the fair value, Step 2 is performed to allocate the fair value of the reporting unit to its assets and liabilities in order to determine the implied fair value of goodwill, which is compared to the carrying value of goodwill to calculate an impairment loss, if any.

For the 2017 annual impairment test, the Company performed Step 1 of the two-step impairment test, which resulted in the fair value of its reporting units that have goodwill exceeding their carrying value. For the 2016 annual impairment test, the Company performed the qualitative Step 0 assessment and determined that it was more likely than not that the fair value of all its reporting units with goodwill exceeded their carrying values and therefore no quantitative assessment was required.

Cash Management Money Pool

The Company participates in Southern Company Gas' utility money pool, under which short-term borrowings are made from the money pool and surplus funds are contributed to the money pool. Borrowings from the money pool are recorded as due to affiliates in the balance sheets and intercompany interest expense is recorded in the statements of income for these borrowings. See Note 10 for additional information.

Receivables and Provision for Uncollectible Accounts

The Company's receivables consist primarily of natural gas sales and transportation services billed to residential, commercial, industrial, and other customers. Customers are billed monthly and payment is due within 30 days. For the majority of receivables, a provision for uncollectible accounts is established based on historical collection experience and other factors. For the remaining receivables, if the Company is aware of a specific customer's inability to pay, a provision for uncollectible accounts is recorded to reduce the receivable balance to the amount the Company reasonably expects to collect. If circumstances change, the estimate of the recoverability of accounts receivable could change as well. Circumstances that could affect this estimate include, but are not limited to, customer credit issues, customer deposits, and general economic conditions. Customers' accounts are written off once they are deemed to be uncollectible.

Materials and Supplies

Generally, materials and supplies include propane gas inventory, fleet fuel, and other materials and supplies. Materials are charged to inventory when purchased and then expensed or capitalized to plant, as appropriate, at weighted average cost when installed.

Natural Gas for Sale

The Company's natural gas inventories are carried at cost on a weighted average cost of gas basis.

Fair Value Measurements

The Company has financial and nonfinancial assets and liabilities subject to fair value measurement. The financial assets and liabilities measured and carried at fair value include derivative instruments. The carrying values of receivables, accounts payable, due to affiliates, other current assets and liabilities, accrued interest, and long-term debt approximate their respective fair value. The nonfinancial assets and liabilities include pension and other postretirement benefits. See Notes 2 and 7 for additional fair value disclosures.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in valuing the asset or liability, including assumptions about risk and the risks inherent in the inputs to

the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements to utilize the best available information. Accordingly, the Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Fair value balances are classified based on the observance of those inputs. The guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy defined by the guidance are as follows:

Level 1

Quoted prices in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. The Company's Level 1 items consist of exchange-traded derivatives, money market funds, and certain retirement plan assets.

Level 2

Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial and commodity instruments that are valued using valuation methodologies. These methodologies are primarily industry-standard methodologies that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace. Market price data is obtained from multiple sources in order to value certain Level 2 transactions and this data is representative of transactions that occurred in the marketplace. Level 2 instruments include non-exchange-traded derivatives such as over-the-counter forwards and options and certain retirement plan assets.

Level 3

Pricing inputs include significant unobservable inputs that may be used with internally developed methodologies to determine management's best estimate of fair value from the perspective of market participants. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs. Level 3 assets, liabilities, and any applicable transfers are primarily related to the Company's pension and other postretirement benefit plan assets as described in Note 2. Transfers into and out of Level 3 are determined using values at the end of the interim period in which the transfer occurred.

Financial Instruments

The Company uses derivative financial instruments to limit exposure to fluctuations in natural gas prices. All derivative financial instruments are recognized as either assets or liabilities on the balance sheets (shown separately as "Risk Management Activities") and are measured at fair value. See Note 7 for additional information regarding fair value. Derivative contracts that qualify as cash flow hedges of anticipated transactions or are recoverable through the respective state regulatory agency approved fuel-hedging programs result in the deferral of related gains and losses in other comprehensive income (OCI) or regulatory assets and liabilities, respectively, until the hedged transactions occur. Any ineffectiveness arising from cash flow hedges is recognized currently in net income. Cash flows from derivatives are classified on the statement of cash flows in the same category as the hedged item. See Note 8 for additional information regarding derivatives.

The Company offsets fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement. The Company had no outstanding collateral repayment obligations or rights to reclaim collateral arising from derivative instruments recognized at December 31, 2017.

Comprehensive Income

The objective of comprehensive income is to report a measure of all changes in common stock equity of an enterprise that result from transactions and other economic events of the period other than transactions with owners. Comprehensive income consists of net income, certain changes in pension and other postretirement benefit plans, and reclassifications for amounts included in net income.

Dividend Distributions

The Company paid dividends of $30.6 million and $29.6 million to Southern Company Gas during 2017 and 2016, respectively. Elizabethtown Gas is restricted by the dividend policy as established by its state regulatory agency (the New Jersey BPU) in the amount it can dividend to Southern Company Gas to the extent of 70% of its quarterly net income.

2. RETIREMENT BENEFITS

The Company participates in the Southern Company Gas qualified defined benefit, trusteed, pension plan covering most eligible employees, which was closed in 2012 to new employees and reopened to all non-union employees on January 1, 2018. The qualified pension plan is funded in accordance with requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA). Southern Company Gas also provides certain non-qualified defined benefit and defined contribution pension plans for a selected group of the Company's management and highly compensated employees. Benefits under these non-qualified pension plans are funded on a cash basis. The Company also participates in the Southern Company Gas postretirement benefit plan, which provides certain medical care and life insurance benefits for eligible retired employees through a postretirement benefit plan.

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. The Company also recorded a related regulatory asset of $55.0 million as of 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 the Company's utilities.

The following discussions reflect the Company's balances and activity under the multiple-employer method of accounting.

Actuarial Assumptions

The weighted average rates assumed in the actuarial calculations used to determine both the net periodic costs for the pension and other postretirement benefit plans for all periods presented and the benefit obligations as of the measurement date are presented below.

Assumptions used to determine net periodic costs:	Year Ended December 31, 2017	July 1, 2016 through December 31, 2016	January 1, 2016 through June 30, 2016
Pension plans			
Discount rate - interest costs	**3.76%**	3.21%	4.00%
Discount rate - service costs	**4.64**	4.07	4.80
Expected long-term return on plan assets	**7.60**	7.75	7.80
Annual salary increase	**3.50**	3.50	3.70
Other postretirement benefit plans			
Discount rate - interest costs	**3.40%**	2.84%	3.60%
Discount rate - service costs	**4.55**	3.96	4.70
Expected long-term return on plan assets	**6.03**	5.93	6.60
Annual salary increase	**3.50**	3.50	3.70

Assumptions used to determine benefit obligations:	December 31, 2017	December 31, 2016
Pension plans		
Discount rate	**3.74%**	4.39%
Annual salary increase	**2.88**	3.50
Other postretirement benefit plans		
Discount rate	**3.62%**	4.15%
Annual salary increase	**2.56**	3.50

The Company estimates the expected return on pension plan and other postretirement benefit plan assets by evaluating expected bond returns, equity risk premiums, asset allocations, the effects of active plan management, the impact of periodic plan asset rebalancing, and historical performance. The Company also considers guidance from its investment advisors in making a final determination of its expected rate of return on assets. To the extent the actual rate of return on assets realized over the course of a year is greater or less than the assumed rate, it does not affect that year's annual pension or other postretirement benefit plan cost; rather, this gain or loss reduces or increases future pension or other postretirement benefit plan costs.

An additional assumption used in measuring the accumulated other postretirement benefit obligations (APBO) was a weighted average medical care cost trend rate. The weighted average medical care cost trend rates used in measuring the APBO as of December 31, 2017 were as follows:

	Initial Cost Trend Rate	Ultimate Cost Trend Rate	Year That Ultimate Rate is Reached
Pre-65	6.40%	4.50%	2038
Post-65 medical	7.80	4.50	2038
Post-65 prescription	7.80	4.50	2038

An annual increase or decrease in the assumed medical care cost trend rate of 1% would affect the APBO; however, the impact on the service and interest cost components would be immaterial.

Pension Plans

The total accumulated benefit obligation for the pension plans was $116.8 million at December 31, 2017 and $106.7 million at December 31, 2016. Changes in the projected benefit obligations and the fair value of plan assets for the Company's qualified pension plans for all periods presented were as follows:

	Year Ended December 31, 2017	July 1, 2016 through December 31, 2016	January 1, 2016 through June 30, 2016
		(in thousands)	
Change in benefit obligation			
Benefit obligation at beginning of period	$ 118,129	$ 131,634	$ 113,676
Service cost	1,698	1,221	1,063
Interest cost	5,426	2,542	2,786
Benefits paid	(12,133)	(4,484)	(4,165)
Actuarial (gain) loss	15,377	(12,784)	18,274
Balance at end of period	128,497	118,129	131,634
Change in plan assets			
Fair value of plan assets at beginning of period	93,210	75,861	76,609
Actual return on plan assets	23,076	4,326	3,417
Employer contributions	—	17,507	—
Benefits paid	(12,133)	(4,484)	(4,165)
Fair value of plan assets at end of period	104,153	93,210	75,861
Accrued liability	$ 24,344	$ 24,919	$ 55,773

At December 31, 2017, the projected benefit obligations for the qualified and non-qualified pension plans were $128.5 million and $4.6 million, respectively. All pension plan assets are related to the qualified pension plan.

Amounts recognized in the balance sheets at December 31, 2017 and 2016 related to the Company's pension plans consist of the following:

	2017	2016
	(in thousands)	
Other regulatory assets, deferred	$ 32,039	$ 35,131
Employee benefit obligations	(24,344)	(24,919)

Presented below are the amounts included in accumulated OCI and regulatory assets at December 31, 2017 and 2016 related to the defined benefit pension plans that had not yet been recognized in net periodic pension cost along with the estimated amortization of such amounts for 2018.

	Amount Subject to Regulatory Amortization	Prior Service Costs	Net (Gain) Loss
		(in thousands)	
Balance at December 31, 2017:			
Accumulated OCI	$ —	$ (163)	$ 2,344
Regulatory assets (liabilities)	**38,584**	**(805)**	**(5,740)**
Total	$ 38,584	$ (968)	$ (3,396)
Balance at December 31, 2016:			
Accumulated OCI	$ —	$ (333)	$ 3,007
Regulatory assets (liabilities)	—	(2,185)	37,316
Total	$ —	$ (2,518)	$ 40,323
Estimated amortization in net periodic cost in 2018:			
Accumulated OCI	$ —	$ (119)	$ 205
Regulatory assets (liabilities)	2,691	(155)	325

The components of OCI and the changes in the balance of regulatory assets (liabilities), related to the defined benefit pension plans for all periods presented were as follows:

	Accumulated OCI	Regulatory Assets
	(in thousands)	
Balance at December 31, 2015:	$ 34,596	$ —
Net (gain) loss	18,085	(11,522)
Reclassification adjustments:		
Amortization of prior service costs	617	477
Amortization of net loss	(1,915)	(2,533)
Reclassification from accumulated OCI to regulatory assets	(48,709)	48,709
Total reclassification adjustments	(50,007)	46,653
Total change	(31,922)	35,131
Balance at December 31, 2016:	$ 2,674	$ 35,131
Net gain	**(398)**	**(340)**
Reclassification adjustments:		
Amortization of prior service costs	**141**	**502**
Amortization of net loss	**(236)**	**(1,884)**
Amortization of regulatory assets	—	**(1,370)**
Total reclassification adjustments	**(95)**	**(2,752)**
Total change	**(493)**	**(3,092)**
Balance at December 31, 2017:	**$ 2,181**	**$ 32,039**

The Company's pro rata components of Southern Company Gas' net periodic pension costs for the years ended December 31, 2017 and 2016 were as follows:

	2017	2016
	(in thousands)	
Service cost	$ 1,698	$ 2,284
Interest cost	5,426	5,328
Expected return on plan assets	(8,132)	(7,789)
Amortization of regulatory assets	1,370	—
Amortization:		
Prior service costs	(643)	(1,094)
Net loss	2,120	4,448
Net periodic pension cost	$ 1,839	$ 3,177

Net periodic pension cost is the sum of service cost, interest cost, and other costs netted against the expected return on plan assets. The expected return on plan assets is determined by multiplying the expected rate of return on plan assets and the market-related value of plan assets.

Future benefit payments reflect expected future service and are estimated based on assumptions used to measure the projected benefit obligation for the pension plans. At December 31, 2017, estimated benefit payments were as follows:

	Benefit Payments
	(in thousands)
2018	$ 8,859
2019	8,567
2020	9,030
2021	8,612
2022	8,427
2023 to 2027	39,894

Other Postretirement Benefits

Changes in the APBO and the fair value of plan assets for all periods presented were as follows:

	Year Ended December 31, 2017	July 1, 2016 through December 31, 2016	January 1, 2016 through June 30, 2016
		(in thousands)	
Change in benefit obligation			
Benefit obligation at beginning of period	$ 15,746	$ 16,761	$ 17,330
Service cost	128	70	60
Interest cost	532	238	277
Benefits paid	(1,131)	(356)	(577)
Actuarial (gain) loss	1,816	(967)	(329)
Benefit obligation at end of period	17,091	15,746	16,761
Change in plan assets			
Fair value of plan assets at beginning of period	16,845	16,322	16,290
Actual return (loss) on plan assets	3,114	523	32
Employer contributions	1,131	356	577
Benefits paid	(1,131)	(356)	(577)
Fair value of plan assets at end of period	19,959	16,845	16,322
(Prepaid asset) accrued liability	$ (2,868)	$ (1,099)	$ 439

Amounts recognized in the balance sheets at December 31, 2017 and 2016 related to the Company's other postretirement benefit plans consist of the following:

	2017	2016
	(in thousands)	
Other regulatory assets, deferred	$ 4,583	$ 4,973
Employee benefit obligations	2,868	1,099

Presented below are the amounts included in accumulated OCI and regulatory assets at December 31, 2017 and 2016 related to the other postretirement benefit plans that had not yet been recognized in net periodic other postretirement benefit cost. The estimated amortization of such amounts for 2018 is immaterial.

	Amount Subject to Regulatory Amortization	Prior Service Costs	Net (Gain) Loss
		(in thousands)	
Balance at December 31, 2017:			
Accumulated OCI	$ —	$ 47	$ 398
Regulatory assets	5,285	456	(1,158)
Total	$ 5,285	$ 503	$ (760)
Balance at December 31, 2016			
Accumulated OCI	$ —	$ —	$ 602
Regulatory assets	—	—	4,973
Total	$ —	$ —	$ 5,575

The components of OCI, along with the changes in the balance of regulatory assets (liabilities), related to the other postretirement benefit plans for all years presented were as follows:

	Accumulated OCI	Regulatory Assets
	(in thousands)	
Balance at December 31, 2015:	$ 7,103	$ —
Net (gain) loss	(11)	(1,079)
Reclassification adjustments:		
Amortization of prior service costs	(1)	(1)
Amortization of net loss	(201)	(235)
Reclassification from accumulated OCI to regulatory assets	(6,288)	6,288
Total reclassification adjustments	(6,490)	6,052
Total change	(6,501)	4,973
Balance at December 31, 2016:	$ 602	$ 4,973
Net (gain) loss	(116)	80
Reclassification adjustments:		
Amortization of prior service costs	—	—
Amortization of net loss	(41)	(191)
Amortization of regulatory assets	—	(279)
Total reclassification adjustments	(41)	(470)
Total change	(157)	(390)
Balance at December 31, 2017:	$ 445	$ 4,583

The Company's pro rata components of Southern Company Gas' other postretirement benefit plans' net periodic cost for the years ended December 31, 2017 and 2016 were as follows:

	2017	2016
	(in thousands)	
Service cost	$ 128	$ 130
Interest cost	532	515
Expected return on plan assets	(837)	(856)
Amortization of regulatory assets	279	—
Amortization:		
Prior service costs	—	2
Net loss	232	435
Net periodic pension cost	$ 334	$ 226

Future benefit payments, including prescription drug benefits, reflect expected future service and are estimated based on assumptions used to measure the APBO for the other postretirement benefit plans. At December 31, 2017, estimated benefit payments were as follows:

	Benefit Payments
	(in thousands)
2018	$ 953
2019	1,016
2020	1,056
2021	1,100
2022	1,134
2023 to 2027	5,472

Benefit Plan Assets

Southern Company Gas' pension plan and other postretirement benefit plan assets are managed and invested in accordance with all applicable requirements, including ERISA and the Internal Revenue Code of 1986, as amended. The investment policies for both the pension plan and the other postretirement benefit plans cover a diversified mix of assets, including equity and fixed income securities, real estate, and private equity. Southern Company Gas minimizes the risk of large losses primarily through diversification but also monitors and manages other aspects of risk.

The composition of Southern Company Gas' pension plan and other postretirement benefit plan assets as of December 31, 2017 and 2016, along with the targets for each plan, is presented below:

	Target	2017	2016
Pension plan assets:			
Equity	53%	65%	69%
Fixed Income	15%	19%	20%
Cash	2%	6%	1%
Other	30%	10%	10%
Balance at end of period	100%	100%	100%
Other postretirement benefit plan assets:			
Equity	72%	76%	74%
Fixed Income	24%	20%	23%
Cash	1%	2%	1%
Other	3%	2%	2%
Total	100%	100%	100%

The investment strategy for plan assets related to Southern Company Gas' qualified pension plan is to be broadly diversified across major asset classes. The asset allocation is established after consideration of various factors that affect the assets and

liabilities of the pension plan including, but not limited to, historical and expected returns and interest rates, volatility, correlations of asset classes, the current level of assets and liabilities, and the assumed growth in assets and liabilities. Because a significant portion of the liability of the pension plan is long-term in nature, the assets are invested consistent with long-term investment expectations for return and risk. To manage the actual asset class exposures relative to the target asset allocation, Southern Company Gas employs a formal rebalancing program for its pension plan assets. To manage the actual asset class exposures relative to the target asset allocation, Southern Company Gas employs a formal rebalancing program for its pension plan assets. As additional risk management, external investment managers and service providers are subject to written guidelines to ensure appropriate and prudent investment practices. Management believes the portfolio is well-diversified with no significant concentrations of risk.

Investment Strategies

Detailed below is a description of the investment strategies for each major asset category for the Southern Company Gas pension and other postretirement benefit plans disclosed above:

- ***Domestic equity.*** A mix of large and small capitalization stocks with generally an equal distribution of value and growth attributes, managed both actively and through passive index approaches.
- ***International equity.*** A mix of growth stocks and value stocks with both developed and emerging market exposure, managed both actively and through passive index approaches.
- ***Fixed income.*** A mix of domestic and international bonds.
- **Special situations.** Investments in opportunistic strategies with the objective of diversifying and enhancing returns and exploiting short-term inefficiencies as well as investments in promising new strategies of a longer-term nature.
- ***Real estate investments.*** Investments in traditional private market equity-oriented investments in real properties (indirectly through pooled funds or partnerships) and in publicly traded real estate securities.
- ***Private equity.*** Investments in private partnerships that invest in private or public securities typically through privately-negotiated and/or structured transactions, including leveraged buyouts, venture capital, and distressed debt.

The investment strategies prior to July 1, 2016 followed a policy to preserve the plans' capital and maximize investment earnings in excess of inflation within acceptable levels of capital market volatility. To accomplish this goal, the plans' assets were managed to optimize long-term return while maintaining a high standard of portfolio quality and diversification. In developing the allocation policy for the assets of the pension and other postretirement benefit plans, Southern Company Gas examined projections of asset returns and volatility over a long-term horizon. In connection with this analysis, the risk and return trade-offs of alternative asset classes and asset mixes were evaluated given long-term historical relationships as well as prospective capital market returns. Southern Company Gas also conducted asset-liability studies to match projected asset growth with projected liability growth to determine whether there is sufficient liquidity for projected benefit payments. Asset mix guidelines were developed by incorporating the results of these analyses with an assessment of Southern Company Gas' risk posture, and taking into account industry practices. Southern Company Gas periodically evaluated its investment strategy to ensure that plan assets were sufficient to meet the benefit obligations of the plans. As part of the ongoing evaluation, the Company made changes to its targeted asset allocations and investment strategy.

Benefit Plan Asset Fair Values

Following are the fair value measurements for the pension plan and the other postretirement benefit plan assets as of December 31, 2017 and 2016. The fair values presented are prepared in accordance with GAAP. For purposes of determining the fair value of the pension plan and other postretirement benefit plan assets and the appropriate level designation, management relies on information provided by the plan's trustee. This information is reviewed and evaluated by management with changes made to the trustee information as appropriate. Management believes the portfolio is well-diversified with no significant concentrations of risk.

Valuation methods of the primary fair value measurements disclosed in the following tables are as follows:

- ***Domestic and international equity.*** Investments in equity securities such as common stocks, American depositary receipts, and real estate investment trusts that trade on a public exchange are classified as Level 1 investments and are valued at the closing price in the active market. Equity investments with unpublished prices (i.e. pooled funds) are valued as Level 2, when the underlying holdings used to value the investment are comprised of Level 1 or Level 2 equity securities.
- ***Fixed income.*** Investments in fixed income securities are generally classified as Level 2 investments and are valued based on prices reported in the market place. Additionally, the value of fixed income securities takes into consideration certain items such as broker quotes, spreads, yield curves, interest rates, and discount rates that apply to the term of a specific instrument.
- ***Real estate investments and private equity.*** Investments in real estate, private equity, and special situations are generally classified as Net Asset Value as a Practical Expedient, since the underlying assets typically do not have publicly available observable inputs. The fund manager values the assets using various inputs and techniques depending on the nature of the underlying investments. Techniques may include purchase multiples for comparable

transactions, comparable public company trading multiples, discounted cash flow analysis, prevailing market capitalization rates, recent sales of comparable investments, and independent third-party appraisals. The fair value of partnerships is determined by aggregating the value of the underlying assets less liabilities.

The Company's pro rata portion of fair values of pension plan assets as of December 31, 2017 and 2016 are presented below. These fair value measurements exclude cash, receivables related to investment income, pending investments sales, and payables related to pending investment purchases. Absolute return investment assets are presented in the tables below based on the nature of the investment.

	Fair Value Measurements Using			
As of December 31, 2017	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Net Asset Value as a Practical Expedient (NAV)**	**Total**
		(in thousands)		
Assets:				
Domestic equity(*)	$ 17,042	$ 35,596	$ —	$ 52,638
International equity(*)	—	18,273	—	18,273
Fixed income:				
U.S. Treasury, government, and agency bonds	—	9,401	—	9,401
Corporate bonds	—	4,334	—	4,334
Cash equivalents and other	9,235	2,744	5,334	17,313
Real estate investments	351	—	1,706	2,057
Private equity	—	—	137	137
Total	$ 26,628	$ 70,348	$ 7,177	$ 104,153

(*) Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds.

	Fair Value Measurements Using			
As of December 31, 2016	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Net Asset Value as a Practical Expedient (NAV)**	**Total**
		(in thousands)		
Assets:				
Domestic equity(*)	$ 13,449	$ 32,507	$ —	$ 45,956
International equity(*)	—	17,581	—	17,581
Fixed income:				
U.S. Treasury, government, and agency bonds	—	8,072	—	8,072
Corporate bonds	—	3,860	—	3,860
Pooled funds	—	6,275	—	6,275
Cash equivalents and other	1,159	467	7,880	9,506
Real estate investments	342	—	1,382	1,724
Private equity	—	—	236	236
Total	$ 14,950	$ 68,762	$ 9,498	$ 93,210

(*) Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds.

The Company's pro rata portion of fair values of other postretirement benefit plan assets as of December 31, 2017 and 2016 are presented below. These fair value measurements exclude cash, receivables related to investment income, pending investments sales, and payables related to pending investment purchases.

As of December 31, 2017	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Net Asset Value as a Practical Expedient (NAV)	Total
		(in thousands)		
Assets:				
Domestic equity(*)	$ 472	$ 11,226	$ —	$ 11,698
International equity(*)	—	3,641	—	3,641
Fixed income:				
U.S. Treasury, government, and agency bonds	—	88	—	88
Corporate bonds	—	37	—	37
Pooled funds	—	3,890	—	3,890
Cash equivalents and other	368	—	169	537
Real estate investments	10	—	54	64
Private equity	—	—	4	4
Total	$ 850	$ 18,882	$ 227	$ 19,959

(*) Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds.

As of December 31, 2016	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Net Asset Value as a Practical Expedient (NAV)	Total
		(in thousands)		
Assets:				
Domestic equity(*)	$ 402	$ 9,286	$ —	$ 9,688
International equity(*)	—	2,820	—	2,820
Fixed income:				
U.S. Treasury, government, and agency bonds	—	82	—	82
Corporate bonds	—	36	—	36
Pooled funds	—	3,760	—	3,760
Cash equivalents and other	126	—	268	394
Real estate investments	10	—	47	57
Private equity	—	—	8	8
Total	$ 538	$ 15,984	$ 323	$ 16,845

(*) Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds.

Employee Savings Plan

Southern Company Services, Inc. sponsors 401(k) defined contribution plans covering certain eligible employees. Through December 31, 2017, the 401(k) plans provided matching contributions of either 65% on up to 8% of an employee's eligible compensation, or a 100% matching contribution on up to 3% of an employee's eligible compensation, followed by a 75% matching contribution on up to the next 3% of an employee's eligible compensation. Total matching contributions made to the 401(k) plans for each of the years ended December 31, 2017 and 2016 was $1.5 million.

For employees not accruing a benefit under the pension plan, additional contributions made to the 401(k) plans for the years ended December 31, 2017 and 2016 were not material.

Effective January 1, 2018, the 401(k) plans were merged into the Southern Company Employee Savings Plan, which is a defined contribution plan covering substantially all employees of the Company. Under this plan, Southern Company Gas matches a portion of the first 6% of employee base salary contributions. The maximum Company match is 5.1% of an employee's base salary.

3. CONTINGENCIES AND REGULATORY MATTERS

General Litigation Matters

The Company is assessing its alleged involvement in an incident that occurred in one of its service territories that resulted in several deaths, injuries, and property damage. One of the Company's utilities has been named as one of the defendants in several lawsuits related to this incident. At December 31, 2017, the Company has reserved for all of its potential exposure from this case. The ultimate outcome of this matter cannot be determined at this time.

The Company is subject to certain claims and legal actions arising in the ordinary course of business. The ultimate outcome of these matters and such pending or potential litigation against the Company cannot be determined 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 the Company's financial statements.

Environmental Matters

The Company's operations are regulated by state and federal environmental agencies through a variety of laws and regulations governing air, water, land and protection of other natural resources. The Company maintains a comprehensive environmental compliance strategy to assess upcoming requirements and compliance costs associated with these environmental laws and regulations. The costs, including capital expenditures and operations and maintenance costs, required to comply with environmental laws and regulations impact future results of operations, cash flows, and financial condition. Compliance costs may result from the installation of additional environmental controls. Compliance with these environmental requirements involves significant capital and operating costs to clean up affected sites. The Company conducts studies to determine the extent of any required clean up and has recognized in its financial statements the costs to clean up known impacted sites. The Company has received authority from the New Jersey BPU to recover approved environmental compliance costs through regulatory mechanisms.

The Company is subject to environmental remediation liabilities associated with seven former manufactured gas plant sites in two different states. Accrued environmental remediation costs of $87.1 million and $111.2 million have been recorded in the balance sheets as of December 31, 2017 and December 31, 2016, respectively. These environmental remediation expenditures are recoverable from customers through rate mechanisms approved by the applicable state regulatory agencies, with the exception of one site, at which a $3.0 million reversal of the accrued liability was recorded during 2017 for a change in estimated remediation costs, that represented $2.0 million of the total accrued remediation costs at December 21, 2017.

The Company's ultimate environmental compliance strategy and future environmental capital expenditures will be affected by the final requirements of new or revised environmental regulations and the outcome of any legal challenges to the environmental rules. The ultimate outcome of these matters cannot be determined at this time.

Regulatory Matters

The Merger was approved by the New Jersey BPU on June 29, 2016 and the Maryland PSC on May 3, 2016. Approval by the Florida PSC was not required. In connection with the Merger approval orders, the Company was required to:

- provide rate credits of $17.9 million to customers in New Jersey and Maryland;
- file a rate case at Elizabethtown Gas no later than September 1, 2016, with another rate case no later than three years after the 2016 rate case; and
- file a base rate case at Elkton Gas within two years of closing the Merger.

The rate credits to customers were paid during the third quarter of 2016 and the Company filed a general base rate case with the New Jersey BPU on September 1, 2016. See "Customer Refunds" and "Base Rate Cases" herein for additional information.

Regulatory Infrastructure Programs

The Company has infrastructure improvement programs at several of its utilities. Descriptions of these programs are as follows:

Elizabethtown Gas

Elizabethtown Gas' 2013 extension of the Aging Infrastructure Replacement (AIR) enhanced infrastructure program allowed for infrastructure investment of $115 million over four years and was focused on the replacement of aging cast iron in its pipeline system. Carrying charges on the additional capital spend are being accrued and deferred for regulatory purposes at a weighted average cost of capital of 6.65%. Effective July 1, 2017, investments under this program, which ended September 30, 2017, are being recovered through base rate revenues. See "Base Rate Cases" herein for additional information.

In 2015, Elizabethtown Gas filed the Safety, Modernization and Reliability Tariff plan with the New Jersey BPU seeking approval to invest more than $1.1 billion to replace 630 miles of vintage cast iron, steel, and copper pipeline, as well as 240 regulator stations. During the first quarter 2018, Elizabethtown Gas withdrew this filing in response to a proposed rule by the New Jersey BPU to incentivize utilities to accelerate investment in infrastructure replacement programs that enhance reliability, resiliency, and/or safety of the distribution system. Elizabethtown Gas expects to file a revised plan during the second half of 2018. The ultimate outcome of this matter cannot be determined at this time.

Florida City Gas

In 2015, the Florida PSC approved Florida City Gas' Safety, Access, and Facility Enhancement (SAFE) program, under which costs incurred for replacing aging pipes are recovered through a rate rider with annual adjustments and true-ups. Under the program, Florida City Gas is authorized to spend $105 million over a 10-year period on infrastructure relocation and enhancement projects.

Base Rate Cases

On June 30, 2017, the New Jersey BPU approved a settlement that provides for a $13 million increase in annual base rate revenues, effective July 1, 2017, based on a ROE of 9.6%. Also included in the settlement was a new composite depreciation rate that is expected to result in a $3 million annual reduction of depreciation. See Note 9 for information on the proposed sale of Elizabethtown Gas and Elkton Gas.

On October 23, 2017, Florida City Gas filed a general base rate case with the Florida PSC, which included an interim rate increase of $5 million annually that was approved and became effective January 12, 2018, subject to refund. On March 26, 2018, the Florida PSC approved a settlement that provides for an $11.5 million increase in annual base rate revenues that includes the impact of the Tax Reform Legislation, effective June 1, 2018, based on a ROE of 10.19%. Also included in the settlement was full recovery of Florida City Gas' liquefied natural gas facility through a step increase in rates.

Other

The New Jersey BPU and Maryland PSC each issued an order effective January 1, 2018 that requires utilities in their respective states to track as a regulatory liability the impact of the Tax Reform Legislation, including the reduction in the corporate income tax rate to 21% and the impact of excess deferred income taxes. Elizabethtown Gas made the required filing on March 2, 2018 seeking to reduce annual rates by $10.9 million with an April 1, 2018 interim effective date and final rates that are anticipated to take effect July 1, 2018. The Maryland PSC's order required Elkton Gas to file an explanation of the impact of the Tax Reform Legislation on its expenses and revenues, as well as when and how it expects to pass through to its customers those effects. Elkton Gas made the required filing on February 15, 2018 and will reduce annual base rates by $0.1 million effective April 1, 2018. Credits will be issued to customers in New Jersey and Maryland for the impact of the Tax Reform Legislation from January 2018 through March 2018.

Unrecognized Ratemaking Amounts

The following table illustrates the Company's authorized ratemaking amounts that are not recognized on its balance sheets. These amounts are primarily comprised of an allowed equity rate of return on assets associated with Elizabethtown Gas' AIR program. These amounts will be recognized as revenues in the Company's financial statements in the periods they are billable to customers. See Note 9 for information on the proposed sale of Elizabethtown Gas and Elkton Gas.

		Elizabethtown Gas
		(in thousands)
December 31, 2017	**$**	**7,392**
December 31, 2016		5,535

Customer Refunds

In the third quarter 2016, Elizabethtown Gas provided direct per-customer rate credits totaling $17.5 million to its customers in accordance with the Merger approval from the New Jersey BPU. These rate credits were allocated among Elizabethtown Gas' customer classes based on the base rate revenues reflected in the rates that resulted from its most recent base rate proceeding.

In the fourth quarter 2016, Elkton Gas provided direct per-customer rate credits totaling $0.4 million to its customers in accordance with the Merger approval from the Maryland PSC. These rate credits were funded from an increase in the amount paid through Elkton Gas' asset management agreement.

4. INCOME TAXES

Subsequent to the Merger, Southern Company files a consolidated federal income tax return and various combined and separate state income tax returns, on behalf of the Company and Southern Company Gas. Under a joint consolidated income tax allocation agreement each Southern Company subsidiary's current and deferred tax expense is computed on a stand-alone basis and no subsidiary is allocated more current expense than would be paid if it filed a separate income tax return. In accordance with Internal Revenue Service (IRS) regulations, the Company is jointly and severally liable for the federal tax liability. Prior to the Merger, the Company was a part of Southern Company Gas' U.S. federal consolidated income tax return and various state income tax returns.

Federal Tax Reform Legislation

Following the enactment of the Tax Reform Legislation, the Securities and Exchange Commission staff issued Staff Accounting Bulletin 118 - "Income Tax Accounting Implications of the Tax Cuts and Jobs Act" (SAB 118), which provides for a measurement period of up to one year from the enactment date to complete accounting under GAAP for the tax effects of the legislation. Due to the complex and comprehensive nature of the enacted tax law changes, and their application under GAAP, the Company considers all amounts recorded in the financial statements as a result of the Tax Reform Legislation to be "provisional" as discussed in SAB 118 and subject to revision. The Company is awaiting additional guidance from industry and income tax authorities in order to finalize its accounting. The ultimate impact of the Tax Reform Legislation on deferred income tax assets and liabilities and the related regulatory assets and liabilities cannot be determined at this time.

Current and Deferred Income Taxes

Details of income tax provisions are as follows:

	2017	2016
	(in thousands)	
Federal —		
Current	$ **(13,322)**	$ 2,410
Deferred	**36,400**	14,655
	23,078	17,065
State —		
Current	**(1,310)**	1,201
Deferred	**5,025**	2,329
	3,715	3,530
Amortization of investment tax credits	**(86)**	(119)
Total	$ **26,707**	$ 20,476

The tax effects of temporary differences between the carrying amounts of assets and liabilities in the financial statements and their respective tax bases, which give rise to deferred tax assets and liabilities, are as follows:

	2017	2016
	(in thousands)	
Deferred tax liabilities —		
Accelerated depreciation	**$ 190,697**	$ 248,736
Property basis differences	**23,861**	32,833
Regulatory assets associated with employee benefit obligations	**11,973**	19,395
Other	**5,802**	4,691
Total	**232,333**	305,655
Deferred tax assets —		
Federal net operating loss	**7,712**	7,558
Federal effect of state deferred taxes	**9,333**	13,286
Tax reform legislation	**41,328**	—
Employee benefit obligations	**8,937**	18,996
Prepaid lease	**—**	4,231
Bad debt and insurance reserves	**1,840**	2,274
Other	**11,715**	9,238
Total	**80,865**	55,583
Accumulated deferred income taxes, net	**$ 151,468**	$ 250,072

The implementation of the Tax Reform Legislation significantly reduced accumulated deferred income taxes, partially offset by bonus depreciation provisions in the Protecting Americans from Tax Hikes Act. The Tax Reform Legislation also significantly increased tax-related regulatory liabilities.

At December 31, 2017, the tax-related regulatory liabilities to be credited to customers were $146.4 million. These liabilities are primarily attributable to deferred taxes previously recognized at rates higher than the current enacted tax law and to unamortized ITCs.

Deferred federal and state ITCs are amortized over the average life of the related property with such amortization normally applied as a credit to reduce depreciation in the statements of income. Credits amortized in this manner amounted to $0.1 million for each year ended December 31, 2017 and 2016. At December 31, 2017, all ITCs available to reduce federal income taxes payable had been utilized.

Effective Tax Rate

A reconciliation of the federal statutory income tax rate to the effective income tax rate is as follows:

	Years Ended December 31,	
	2017	2016
Federal statutory rate	**35.0%**	35.0%
State income tax, net of federal deduction	**5.6**	5.3
Other	**(1.8)**	(0.1)
Effective income tax rate	**38.8%**	40.2%

Unrecognized Tax Benefits

The Company has no unrecognized tax benefits for any year presented.

The Company classifies interest on tax uncertainties as interest expense; however, the Company had no accrued interest or penalties for unrecognized tax benefits for any year presented.

It is reasonably possible that the amount of the unrecognized tax benefits could change within 12 months. The settlement of federal and state audits could impact the balances. At this time, an estimate of the range of reasonably possible outcomes cannot be determined.

Southern Company is a participant in the Compliance Assurance Process of the IRS. The IRS has finalized its audits of Southern Company's consolidated federal tax returns through 2016. However, the pre-Merger Southern Company Gas 2014, 2015, and June 30, 2016 federal tax returns are currently under audit. The audits for Southern Company Gas by any state have either concluded, or the statute of limitations has expired with respect to income tax examinations, for years prior to 2011.

5. FINANCING

The following table provides maturity dates, year-to-date weighted average interest rates, and amounts outstanding for various debt securities and facilities that are included in the balance sheets.

		December 31, 2017		December 31, 2016	
(Dollars in thousands)	**Year(s) due**	**Weighted average interest rate**	**Outstanding**	**Weighted average interest rate**	**Outstanding**
Gas facility revenue bonds	2022-2033	**1.7%**	**$ 200,100**	1.3%	$ 200,100
Affiliate promissory note	2034	**3.7**	**377,744**	3.6	305,254
Total principal long-term debt		**3.0%**	**$ 577,844**	2.7%	$ 505,354
Unamortized debt issuance costs		**n/a**	**$ (789)**	n/a	$ (872)
Total debt		**n/a**	**$ 577,055**	n/a	$ 504,482

Gas Facility Revenue Bonds

The Company is party to a series of loan agreements with the New Jersey Economic Development Authority and Brevard County, Florida under which five series of gas facility revenue bonds have been issued. These revenue bonds are issued by state agencies or counties to investors, and proceeds from each issuance then are loaned to the Company. Southern Company Gas fully and unconditionally guarantees all of the Company's gas facility revenue bonds.

Elizabethtown Gas' asset sale agreement requires that bonds representing $180 million of the total that are currently eligible for redemption at par be redeemed on or prior to consummation of the sale. The ultimate outcome of this matter cannot be determined at this time. See Note 9 for information on the proposed sale of Elizabethtown Gas and Elkton Gas.

Affiliate Promissory Note

The Company entered into a promissory note with Southern Company Gas (Affiliate Promissory Note) for the purpose of refinancing its short-term debt and recapitalizing its capital structure in accordance with the target capitalization of 47% for Elizabethtown Gas and 45% for Elkton Gas and Florida City Gas. The Affiliate Promissory Note is adjusted periodically to maintain the appropriate targeted capitalization percentages. During 2017, $72.5 million was converted to the Affiliate Promissory Note and $64.8 million was converted to equity. The Affiliate Promissory Note is due December 31, 2034 and had an initial interest rate at December 31, 2004 of 6.3%, which adjusts on a periodic basis based upon weighted average costs and expenses of borrowing the then-outstanding long-term debt of both Southern Company Gas and Southern Company Gas Capital Corporation, a 100%-owned financing subsidiary of Southern Company Gas. As of December 31, 2017, the effective interest rate on this note was 3.7% which consists of two components. The first is incurred equal to the weighted average costs that is applied to the principal amount of the Affiliate Promissory Note. The second component is an adjustment to increase the effective interest incurred on long-term debt other than the Affiliate Promissory Note to the weighted average cost applicable to the Affiliate Promissory Note.

6. COMMITMENTS

Pipeline Charges, Storage Capacity, and Gas Supply

Pipeline charges, storage capacity, and gas supply include charges recoverable through a natural gas cost recovery mechanism, or alternatively, billed to marketers of natural gas as well as demand charges associated with Sequent Energy Management, L.P. (Sequent), a wholly-owned subsidiary of Southern Company Gas that engages in wholesale marketing of natural gas supply services.

Contractual Obligations

Contractual obligations at December 31, 2017 were as follows:

	2018	2019-2020	2021-2022	After 2022	Total
			(in thousands)		
Long-term debt[(a)] -					
Principal	$ —	$ —	$ 46,500	$ 531,344	$ 577,844
Interest	3,425	6,850	6,850	20,237	37,362
Pipeline charges, storage capacity, and gas supply[(b)]	72,667	136,344	89,896	288,419	587,326
Operating leases[(c)]	4,366	8,490	5,661	—	18,517
Asset management agreements[(d)]	4,253	2,125	—	—	6,378
Financial derivative obligations[(e)]	1,587	419	—	—	2,006
Other purchase commitments[(f)]	7,182	—	—	—	7,182
Total	$ 93,480	$ 154,228	$ 148,907	$ 840,000	$ 1,236,615

(a) Amounts are reflected based on final maturity dates. The Company plans to continue, when economically feasible, to retire higher-cost securities and replace these obligations with lower-cost capital if market conditions permit. Variable rate interest obligations are estimated based on rates at December 31, 2017 and do not include interest on the affiliated promissory note.

(b) Includes charges recoverable through a natural gas cost recovery mechanism, subject to review by the respective state regulatory agencies.

(c) Certain operating leases have provisions for step rent or escalation payments and certain lease concessions are accounted for by recognizing the future minimum lease payments on a straight-line basis over the respective minimum lease terms. However, this accounting treatment does not affect the future annual operating lease cash obligations as shown herein. In terms of rental charges and duration contracts, the Company's most significant operating leases relate to real estate and fleet vehicles.

(d) Represent fixed-fee minimum payments for Sequent's affiliated asset management agreements.

(e) See Notes 1 and 9 for additional information.

(f) Includes contractual environmental remediation liabilities that are generally recoverable through base rates or rate rider mechanisms.

Indemnities

In certain instances, the Company has undertaken to indemnify current property owners and others against costs associated with the effects and/or remediation of contaminated sites for which it may be responsible under applicable federal or state environmental laws, generally with no limitation as to the amount. These indemnifications relate primarily to ongoing coal tar cleanup. See Note 3 under "Environmental Matters" for additional information. The Company believes that the likelihood of payment under its other environmental indemnifications is remote. No liability has been recorded for such indemnifications as the fair value was inconsequential at inception.

7. FAIR VALUE MEASUREMENTS

Fair value measurements are based on inputs of observable and unobservable market data that a market participant would use in pricing the asset or liability. The use of observable inputs is maximized where available and the use of unobservable inputs is minimized for fair value measurement and reflects a three-tier fair value hierarchy that prioritizes inputs to valuation techniques used for fair value measurement. See Note 1 under "Fair Value Measurements" for additional information on the fair value hierarchy.

As of December 31, 2017, liabilities measured at fair value on a recurring basis during the year, 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 thousands)		
Liabilities:					
Energy-related derivatives	$ —	$ 2,006	$ —	$ —	$ 2,006

As of December 31, 2016, assets measured at fair value on a recurring basis during the year, 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 thousands)		
Assets:					
Energy-related derivatives	$ —	$ 8,385	$ —	$ —	$ 8,385

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 8 for additional information on how these derivatives are used.

8. DERIVATIVES

The Company is exposed to market risks, primarily commodity price risk, interest rate risk, and weather risk. To manage the volatility attributable to these exposures, the Company nets its exposures, where possible, to take advantage of natural offsets and enters into various derivative transactions for the remaining exposures pursuant to the Company's policies in areas such as counterparty exposure and risk management practices. The Company's 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 7 for additional information. In the statements of cash flows, the cash impacts of settled energy-related are recorded as operating activities.

Energy-Related Derivatives

The Company 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, the Company has limited exposure to market volatility in prices of natural gas. The Company manages fuel-hedging programs, implemented per the guidelines of each respective state regulatory agencies, 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 the Company's 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 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 December 31, 2017, the net volume of energy-related derivative contracts for natural gas positions totaled 18 billion cubic feet for the Company, together with the longest hedge date of 2019 over which the Company is hedging its exposure to the variability in future cash flows for forecasted transactions.

Derivative Financial Statement Presentation and Amounts

The derivative contracts of the Company are subject to master netting arrangements or similar agreements and are reported net in the financial statements. Some of these energy-related 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 December 31, 2017 and 2016, the fair value of energy-related derivatives was reflected in the balance sheets as follows:

Derivative Category	Balance Sheet Location	Asset Derivatives 2017	Asset Derivatives 2016	Balance Sheet Location	Liability Derivatives 2017	Liability Derivatives 2016
		(in thousands)			*(in thousands)*	
Derivatives designated as hedging instruments for regulatory purposes						
Energy-related derivatives:						
	Assets from risk management activities – current	$ —	$ 7,473	Liabilities from risk management activities – current	$ **1,694**	$ —
	Other deferred charges and assets	—	912	Other deferred charges and assets	**312**	—
Total derivatives designated as hedging instruments for regulatory purposes		$ —	$ 8,385		$ **2,006**	$ —
Gross amounts of recognized		$ —	$ 8,385		$ **2,006**	$ —
Gross amounts offset		$ —	$ —		$ **—**	$ —
Net amounts recognized in the Balance Sheets		$ —	$ 8,385		$ **2,006**	$ —

At December 31, 2017 and 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:

Derivative Category	Balance Sheet Location	Unrealized Losses 2017	Unrealized Losses 2016	Balance Sheet Location	Unrealized Gains 2017	Unrealized Gains 2016
		(in thousands)			*(in thousands)*	
Energy-related derivatives:						
	Other regulatory assets, current	$ **(1,694)**	$ —	Other regulatory liabilities, current	$ —	$ 7,473
	Other regulatory assets, deferred	**(312)**	—	Other regulatory liabilities, deferred	—	912
Total energy-related derivative gains (losses)		$ **(2,006)**	$ —		$ —	$ 8,385

Contingent Features

The Company 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 December 31, 2017, the Company had no collateral posted with derivative counterparties to satisfy these arrangements.

At December 31, 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.

The Company is exposed to losses related to financial instruments in the event of counterparties' nonperformance. The Company 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 or with counterparties who have posted collateral to cover potential

credit exposure. The Company has also established risk management policies and controls to determine and monitor the creditworthiness of counterparties in order to mitigate its exposure to counterparty credit risk.

The Company also utilizes master netting agreements whenever possible to mitigate exposure to counterparty credit risk. When the Company 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 the Company's credit risk. The Company also uses other netting agreements with certain counterparties with whom it conducts significant transactions. Master netting agreements enable the Company to net certain assets and liabilities by counterparty. The Company also nets across product lines and against cash collateral, provided the master netting and cash collateral agreements include such provisions. The Company may require counterparties to pledge additional collateral when deemed necessary. Therefore, the Company does not anticipate a material adverse effect on the financial statements as a result of counterparty nonperformance.

9. DISPOSITIONS

Proposed Sale of Elizabethtown Gas and Elkton Gas

On October 15, 2017, the Company entered into agreements for the sale of the assets of Elizabethtown Gas and Elkton Gas to South Jersey Industries, Inc. for a total cash purchase price of $1.7 billion. The completion of each asset sale is subject to the satisfaction or waiver of certain conditions, including, among other customary closing conditions, the receipt of required regulatory approvals, including the FERC, the Federal Communications Commission, the New Jersey BPU, and, with respect to the sale of Elkton Gas, the Maryland PSC. The Company and South Jersey Industries, Inc. made joint filings on December 22, 2017 and January 16, 2018 with the New Jersey BPU and the Maryland PSC, respectively, requesting regulatory approval. The asset sales are expected to be completed by the end of the third quarter 2018.

The ultimate outcome of these matters cannot be determined at this time.

10. AFFILIATE TRANSACTIONS

The Company has agreements with Sequent for transportation and storage capacity to meet natural gas demands. The following table provides additional information on the Company's asset management agreements with Sequent.

	Expiration date	Type of fee structure	Annual fee	Profit sharing / fees payments 2017	Profit sharing / fees payments 2016
				(in thousands)	
Elizabethtown Gas	March 2019	Tiered	[a]	$ 11,195	$ 15,043
Florida City Gas	[b]	Profit-sharing	50%	1,276	1,169
Elkton Gas	March 2018	Fixed	[c]	14	14
Total				$ 12,485	$ 16,226

(a) In March 2014, the New Jersey BPU authorized the renewal of the asset management agreement between Elizabethtown Gas and Sequent for five years. This renewed agreement began on April 1, 2014 and requires Sequent to pay minimum annual fees of $4.25 million to Elizabethtown Gas and includes tiered margin sharing levels between Elizabethtown Gas and Sequent.

(b) The agreement renews automatically each year unless terminated by either party.

(c) In December 2016, the term of the agreement was extended to March 31, 2018 at a rate of $1,125 per month.

Upon consummation of the asset sales of Elizabethtown Gas and Elkton Gas, South Jersey Industries, Inc. will assume the asset management agreements of Elizabethtown Gas and Elkton Gas. See Note 9 for information on the proposed sale of Elizabethtown Gas and Elkton Gas.

Amounts Due to Affiliates

The Company had $118.6 million and $62.6 million in payable at December 31, 2017 and 2016, respectively, which was due to Southern Company Gas, primarily related to the participation in the Southern Company Gas money pool. The Company also had $377.7 million and $305.3 million outstanding at December 31, 2017 and 2016, respectively, related to a promissory note with Southern Company Gas. See Note 5 for additional information on the Affiliate Promissory Note.

The Company is covered by Southern Company Gas' agreement with Southern Company Services, Inc. under which various services are currently being rendered to the Company as direct or allocated cost. Additionally, the Company engages in transactions with Southern Company Gas' affiliates consistent with its services and tax allocation agreements.

11. SUBSEQUENT EVENTS

Management evaluated subsequent events for potential recognition and disclosure through March 29, 2018, the date these financial statements were available to be issued, and determined that, except as discussed in Note 3 under the captions "Regulatory Infrastructure Programs - Elizabethtown Gas," "Base Rate Cases," and "Other," no significant events have occurred subsequent to period end.

Exhibit B

2019 and 2020 Sources and Uses of Funds Forecast and Construction Budget

FLORIDA CITY GAS
2019 and 2020 Sources and Uses of Funds Forecast
(Millions of Dollars)

Selected cash flow items (1)	**2019**	**2020**
Depreciation and amortization **(2)**	$16	$17
Deferred income taxes	(1.3)	(0.3)
Deferred investment tax credit – net	0	0
Total	$14.7	$16.7

Capital requirements	**2019**	**2020**
Construction expenditures **(3)**	$100	$40
Long-term debt maturities	0	0
Total capital requirements	$100	$40

FLORIDA CITY GAS
Construction Budget Forecast for Gross Property Additions
(Millions of Dollars)

	2019	2020
Construction expenditures **(3)**:	$100	$40

(1) Projected amounts do not include any effect of potential changes in retail base rates or other regulated activities which could cause the projections to change.

(2) Projections presented on a GAAP basis and calculates depreciation expense based on current approved accrual rates.

(3) All of the estimated construction expenditures are subject to continuing review and adjustment and actual construction expenditures may vary from these estimates due to factors such as changes in customers, energy sales, demand, business and economic conditions, construction and design requirements, fuel supply and costs, availability and cost of labor, supplies and materials, regulatory treatment, environmental and conservation requirements, pending requests for proposals, and existing and proposed legislation. FCG is keeping its construction program as flexible as possible with the intention of accommodating those factors that may develop or change.