

COVER SHEET

SEC Registration Number

P	W	-	1	0	2						
---	---	---	---	---	---	--	--	--	--	--	--

Company Name

M	A	N	I	L	A		E	L	E	C	T	R	I	C		C	O	M	P	A	N	Y								
---	---	---	---	---	---	--	---	---	---	---	---	---	---	---	--	---	---	---	---	---	---	---	--	--	--	--	--	--	--	--

--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--

Principal Office (No./Street/Barangay/City/Town)Province)

L	O	P	E	Z		B	U	I	L	D	I	N	G	,	O	R	T	I	G	A	S		A	V	E	N	U	E	,
---	---	---	---	---	--	---	---	---	---	---	---	---	---	---	---	---	---	---	---	---	---	--	---	---	---	---	---	---	---

B	R	G	Y		U	G	O	N	G	,	P	A	S	I	G		C	I	T	Y										
---	---	---	---	--	---	---	---	---	---	---	---	---	---	---	---	--	---	---	---	---	--	--	--	--	--	--	--	--	--	--

Form Type

1	7	-	Q
---	---	---	---

Department requiring the report

--	--	--	--

Secondary License Type, If Applicable

--	--	--	--

COMPANY INFORMATION

Company's Email Address

N/A

Company's Telephone Number/s

6312222/16220

Mobile Number

N/A

No. of Stockholders

44,197

Annual Meeting
Month/Day

Last Tuesday of May

Fiscal Year
Month/Day

December 31

CONTACT PERSON INFORMATION

The designated contact person **MUST** be an Officer of the Corporation

Name of Contact Person

Atty. William S. Pamintuan

Email Address

wspamintuan@meralco.com.ph

Telephone Number/s

632-8014

Mobile Number

N/A

Contact Person's Address

Lopez Building, Ortigas Avenue, Brgy. Ugong, Pasig City

Note: In case of death, resignation or cessation of office of the officer designated as contact person, such incident shall be reported to the Commission within thirty (30) calendar days from the occurrence thereof with information and complete contact details of the new contact person designated.

SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q

QUARTERLY REPORT PURSUANT TO SECTION 17 OF THE SECURITIES REGULATION CODE AND SRC RULE 17(2)(b) THEREUNDER

1. For the quarterly period ended: *September 30, 2016*
2. Commission identification number: *PW-102*
3. BIR Tax Identification Code: *000-101-528-000*
4. Exact name of issuer as specified in its charter: *Manila Electric Company*
5. Country of Incorporation: *Philippines*
6. Industry Classification: (SEC use only)
7. Address of issuer's principal office: *Lopez Building, Ortigas Avenue,
Barangay Ugong, Pasig City
Postal Code: 1605*
8. Issuer's Telephone Numbers including area code: *(+632) 631-5567*
9. Former name, former address and former fiscal year, if changed since last report: *N/A*
10. Securities registered pursuant to Sections 8 and 12 of the Code, or Sections 4 and 8 of RSA:

Title of Each Class	Number of Shares of Common Stock Outstanding
Common Stock	1,127,098,705
Debt Securities – bonds	Amount of Debt Outstanding PhP18.5 billion

11. Are any or all of these Securities listed on a Stock Exchange?

Yes ☒ No ☐

If yes, the name of such Stock Exchange and the class/es of Securities:

Philippine Stock Exchange

12. Indicate by check mark whether the registrant:

- (a) has filed all reports required to be filed under Section 17 of the Code and SRC Rule 17 thereunder or Sections 11 of the RSA and RSA Rule 11(a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines, during the preceding twelve (12) months (or for such shorter period that the registrant was required to file such reports):

Yes ☒ No ☐

- (b) has been subject to such filing requirements for the past ninety (90) days:

Yes ☒ No ☐

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

The 3Q 2016 Financial Statements is hereto attached and made integral part of this report.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Please refer to the attached 3Q 2016 Management's Discussion and Analysis of Financial Condition and Results of Operations.

PART II – OTHER INFORMATION

Not applicable.

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the issuer has caused this report to be signed on its behalf by the undersigned duly authorized representatives.

MANILA ELECTRIC COMPANY
Issuer



WILLIAM S. PAMINTUAN
First Vice President,
Assistant Corporate Secretary &
Information Disclosure Officer



BETTY C. SIY-YAP
Senior Vice President &
Chief Finance Officer

Date: November 14, 2016

*Cc: Disclosure Department
Listings and Disclosure Group
Philippine Stock Exchange*

*Issuer Compliance and Disclosure Department
Philippine Dealing & Exchange Corp.*

Management's Discussion and Analysis of Financial Position and Results of Operations

The following discussion and analysis of financial position and results of operations of Manila Electric Company or *MERALCO* and its subsidiaries, collectively referred to as the "*MERALCO Group*" should be read in conjunction with the unaudited interim consolidated financial statements as at September 30, 2016 and December 31, 2015 and for the nine months ended September 30, 2016 and 2015. The consolidated financial statements have been prepared in compliance with the Philippine Financial Reporting Standards ("*PFRS*"). *PFRS* includes statements named *PFRS* and Philippine Accounting Standards, including Interpretations issued by the *PFRS* Council.

The financial information appearing in this report and in the accompanying unaudited interim consolidated financial statements is presented in Philippine pesos, *MERALCO Group*'s functional and presentation currency, as defined under *PFRS*. All values are rounded to the nearest million pesos, except when otherwise indicated. The exchange rate used to translate U.S. dollars to Philippine peso in this report and in the accompanying consolidated financial statements is US\$1.00 to ₱48.50, the closing rate as at September 30, 2016 (the last trading day in September 2016) quoted through the Philippine Dealing System.

Financial Highlights and Key Performance Indicators

(Amounts in millions, except financial ratios, earnings per share, and operational data)	Increase (Decrease)			
	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)	Amount	%
Condensed Statements of Financial Position				
Total assets	₱286,572	₱282,239	₱4,333	2
Current assets	77,743	95,295	(17,552)	(18)
Cash and cash equivalents	36,581	50,840	(14,259)	(28)
Equity attributable to equity holders of the parent	68,907	80,276	(11,369)	(14)
Total debt	40,114	30,308	9,806	32
Current liabilities	98,515	93,215	5,300	6
Financial Ratios				
Debt to equity	0.58	0.38	0.20	53
Current ratio	0.79	1.02	(0.23)	(23)
Operational Data				
Number of customers (in thousands):				
Residential	5,479	5,296	183	4
Commercial	484	474	10	2
Industrial	10	10	-	-
Streetlight	5	4	1	25
(Unaudited)				
	Nine Months Ended September 30		Increase (Decrease)	
	2016	2015	Amount	%
Condensed Statements of Income				
Revenues	₱195,164	₱197,047	(₱1,883)	(1)
Costs and expenses	174,941	175,345	(404)	-
Other income, net of expenses	1,768	1,252	516	41
Income before income tax	21,991	22,954	(963)	(4)
Net income	15,820	16,216	(396)	(2)
Net income attributable to equity holders of the parent	15,676	16,149	(473)	(3)
Earnings per share attributable to equity holders of the parent	13.91	14.33	(0.42)	(3)
Condensed Statements of Cash Flows				
Net cash provided by operating activities	26,094	31,208	(5,114)	(16)
Net cash used in investing activities	(24,315)	(38,330)	14,015	(37)
Net cash used in financing activities	(16,038)	(17,426)	1,388	(8)
Financial Ratios				
Profit margin	8%	8%	-	-
Return on equity	23%	20%	3	15
Asset turnover	0.69	0.70	(0.01)	(1)
Operational Data				
Electricity sales volume (in GWh)	30,103	27,496	2,607	9
System loss (in percentage) ¹ :				
MERALCO	6.40%	6.56%	(0.16%)	(2)
Clark Electric Distribution Corporation (“CEDC”)	3.84%	4.06%	(0.22%)	(5)

¹ Based on 12-month moving average

OVERVIEW

MERALCO is the Philippines' largest electric power distribution company, with franchise area covering 9,337 square kilometers. It provides power to almost 6 million customer accounts in 36 cities and 75 municipalities, which include Metro Manila, all of the provinces of Rizal, Cavite and Bulacan, and parts of the provinces of Pampanga, Batangas, Laguna and Quezon. Turnover of business establishments in the franchise area accounts for about 50% of the country's Gross Domestic Product ("GDP").

Through *CEDC*, a 65%-subsidiary, it holds the power distribution franchise for the Clark Special Economic Zone ("CSEZ") in Clark, Pampanga. The *CEDC* franchise area covers 320 square kilometers and services 1,988 customer accounts as of September 30, 2016. *CEDC* is a registered private distribution utility granted by Clark Development Corporation ("CDC") a franchise to own, operate and maintain a power distribution system and to distribute power exclusively within its franchise area, which includes the Clark Freeport Zone and the sub-zone as determined pursuant to Presidential Decree No. 66 and the Joint Venture Agreement executed between *CDC* and Meralco Industrial Engineering Services Corporation ("*MIESCOR*") on February 19, 1997.

MERALCO and its directly and indirectly-owned subsidiaries are collectively referred to as the *MERALCO Group*. *MERALCO Group*'s business is divided into two segments, namely, power and other services. The power segment, primarily power distribution, consists of operations of *MERALCO* and its subsidiary, *CEDC*.

- Power

The Power segment consists of (a) electricity distribution, (b) power generation and (c) Retail Electricity Supply ("*RES*").

Electricity distribution – This is principally electricity distribution and supply of power to the captive customers on a pass-through basis within the *MERALCO* and the *CEDC* franchise areas in the Luzon Grid. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country.

Power generation – The *MERALCO Group*'s re-entry to the power generation business is through investments in operating companies or participation in the development of such power generation projects. *MERALCO* PowerGen Corporation ("*MGen*"), the power generation arm of the *MERALCO Group*, has a 14%-equity interest in Global Business Power Corporation ("*GBPC*"). *GBPC* currently operates a total of 854 MegaWatt ("*MW*") gross of coal and diesel-fired power plants and has a 150 *MW* gross coal-fired power plant in Panay Island in the Visayas.

MGen also owns an effective 28% equity in PacificLight Power Pte Ltd. ("*PacificLight Power*") in Jurong Island, Singapore. The *PacificLight Power* began commercial operations of a 2 x 400 *MW* liquefied natural gas ("*LNG*") power plant in February 2014.

MGen is currently constructing and developing coal-fired power plants which include (i) 455 *MW* net capacity supercritical coal-fired power plant in Mauban, Quezon through San Buenaventura Power Ltd. ("*SBPL*"), (ii) 2 x 600 *MW* coal-fired power plant in Atimonan, Quezon through Atimonan One Energy Inc. ("*A1E*"), (iii) 2 x 300 *MW* Circulating Fluidized Bed ("*CFB*") coal-fired power plant in the Subic Freeport Zone through Redondo Peninsula Energy, Inc. ("*RP Energy*"), (iv) 2 x 350 *MW* sub-critical pulverized coal-fired plant in Calaca, Batangas through St. Raphael Power Generation Corporation ("*SRPGC*"), and (v) 4 x 132 *MW* net coal-fired power plant in Mariveles, Bataan through Mariveles Power Generation Corporation ("*MPGC*").

In 2016, *MERALCO* has also subscribed to a 50% equity interest in Pure Meridian Hydropower Corporation which will undertake the development of various mini hydroelectric power or run-of river projects.

RES – This covers the sourcing and supply of electricity to qualified contestable customers. *MERALCO* serves as a local *RES* within its franchise area under a separate business unit, *MPower*. Under Retail

Competition and Open Access (“*RCOA*”), qualified contestable customers who opt to switch to contestability and become contestable customers may source their electricity supply from competing retail electricity suppliers (“*RESs*”), including *MPower*. Refer to Page 31 on related developments on *RCOA*.

- Other Services

The other services segment is involved principally in electricity-related services, such as; electro-mechanical engineering, construction, consulting and related manpower services, e-transaction and bills collection, telecoms services, rail-related operations and maintenance services, insurance and re-insurance, e-business development, power distribution management, energy systems management and harnessing renewable energy. These services are provided by *MIESCOR*, Miescor Builders, Inc., and Miescor Logistics, Inc. (collectively known as “*MIESCOR Group*”), Corporate Information Solutions, Inc. (“*CIS*”), CIS Bayad Center, Inc. (“*Bayad Center*”), Customer Frontline Solutions, Inc. (“*CFS*”) and Fieldtech Specialist, Inc. (collectively referred to as “*CIS Group*”), Comstech Integration Alliance, Inc. (*Comstech*), MRail, Inc. (“*MRail*”), Republic Surety and Insurance Corporation (“*RSIC*”), Lighthouse Overseas Insurance Limited (“*LOIL*”), Meralco Financial Services, Inc. (“*Finserve*”), eMERALCO Ventures, Inc. (“*e-MVI*”), Meralco Energy, Inc. (“*MServ*”) and MSpectrum, Inc. (“*MSpectrum*”).

Below is the summary of *MERALCO Group*’s business segments:

BUSINESS SEGMENTS	
Power	Other Services
Electricity distribution <ul style="list-style-type: none"> • <i>MERALCO</i> • <i>CEDC</i> Power generation <ul style="list-style-type: none"> • <i>MGen</i> and its subsidiaries Retail electricity supply <ul style="list-style-type: none"> • <i>MERALCO</i> through <i>MPower</i> business unit 	<ul style="list-style-type: none"> • <i>CIS Group</i> • <i>Comstech</i> • <i>e-MVI</i> and subsidiaries • <i>Finserve</i> • <i>LOIL</i> • <i>MIESCOR Group</i> • <i>MRail</i> • <i>MServ</i> • <i>MSpectrum</i> • <i>RSIC</i>

RESULTS OF OPERATIONS

The table below summarizes the consolidated results of operations and the contribution of each business segment of *MERALCO Group*'s revenues, costs and expenses, and net income for the nine months ended September 30, 2016 and 2015.

For the Nine Months Ended September 30, 2016				
(Unaudited)				
	Power²	Other Services	Inter-segment Transactions	Consolidated
	<i>(Amounts in millions)</i>			
Revenues	₱189,135	₱7,262	(₱1,233)	₱195,164
Costs and expenses	170,300	5,874	(1,233)	174,941
Other income - net	1,718	50	-	1,768
Net income attributable to equity holders of the parent	14,812	1,008	(144)	15,676

For the Nine Months Ended September 30, 2015				
(Unaudited)				
	Power³	Other Services	Inter-segment Transactions	Consolidated
	<i>(Amounts in millions)</i>			
Revenues	₱191,496	₱6,758	(₱1,207)	₱197,047
Costs and expenses	171,123	5,429	(1,207)	175,345
Other income - net	1,245	7	-	1,252
Net income attributable to equity holders of the parent	15,264	952	(67)	16,149

2016 compared with 2015

REVENUES

The following table shows the composition of *MERALCO Group*'s consolidated revenues for the nine months ended September 30, 2016 and 2015 by business segment.

Unaudited						
	September 30, 2016		September 30, 2015		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	<i>(Amounts in millions)</i>					
Power ⁴	₱189,135	97	₱191,496	97	(₱2,361)	(1)
Other services	7,262	4	6,758	3	504	7
Inter-segment transactions	(1,233)	(1)	(1,207)	-	(26)	2
Total	₱195,164	100	₱197,047	100	(₱1,883)	(1)

The total amount of revenues for the nine (9) months ended September 30, 2016 of ₱195,164 million is lower by 1% or ₱1,883 million compared with ₱197,047 million in the same period in 2015. The decrease in total revenues in 2016 is due to the combined effects of (i) voluntary reduction in *MERALCO*'s distribution rate by ₱0.1889 per *kwh* representing the 2RP under recovery charges included in the Third Regulatory Period ("3RP"). The 3RP ended June 30, 2015; and (ii) lower pass-through generation and other charges as a result of

²Principally electricity distribution

³Ibid

⁴Ibid

continuing downward trend of global fuel prices, higher availability of *MERALCO*'s contracted power plants, and lesser forced outages incidents and lower Wholesale Electricity Spot Market ("WESM") prices compared with same period last year. The decrease in revenues was partially offset by higher energy sales volume driven by growth in the customer base, warmer temperature, lower inflation and lower electricity retail rates.

Non-electric revenues, which accounted for 4% of consolidated revenues, increased by 7%. The higher revenues were due to (i) higher demand for strategic loadside outsourcing ("*SLO*") and energy efficiency services of *MServ*; (ii) additional circuits served and higher monthly recurring fees billed for back-up telecommunications services of Radius Telecoms, Inc. ("*Radius*"); and (iii) higher volume of bills payment services, load top-up and remittances served by *Bayad Center* and more tellering seats served by its subsidiary, *CFS*.

Power

Revenues from the power segment consists of generation, transmission, distribution, subsidies and other charges related to electricity distribution within the *MERALCO* and *CEDC* franchise areas. *MERALCO* and *CEDC* distribute electricity to industrial, commercial and residential customers, while *MPower* supplies electricity to qualified contestable customers within *MERALCO*'s franchise area only.

Generation charge, which is the single largest component, represents 58% of electricity revenues in 2016. The average generation charge to captive customers was at ₱3.87 per *kWh* for the nine months ended September 30, 2016 against ₱4.67 per *kWh* in the same period in 2015. Transmission charge represents 14% of the total power revenues or equivalent to ₱0.88 per *kWh* in 2016, 1% lower compared with ₱0.89 per *kWh* in 2015 due to higher volume transmitted through the grid. The *MERALCO*'s 12-month moving average *SL* rate as at September 30, 2016 was at 6.40%, 0.16 percentage point lower compared with the 6.56% rate as at September 30, 2015. *CEDC*'s 12-month moving average *SL* rate as at September 30, 2016 improved by 0.22 percentage points from 4.06% in 2015.

The lower generation charges are attributable to the significantly lower fuel costs and higher availability of contracted plants. In addition, the Power Supply Agreements ("*PSA*") negotiated by *MERALCO*, which no longer have energy "take-on-pay" provisions and consist of purely peso-denominated capacity fee, and largely peso-denominated fixed and variable fees, except for the fuel components, contributed to the lower cost.

Distribution revenues comprise 23% of the total electric revenues. Following the completion of its *3RP* on June 30, 2015, *MERALCO* implemented an interim rate duly approved by the *ERC* of ₱1.3810 per *kWh* beginning July 1, 2015 resulting in a lower average distribution rate of ₱1.43 per *kWh* for the nine months ended September 30, 2016 compared with ₱1.52 per *kWh* for the same period in 2015.

The following table summarizes the customer count as at September 30, 2016 and 2015 and the corresponding electric consumption per customer class for the nine months ended September 30, 2016 and 2015:

Customer Class	No. of Customers		Electricity Sales		% Change	
	(in thousands)		(in GWh)		No. of Customers	Electricity Sales
	2016	2015	2016	2015		
Residential	5,479	5,256	9,412	8,240	4	14
Commercial	484	472	11,856	10,849	3	9
Industrial	10	10	8,735	8,308	-	5
Streetlights	5	4	100	99	25	1
Total	5,978	5,742	30,103	27,496	4	9

Total volume of electricity distributed grew by 9%, significantly stronger compared with the growth forecast of almost 4% prior to the start of 2016. The increase in energy sales was driven by the following: (a) growth in customer base, (b) much warmer temperature in the first four (4) months of 2016 due to the effects of "*El Nino*", (c) positive economic conditions with lower inflation and significantly lower overall electricity prices, (d) new and expansion of existing malls and office spaces for the business process outsourcing industry, and (e) completion of large hotels in Metro Manila.

MERALCO and *CEDC*'s own initiatives to fully serve customers such as (a) early customer prospecting and planning; (b) early energization through faster and better processing, design and facilitation; (c) new customer programs, and (d) a more robust and reliable sub-transmission and distribution system contributed to boosting customer count and energy sales. The positive impact of these conditions is reflected in the consolidated sales volume of 30,103 *GWh* for the nine months ended September 30, 2016 compared with 27,496 *GWh* in 2015.

Since the start of the *RCOA*, *MPower* serves an increasing number of contestable customers with a suite of competitive product offerings for the benefit of its customers which total to 235 customers out of the 395 customers who have switched to contestability. The semiconductor industry continues to occupy the largest share in the contestable space, followed by the food and beverage and the non-metallic industries.

Other Services

Revenues from other services pertain mainly to revenues of subsidiaries, excluding *CEDC*. Revenues generated from other services increased to ₱7,262 million for the nine months ended September 30, 2016 from ₱6,758 million in same period last year. The 7% increase in the revenues from other services was mainly due to the following operating subsidiaries (i) *CIS*, whose bill payment transactions handled have reached 7.1 million or 6% more than in the same period in 2015. In addition, the number of *Bayad Center* sites grew by 42% from 4,198 to 5,968 sites in September 2016. *CIS* has also ventured into spot billing beginning 2015 through a 51%-owned subsidiary, *Fieldtech Specialist, Inc.*; (ii) *Radius*, whose fiber-based data connectivity and internet services grew by 24% in terms of revenues, as a result of significant deals with international clients; (iii) *MServ*, whose revenue significantly grew by 225% due to higher demand for *SLO* and energy efficiency services; and (iv) *MRail*, whose revenue grew by 33% due to the completion of the existing and new projects.

COSTS AND EXPENSES

Consolidated costs and expenses for the nine months ended September 30, 2016 amounted to ₱174,941 million, slightly lower by ₱404 million compared with ₱175,345 million in 2015. The details of *MERALCO Group*'s consolidated costs and expenses for the nine months ended September 30, 2016 and 2015 by business segment are as follow:

	Unaudited					
	September 30, 2016	%	September 30, 2015	%	Increase/Decrease Amount	%
	<i>(Amounts in millions)</i>					
Power ⁵	₱170,300	97	₱171,123	98	(₱823)	(1)
Other services	5,874	3	5,429	3	445	8
Inter-segment transactions	(1,233)	-	(1,207)	(1)	(26)	2
Total	₱174,941	100	₱175,345	100	(₱404)	-

⁵*Ibid.*

Power

The details of costs and expenses are summarized in the following table:

	Unaudited					
	September 30, 2016	%	September 30, 2015	%	Increase/Decrease	
					Amount	%
	<i>(Amounts in millions)</i>					
Purchased power	₱144,423	85	₱147,537	86	(₱3,114)	(2)
Salaries, wages and employee benefits	7,818	5	7,297	4	521	7
Depreciation and amortization	4,972	3	4,816	3	156	3
Contracted services	3,652	2	3,314	2	338	10
Others	9,435	5	8,159	5	1,276	16
Total	₱170,300	100	₱171,123	100	(₱823)	(1)

Costs and expenses of the power segment for the nine months ended September 30, 2016 amounted to ₱170,300 million, 1% lower compared with ₱171,123 million in 2015.

Purchased power accounted for 85% of the total costs and expenses in 2016. *MERALCO* and *CEDC* do not operate their own generation capacity. All of the electricity distributed are contracted through *PSAs* with generators and long-term Power Purchase Agreements (“*PPA*”) with Independent Power Producers (“*IPPs*”). The remaining balance is purchased from the *WESM*.

The lower purchased power cost in 2016 was due to (a) lower generation cost as a result of global decline in fuel and natural gas prices, (b) lower *WESM* prices and, (c) lower forced outage days of contracted plants.

The volume of energy purchased under long-term *PPAs* with *IPPs*, namely, First Gas Corporation (“the *Sta. Rita Power Plant*”), *FGP Corp.* (“the *San Lorenzo Power Plant*”) and Quezon Power (Philippines) Limited Co. (“*QPPL*”), represents 33% of *MERALCO*’s Net System Input. Purchases from power generators under *PSAs*, and other special programs accounted for 59% with the balance of 8% sourced from the *WESM*.

Salaries, wages and employee benefits increased from ₱7,297 million in 2015 to ₱7,818 million in 2016 due to annual adjustments based on terms of the collective bargaining agreement and merit adjustments.

Depreciation and amortization increased by 3% to ₱4,972 million in 2016 from ₱4,816 million in 2015. This is mainly due to completed capital expenditure projects such as development of the Banawe 115 kV-34.5 kV substation and expansion of Bagbaguin 115 kV-34.5 kV substation.

Contracted services increased by 10% from ₱3,314 million in 2015 to ₱3,652 million in 2016. This was mainly due to the increase in cost of Information System/Information Technology services and consultancy for various system enhancements. Customer-related expenses such as collection services and meter reading services also increased due to higher growth in number of customer accounts.

Other expenses consist of business taxes and permits, provision for probable losses and expenses from claims, provision for doubtful accounts, costs of materials, transportation, and other corporate expenses. The increase is due to higher taxes and *ERC* permit fees.

Other Services

The cost and expenses of other services business segment for the nine months ended September 30, 2016 amounted to ₱5,874 million, 8% higher compared with ₱5,429 million in 2015.

	Unaudited					
	September 30, 2016	%	September 30, 2015	%	Increase/Decrease	
					Amount	%
<i>(Amounts in millions)</i>						
Salaries, wages and employee benefits	₱1,820	31	₱2,268	42	(₱448)	(20)
Contracted services	1,356	23	1,085	20	271	25
Depreciation and amortization	234	4	219	4	15	7
Others	2,464	42	1,857	34	607	33
Total	₱5,874	100	₱5,429	100	₱445	8

Salaries, wages and other employee benefits decreased mainly due to the termination of project-hired personnel of *MIESCOR* and *MRAIL*, which coincides with project completion.

Contracted services increased by ₱271 million due to higher spending for engineering services for on-going projects of *MServ*.

Other expenses mainly consist of materials, transportation and travel, rental and utility expenses. The increase by ₱607 million is due to business expansion of operating subsidiaries.

OTHER INCOME

The following table shows the breakdown of other income, net of expenses, for the nine months ended September 30, 2016 and 2015 by business segment:

	Unaudited			
	September 30, 2016	September 30, 2015	Increase/Decrease	
			Amount	%
<i>(Amounts in millions)</i>				
Power ⁶	₱1,718	₱1,245	₱473	38
Other services	50	7	43	614
Total	₱1,768	₱1,252	₱516	41

Power

Breakdown of other income (expenses) of power segment is summarized as follows:

	Unaudited			
	September 30, 2016	September 30, 2015	Increase/Decrease	
			Amount	%
<i>(Amounts in millions)</i>				
Interest and other financial income	₱1,498	₱1,045	₱453	43
Interest and other financial charges	(949)	(883)	(66)	7
Foreign exchange gains	465	773	(308)	(40)
Equity in net losses of associates and joint ventures	(40)	(144)	104	(72)
Others	744	454	290	64
Total	₱1,718	₱1,245	₱473	38

⁶*Ibid.*

Interest income and other financial income increased to ₱1,498 million in 2016 compared with ₱1,045 million in 2015 as a result of higher yields from investments in government securities.

Other income includes the gain of ₱93 million from the partial divestment of *MGen*'s interest in *GBPC*.

NET INCOME ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The following table shows the breakdown of net income attributable to equity holders of the parent for the nine months ended September 30, 2016 and 2015 by business segment:

	Unaudited					
	September 30, 2016	%	September 30, 2015	%	Increase/Decrease	
					Amount	%
<i>(Amounts in millions)</i>						
Power ⁷	₱14,812	94	₱15,264	95	(₱452)	(3)
Other services	1,008	7	952	5	56	6
Inter-segment transactions	(144)	(1)	(67)	-	(77)	115
Total	₱15,676	100	₱16,149	100	(₱473)	(3)

Net income attributable to equity holders of the parent for the nine months ended September 30, 2016 is lower by 3% compared with the same period last year due to lower average distribution rate as a result of the reduction in the interim distribution tariff beginning July 1, 2015 and lower contribution from certain subsidiaries. The decrease was mitigated by the increase in electricity sales volume, and significantly higher yields from temporary investments.

2015 compared with 2014

REVENUES

The following table shows the composition of revenues for the nine months ended September 30, 2015 and 2014 by business segment:

	Unaudited					
	September 30, 2015	%	September 30, 2014	%	Increase/Decrease	
					Amount	%
<i>(Amounts in millions)</i>						
Power ⁸	₱191,496	97	₱199,042	98	(₱7,546)	(4)
Other services	6,758	3	4,713	2	2,045	43
Inter-segment transactions	(1,207)	-	(865)	-	(342)	40
Total	₱197,047	100	₱202,890	100	₱5,843	(3)

Total revenues for the nine months ended September 30, 2015 were 3% lower at ₱197,047 million compared with ₱202,890 million in the same period last year. The slightly lower consolidated revenues in 2015 is due to the combined effects of (i) lower average distribution tariff and (ii) net lower pass-through generation and other charges as a result of significantly lower fuel prices, the competitively negotiated *PSAs* and the loss of contestable supply revenues to other retail electricity suppliers.

Electricity sales amounted to ₱191,496 million for the nine months ended September 30, 2015, 4% lower than 2014. Pass-through charges consisting mainly of generation and transmission costs and system loss (excluding related taxes), which represent 78% of electricity sales, were lower by 4%. For the nine months ended September 30, 2015, the decrease in supply revenues is attributable to (a) record-low generation charge and its

⁷*Ibid.*

⁸*Ibid.*

corresponding effect on other bill components; and (b) qualified contestable customers who opted to source their power supply from other retail electricity suppliers.

Non-electricity revenues, which accounted for 3% of consolidated revenues, increased by 43%. Higher revenues were generated by (i) *Miescor* and its subsidiaries with the completion of construction and maintenance contracts; (ii) *MServ* from increased *SLO* and energy efficiency services; (iii) *Bayad Center* from higher volume of bills payment services, load top-up and remittances; and (iv) *Radius* from additional circuits served and increased monthly recurring fees billed for back-up telecommunications services.

Power

Revenues from the power segment consists of generation, transmission, distribution, subsidies and other charges of the distribution and *RES* businesses. *MERALCO* and *CEDC* distribute electricity to industrial, commercial and residential customers, while *MPower* provides electricity supply to certain qualified contestable customers within *MERALCO*'s franchise area only.

In March 2014, the *PEMC* recalculated the prices of power purchases from *WESM* in December 2013 based on an order of the *ERC*. The resulting adjustment, which amounted to ₱9.3 billion and was a pass-through to the customers, to a large extent, accounted for the significantly lower 2014 revenues compared with 2015.

Electricity Revenues

Generation charge represents the largest component of electricity revenues, at 60% in 2015. Average generation charge to captive customers was at ₱4.72 per *kWh* for the nine months ended September 30, 2015 against ₱5.15 per *kWh* (representing average generation charge before effecting *PEMC* adjustment) in the same period of 2014. Transmission charge represents 13% of the total power revenues or equivalent to ₱0.89 per *kWh* in 2015, slightly lower compared with ₱0.95 per *kWh* in 2014. *MERALCO*'s 12-month moving average system loss rate as at September 30, 2015 was at 6.56%, 0.11 percentage point lower compared with the 6.67% system loss rate as at September 30, 2014, and outperforming the *ERC*-imposed 8.5% cap by 1.94 percentage points as a result of its institutionalized system loss management programs. *CEDC*'s 12-month moving average system loss rate as at September 30, 2015 was at 4.06%.

The lower generation charges are attributable to the significantly lower fuel costs (except for a slight upstick in July 2015), the effect of tightly negotiated *PSA* prices for our captive customers, and well-stacked dispatch capability.

Distribution revenues comprise 22% of the total electric revenues. The average distribution charge per *kWh* decreased by ₱0.11 from ₱1.63 per *kWh* for the nine months ended September 30, 2014 to ₱1.52 per *kWh* in 2015.

The implementation at the start of *MERALCO*'s 4th Regulatory Period ("4RP") of an interim average rate of ₱1.381 per *kWh* beginning July 1, 2015 reduced the average distribution charge for the nine months ended September 30, 2015 to ₱1.52 per *kWh*. As a result, year-to-date distribution revenues declined by about ₱1 billion compared with the same period in 2014 – reflecting the combined effect of lower tariff partially offset by the increase in volume distributed

Since the start of the *RCOA*, *MPower* managed to serve an increasing number of contestable customers with a suite of competitive product offerings, which benefited its customers, totalling to 212 customers out of the 360 who have switched contestability.

The following table summarizes the customer count as at September 30, 2015 and 2014 and the corresponding electric consumption per customer class for the nine months ended September 30, 2015 and 2014:

Customer Class	No. of Customers (in thousands)		Electricity Sales (in GWh)		% Change	
	2015	2014	2015	2014	No. of Customers	Electricity Sales
Residential	5,256	5,057	8,240	7,796	4	6
Commercial	472	461	10,849	10,278	2	6
Industrial	10	10	8,308	8,081	-	3
Streetlights	4	5	99	98	(20)	1
Total	5,742	5,533	27,496	26,253	4	5

Total volume of electricity distributed grew by almost 5%. This was largely attributable to the strong demand from all customer classes on account of new customer connections, particularly residential and commercial, increased economic activities and benign inflation. Billed customers grew to 5.7 million, with almost 168 thousand new customer accounts since the start of the year, and over 209,000 since September 2014. This reflects a steady increase of 4% year-on-year.

The ramp-up in real estate, retail trade and hotel and entertainment industries contributed to the larger portion of the increase in commercial sales. The growth in sales volume in September 2015 alone was 8%, the third highest growth during the first nine months of 2015.

Increased production in the food and beverage, basic metals, and electricity, gas and water industries in anticipation of the December holiday season boosted industrial sales volume.

Other Services

Revenues from other services pertain mostly to non-electric revenues of *MERALCO* and revenues from subsidiaries excluding *CEDC* and *MGen*. Revenues generated from other services increased to ₱6,758 million for the nine months ended September 30, 2015 from ₱4,713 million in the same period of 2014. The 43% increase in revenues from other services was mainly due to higher volume of bills payment services, load top-up and remittances handled by the *CIS* Group, completed projects of the *MIESCOR* Group, increased *SLO* and energy efficiency services by *MServe*, and additional circuits served and increased monthly recurring fees billed for back-up telecommunication services by *Radius*.

COSTS AND EXPENSES

Costs and expenses for the nine months ended September 30, 2015 amounted to ₱175,345 million, slightly lower compared with ₱181,149 million for the same period in 2014. The following table shows the composition of *MERALCO Group's* consolidated costs and expenses for the nine months ended September 30, 2015 and 2014 by business segment:

	September 30, 2015		September 30, 2014		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	<i>(Amounts in millions)</i>					
Power ⁹	₱171,123	98	₱178,261	98	(₱7,138)	(4)
Other services	5,429	3	3,753	2	1,676	45
Inter-segment transactions	(1,207)	(1)	(865)	-	(342)	(40)
Total	₱175,345	100	₱181,149	100	(₱5,804)	(3)

⁹*Ibid.*

Power

The details of costs and expenses are summarized in the following table:

	Unaudited					
	September 30,		September 30,		Increase/Decrease	
	2015	%	2014	%	Amount	%
	<i>(Amounts in millions)</i>					
Purchased power	₱147,537	86	₱154,489	86	(₱6,952)	(5)
Salaries, wages and employee benefits	7,297	4	6,481	4	816	13
Depreciation and amortization	4,816	3	3,925	2	891	23
Contracted services	3,314	2	3,224	2	90	3
Others	8,159	5	10,142	6	(1,983)	(20)
Total	₱171,123	100	₱178,261	100	(₱7,138)	(4)

Costs and expenses of the power segment for the nine months ended September 30, 2015 amounted to ₱171,123 million, 4% lower compared with the ₱178,261 million in 2014.

Purchased power accounted for 86% of the total costs and expenses. *MERALCO* does not operate its own generation capacity. It purchases all of the electricity distributed through contracted *PSAs* with generators, National Power Corporation or ("*NPC*") (up to June 25, 2014), long-term *PPA* with *IPPs* and the *WESM*. Lower purchased power cost in 2014 was primarily due to the billing adjustment by *PEMC* for power purchases in December 2013. Moreover, with the implementation of *RCOA*, contestable customers, who were not serviced by *MPower*, effectively sourced their power supply from other retail electricity suppliers.

The volume of energy purchased under long-term *PPAs* with *IPPs*, namely, First Gas Corporation or the *Sta. Rita Power Plant*, *FGP Corp.* or the *San Lorenzo Power Plant* and *QPPL*, represent 35% of *MERALCO*'s Net Systems Input. Purchases from power generators under *PSAs*, and other special programs accounted for 60%, while the balance of 5% was sourced from the *WESM*.

Salaries, wages and employee benefits increased from ₱6,481 million in 2014 to ₱7,297 million in the same period in 2015 due mainly to annual merit increase given to employees.

Depreciation and amortization increased by 23% to ₱4,816 million in 2015 from ₱3,925 million in 2014. This is mainly due to completed capital expenditure projects.

Contracted services increased by 3% from ₱3,224 million for the nine months ended September 30, 2014 to ₱3,314 million for the same period in 2015. This was mainly due to increased bill deliveries, collection services, disconnection and reconnection expenses with the increase in customer connections.

Other expenses consist of business taxes and permits, provision for probable losses and expenses from claims, provision for doubtful accounts, costs of materials, transportation, and other corporate expenses. The decrease was mainly due to lower provision for probable losses for the nine months ended September 30, 2015 compared with the same period last year.

Other Services

Cost and expenses of other services business segment for the nine months ended September 30, 2015 amounted to ₱5,429 million, 45% higher compared with ₱3,753 million in 2014. The details are as follows:

	Unaudited					
	September 30, 2015	%	September 30, 2014	%	Increase/Decrease Amount	%
	<i>(Amounts in millions)</i>					
Salaries, wages and employee benefits	₱2,268	42	₱1,444	38	₱824	57
Contracted services	1,085	20	789	21	296	38
Depreciation and amortization	219	4	171	5	48	28
Others	1,857	34	1,349	36	508	38
Total	₱5,429	100	₱3,753	100	₱1,676	45

The increase of ₱1,676 million in 2015 was driven by higher contracted services and salaries, wages and other employee benefits, with the increase in number of projects closed as well as business expansion initiatives of MERALCO subsidiaries.

Depreciation and amortization for the nine months ended September 30, 2015 amounted to ₱219 million, 28% higher compared with the same period in 2014 as a result of capital expenditures of the subsidiaries.

Other expenses, which accounted for 34% of the total costs and expenses, increased by 38% from ₱1,349 million in 2014 to ₱1,857 million in 2015 due to business expansion of the subsidiaries.

OTHER INCOME (EXPENSES)

The following table shows the breakdown of other income, net of expenses, for the nine months ended September 30, 2015 and 2014 by business segment:

	Unaudited			
	September 30, 2015	September 30, 2014	Increase/Decrease Amount	%
	<i>(Amounts in millions)</i>			
Power ¹⁰	₱1,245	₱286	₱959	335
Other services	7	(50)	57	(114)
Total	₱1,252	₱236	₱1,016	431

Power

Breakdown of other income (expenses) of power segment is summarized in the following table:

	Unaudited			
	September 30, 2015	September 30, 2014	Increase/Decrease Amount	%
	<i>(Amounts in millions)</i>			
Interest and other financial income	₱1,045	₱494	₱551	112
Interest and other financial charges	(883)	(1,140)	257	(23)
Equity in net losses of associates and joint ventures	(144)	(1)	(143)	143
Foreign exchange gain	773	161	612	380
Others	454	772	(318)	(41)
Total	₱1,245	₱286	₱959	335

¹⁰Ibid.

Other income - net for the nine months ended September 30, 2015 amounted to ₱1,245 million, higher by ₱959 million compared to last year.

Interest and other financial charges in 2014 included the accelerated amortization of debt issue costs as a result of the prepayment of certain long-term debt.

In 2015, *MERALCO* recognized the *ERC*-approved carrying charge on 2nd Generation Rate Adjustment Mechanism as interest and other financial income amounting to ₱197 million. Additional yields on *MERALCO*'s investments in government securities contributed to the increase in interest and other financial income.

NET INCOME ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The following table shows the breakdown of net income attributable to the equity holders of the parent for the nine months ended September 30, 2015 and 2014 by business segment:

	Unaudited					
	September 30, 2015	%	September 30, 2014	%	Increase/Decrease	
					Amount	%
			(Amounts in millions)			
Power ¹¹	₱15,264	95	₱14,100	98	₱1,164	8
Other services	952	5	266	2	686	258
Inter-segment transactions	(67)	-	(58)	-	(9)	(16)
Total	₱16,149	100	₱14,308	100	₱1,841	13

Power

Net income attributable to equity holders of the parent for the nine months ended September 30, 2015 is higher by 13% compared with the same period last year largely attributable to the combined effects of the following: (a) 5% increase in electricity volume distributed, supported by a 4% growth in the customer base; (b) growth in the number and volume of contestable customers of *MPower*; (c) increase in the contribution of operating subsidiaries and associates and; (d) improved yield on cash and cash equivalents and other financial instruments.

¹¹*Ibid.*

LIQUIDITY AND CAPITAL RESOURCES

The following table shows the cash flows for the nine months ended September 30, 2016 and 2015 as well as the capitalization and other selected consolidated financial data as at September 30, 2016 and December 31, 2015:

	For the Nine Months Ended September 30	
	2016	2015
	<i>(Amounts in millions)</i>	
<u>Cash Flows</u>		
Net cash provided by operating activities	₱26,094	₱31,208
Net cash used in investing activities	(24,315)	(38,330)
Net cash used in financing activities	(16,038)	(17,426)
Net decrease in cash and cash equivalents	(14,259)	(24,548)
<u>Capital Expenditures</u>	7,509	7,784
	September 30, 2016	December 31, 2015
	<i>(Amounts in millions)</i>	
<u>Capitalization</u>		
Interest-bearing long-term financial liabilities		
Current portion	₱1,874	₱1,895
Noncurrent portion	27,004	27,370
Notes payable	11,236	1,043
Equity attributable to equity holders of the parent	68,907	80,276
<u>Other Selected Financial Data</u>		
Total assets	286,572	282,239
Utility plant and others	126,826	124,913
Cash and cash equivalents	36,581	50,840

As at September 30, 2016, cash and cash equivalents amounted to ₱36,581 million, ₱14,259 million lower compared with ₱50,840 million as at December 31, 2015. The following are the significant sources and uses of cash and cash equivalents for the nine months ended September 30, 2016: a) cash flows from operating activities of ₱26,094 million; b) cash disbursements for capital expenditures of ₱7,509 million; c) investments in available-for-sale (“AFS”) and held-to-maturity (“HTM”) investments of ₱20,216 million; d) proceeds from partial divestment of interest in an associate amounting to ₱3,151 million; e) availment of notes payable of ₱10,222 million; and f) payment of dividends amounting to ₱28,110 million.

Debt Financing

On December 12, 2013, *MERALCO* issued ₱11.5 Billion and ₱7.0 Billion of 7-year (puttable in 2018) and 12-year (puttable in 2023) corporate bonds, respectively. The 12-year corporate bonds also include a call option, whereby *MERALCO* may redeem (in whole but not in part only) the outstanding bonds beginning on the 7th year from issue date at an early redemption price of 101%. The put and call options are clearly and closely related to the host instruments, thus, were not recognized separately.

The Bonds were listed in the board of the Philippine Dealing and Exchange Corporation.

The net proceeds from the bond issuance were used to refinance certain loans, which included principal, interest, prepayment penalties and other financing costs.

MERALCO’s loan agreements require compliance with debt service coverage of 1.2 times calculated at specific measurement dates. The agreements also contain restrictions with respect to the creation of liens or encumbrances on assets, issuance of guarantees, mergers or consolidations, disposition of a significant portion of its assets and related party transactions.

As at September 30, 2016, *MERALCO* is in compliance with all covenants of its loan agreements.

Equity Financing

Consistent with the provisions of PAS 32, “Financial Instruments: Disclosure and Presentation”, *MERALCO*’s preferred shares are presented as debt with the dividends declared recorded as interest expense. Accumulated and unpaid dividends were accrued and classified as accrued interest payable. Coupon rate on such preferred share is fixed at 10%. The preferred shares were issued related to service applications, which required extension or new distribution facilities beyond a specific distance or standard provisions. Beginning April 8, 2005, such requirement was discontinued. Instead, as provided in the “Implementing Guidelines of the Magna Carta for Residential Electricity Consumers”, customers were required to advance the costs of extension of lines and installation of additional facilities. All of the outstanding redeemable preferred shares have been called for redemption as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. Total unclaimed dividends amounted to ₱250 million as at September 30, 2016 and December 31, 2015. Interest is no longer accrued when the preferred shares have been called for redemption.

As at September 30, 2016 and December 31, 2015, *MERALCO*’s capital stock consists of:

<i>(Amounts in millions, except par value and number of shares)</i>	September 30, 2016	December 31, 2015
Common stock - ₱10 par value		
Authorized - 1,250,000,000 shares	₱12,500	₱12,500
Issued - 1,127,271,117 shares	11,273	11,273
Treasury - 172,412 shares	(11)	(11)

Treasury shares represent subscribed shares and the related rights of employees who have opted to withdraw from the Employee Stock Purchase Plan (“*ESPP*”) in accordance with the provisions of the *ESPP* and which *MERALCO* purchased.

The table below summarizes the cash dividends declared for the nine months ended September 30, 2016 and 2015:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				<i>(In millions)</i>
July 25, 2016	August 24, 2016	September 19, 2016	₱13.48	₱15,193
April 25, 2016	May 25, 2016	June 17, 2016	1.68	1,894
February 26, 2016	March 23, 2016	April 15, 2016	9.92	11,181
July 27, 2015	August 26, 2015	September 18, 2015	6.76	7,619
February 23, 2015	March 23, 2015	April 15, 2015	8.49	9,569

MERALCO pays regular cash dividends equivalent to 50% of consolidated core net income (“*CCNI*”) for the year, which may be supplemented by a special dividend determined on a “look-back” basis. Declaration and payment of special dividend are dependent on the availability of unrestricted retained earnings and availability of free cash. The declaration, record and payment dates shall be consistent with the guidelines and regulations of the Philippine Securities and Exchange Commission (“*SEC*”).

RISK FACTORS

The major factors affecting *MERALCO*’s financial position and results of operations are:

- Regulated rates and cost recoveries
- Sales volume and Philippine economic conditions
- Electricity supply
- Industry restructuring

Regulated Rates and Cost Recoveries

The most significant determinants of *MERALCO*'s and *CEDC*'s rate structure vis-à-vis operating results are "valuation of regulatory asset base ("*RAB*")", "allowable return" and "permitted cost recoveries". Distribution rates billed by *MERALCO* and *CEDC* are approved by the *ERC* and are set to allow a reasonable rate of return on investments. *MERALCO* and *CEDC*'s rate structure also allows pass-through of certain purchased power costs, system loss charge up to an annual cap enforced by the *ERC*, taxes, among others.

Performance-Based Regulations ("PBR")

MERALCO is among the Group A entrants to the *PBR*, together with two other private distribution utilities ("*DUs*").

Rate-setting under *PBR* is governed by the Rules for the Setting of Distribution Wheeling Rates ("*RDWR*"). The *PBR* scheme sets tariffs once every Regulatory Period ("*RP*") based on the regulated asset base of the *DUs*, and the required operating and capital expenditures to meet operational performance and service level requirements responsive to the needs for adequate, reliable and quality power, efficient service, and growth of all customer classes in the franchise area as approved by the *ERC*. *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

Rate filings and settings are done on a *RP* basis. One (1) *RP* consists of four (4) Regulatory Years ("*RYs*"). An *RY* for *MERALCO* begins on July 1 and shall end on June 30 of the following year. The fourth (4th) *RP* for Group A began on July 1, 2015 and shall end on June 30, 2019.

Pass-through of Allowable Costs

The pass-through of allowable costs or costs that do not entail a revision of the rate base and/or rate of return of *MERALCO* is governed by various adjustment mechanisms promulgated by the *ERC*.

In approving *MERALCO*'s unbundled rate in May 2003, the *ERC* prescribed a generation charge that will be adjusted under the *GRAM*. This has since been superseded by the Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities. The monthly automatic adjustment under the Automatic Generation Rate Adjustment ("*AGRA*") mechanism provides timely price signals to consumers. While the *GRAM* only provided for changes in the generation charge, the new mechanism also allows the monthly adjustment of the *SL* charge. Implementation of the guidelines started with the November 2004 billing cycle.

The *ERC*'s approval of *MERALCO*'s 2nd *GRAM* filing was questioned before the Supreme Court ("*SC*") for failure by *MERALCO* and the *ERC* to comply with Section 4 (e) Rule 3 of the Electric Power Industry Reform Act ("*EPIRA*") Implementing Rules and Regulations ("*IRR*") which required publication, notice, and hearing of an application prior to issuance of an Order. On August 16, 2006, the *SC* ruled with finality that strict compliance with the requirements under the *IRR* of the *EPIRA* is jurisdictional and applies to any adjustment to the retail rate, including those for pass-through costs. Beginning September 2006, the Automatic Generation Rate Adjustment ("*AGRA*") was suspended and *MERALCO* could adjust generation and other pass-through charges only after the filing and approval by the *ERC* of an appropriate application.

On June 7, 2007, the Joint Congressional Power Commission approved amendments to Section 4 (e), Rule 3 of the *EPIRA*'s *IRR* that exempt the adjustments of pass-through electric rate components from the jurisdictional and hearing requirements of the *IRR*. The amendments were subsequently promulgated by the Department of Energy ("*DOE*") on June 21, 2007. Thereafter, the *ERC* lifted the suspension of the *AGRA*, which allowed *MERALCO* to resume the monthly updating of generation and system loss charges beginning July 2007.

On August 12, 2009, the *ERC* issued its Resolution No. 16, Series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities". These rules govern the recovery of pass-through costs, including over- or under-recoveries in the following bill components: generation charge, transmission charge, *SL* charge, lifeline rate subsidies, local franchise and business taxes.

The rules will also synchronize the various confirmation processes for the foregoing charges, in which the *ERC* will verify whether the *DU* incurred over- or under-recoveries in the implementation of the said charges. Luzon *DUs*, such as *MERALCO*, were required to file not later than October 30, 2009 their consolidated applications to resolve over- or under-recoveries accumulated from the start of their rate unbundling until December 2008. Subsequent filings will be every three years thereafter.

On October 8, 2009, *MERALCO* filed a petition at the *ERC* seeking an amendment to the *ERC*'s Resolution No. 16, Series of 2009. In particular, *MERALCO* proposed a modification to the formula used in confirming the *SL* charges of *DUs*, shifting the reckoning of the *SL* cap from a monthly to an annual reckoning to more fairly reflect the actual *SL* performance of *DUs*.

On October 18, 2010, the *ERC* ruled on *MERALCO*'s Petition and agreed that there is a need to address the mismatch between the billing periods of the *DUs* and of their suppliers in the confirmation of the system loss. However, the *ERC* did not adopt *MERALCO*'s proposed modification to the formula and instead prescribed a new formula. Resolution No. 21, Series of 2010 adopted the new formula and correspondingly amended the one prescribed in Resolution No. 16, Series of 2009. The Resolution also prescribed the period of filing for the *DUs*' consolidated applications, which for Luzon *DUs* will be by March 31, 2011 and setting March 31, 2011 (covering adjustments implemented from the rate unbundling until the billing month of December 2010) and March 31, 2015 (covering adjustments from January 2011 to December 2014) as the new deadlines for *DUs* in Luzon to file their respective applications. Subsequent filings shall likewise be every three (3) years thereafter.

System Loss

On December 8, 2008, the *ERC* promulgated resolution No.17, Series of 2008 adopting a lower maximum rate of *SL* (technical and non-technical) that a utility can pass on to its customers. The revised *SL* cap is 8.5% for private utilities, effective January 2010 billing. The said cap is one percentage point lower than the *SL* cap of 9.5% provided under RA No. 7832. The actual volume of electricity used by *MERALCO* (administrative loss) is treated as part of the operation and maintenance expense beginning July 2011. The manner by which the utility is rewarded for its efforts in *SL* reduction is addressed by the *ERC* in the Performance Incentive Scheme ("*PIS*") under *PBR*.

On December 8, 2009, *MERALCO* filed a Petition to amend the said Resolution with an urgent prayer for the immediate suspension of the implementation of the new *SL* cap of 8.5% starting January 2010. The proposed amendment is aimed at making the Resolution consistent with the provisions of RA No. 9136 and RA No. 7832, by increasing the *SL* cap to not less than 9%. The hearings on this case have been completed. As at September 30, 2016, this Petition is pending decision by the *ERC*.

MERALCO's 12-month moving average *SL* rate as at September 30, 2016 was at 6.40%, 0.16 percentage points lower compared with the 6.56% system loss rate as at September 30, 2015. *CEDC*'s 12-month moving average *SL* rate of 3.84% as at September 30, 2016 improved by 0.22 percentage points from the 4.06% registered in 2015.

On October 4, 2016, a legislator proposed a bill to lower the current cap of system loss charges from 8.5% to 5% for private distribution utilities ("*DU*") and from 13% to 10% for electric cooperatives and to exclude non-technical system losses and electricity used by the private *DUs* and electrical cooperatives from what may be passed on to consumers as system loss charges. As of September 30, 2016, this proposed bill is still subject for deliberation of the senate.

Sales Volume and Philippine Economic Conditions

The sale of electric energy is driven mainly by prevailing economic conditions and the number of customers being served by *MERALCO*. *MERALCO*'s franchise area accounts for an estimated 55% of the Philippines' GDP, with 37% from Metro Manila.

For the nine months ended September 30, 2016, *MERALCO* and *CEDC*'s combined energy sales volume was 30,103 GWh, 9% higher compared with 27,496 GWh in same period in 2015. The growth in sales volume in 2015 was due to external factors conducive to strong power demand, such as (a) the much warmer

temperature beginning August 2015 with the onset of “*El Nino*”; (b) better power plant capacity availability and (c) positive economic conditions of record-low inflation, much lower electricity prices and healthy *GDP* growth. *MERALCO* managed to grow customers by 3% largely from the commercial and residential sectors. *MERALCO* and *CEDC* have more than 5.9 million customers as at September 30, 2016.

Average temperature for the nine months ended September 30, 2016 is hotter by 0.7°C from 28.0°C in 2015 to 28.7°C in 2016.

Electricity Supply

MERALCO and *CEDC* do not operate its own generation capacity. Both purchase all of the power they distributes from the power supplier generators under *PSAs*, *IPPs* and *WESM*. *WESM* is a venue where suppliers and buyers trade electricity as a commodity. For the nine months ended September 30, 2016, *MERALCO* purchased 44% of its requirements from *IPPs*, 48% from power supply generators under *PSAs*, and 8% from the *WESM*.

IPPs

FGPC and FGP

In compliance with the *DOE*’s program to create a market for the Camago-Malampaya gas field and enable its development, *MERALCO* was committed to contract 1,500 MW of the 2,700 MW output of the Malampaya gas field.

Accordingly, *MERALCO* entered into separate 25-year *PPAs* with *FGPC* (March 14, 1995) and *FGP* (July 22, 1999) for a minimum number of *kWh* of the net electrical output of the Sta. Rita and San Lorenzo power plants, respectively, from the start of their commercial operations. The *PPA* with *FGPC* terminates on August 17, 2025, while that of *FGP* ends on October 1, 2027.

On January 7, 2004, *MERALCO*, *FGP* and *FGPC* signed an Amendment to their respective *PPAs*. The negotiations resulted in certain new conditions including the assumption of *FGP* and *FGPC* of community taxes at current tax rate, and subject to certain conditions increasing the discounts on excess generation, payment of higher penalties for non-performance up to a capped amount, recovery of accumulated deemed delivered energy until 2011 resulting in the non-charging of *MERALCO* of excess generation charge for such energy delivered beyond the contracted amount but within a 90% capacity quota. The amended terms under the respective *PPAs* with *FGP* and *FGPC* were approved by the *ERC* on May 31, 2006.

Under the respective *PPAs* of *FGP* and *FGPC*, the fixed capacity fees and fixed operating and maintenance fees are recognized monthly based on the actual Net Dependable Capacity tested and proven, which is usually conducted on a semi-annual basis.

QPPL

MERALCO entered into a *PPA* with *QPPL* on August 12, 1994, which was subsequently amended on December 1, 1996. Under the terms of the amended *PPA*, *MERALCO* is committed to purchase a specified volume of electric power and energy from *QPPL*, subject to certain terms and conditions. The *PPA* is for a period of 25 years from the start of commercial operations up to July 12, 2025.

In a Letter Agreement signed on February 21, 2008, the amount billable by *QPPL* included a transmission line charge reduction in lieu of a previous rebate program. The Letter Agreement also provides that *MERALCO* advances to *QPPL* US\$2.85 million per annum for 10 years beginning 2008 to assist *QPPL* in consideration of the difference between the transmission line charge specified in the Transmission Line Agreement (“*TLA*”) and the *ERC*-approved transmission line charge in March 2003. *QPPL* shall repay *MERALCO* the same amount at the end of the 10-year period in equal annual payments without adjustment. However, should *MERALCO* dispatches *QPPL* at a plant capacity factor of no less than 86% in any particular year, *MERALCO* shall not be required to pay the US\$2.85 million on that

year. This arrangement did not have any impact on the rates to be charged to consumers and hence, did not require any amendment in the *PPA*, as approved by *ERC*.

Committed Energy Volume to be Purchased

The following are forecasted purchases/payments to *FGPC*, *FGP* and *QPPL* corresponding to the Minimum Energy Quantity (“*MEQ*”), provisions of the contracts. The forecasted fixed payments include capacity charge and fixed operation and maintenance cost escalated using the *US* and Philippine Consumer Price Index.

Year	<i>MEQ</i> (In million kwh)	Equivalent Amount (In Million)
2017	14,758	₱20,416
2018	14,758	20,560
2019	14,758	20,681
2020	14,758	20,804
2021 to 2027	81,631	115,510

Power Supply Generators Under PSAs

The table below summarizes the salient features of the *PSAs*/Contract to Sell of Electricity (“*CSE*”) with power supply generators:

Date	Power Supplier	Plant/Contracted Capacity	Terms of <i>PSA/CSE</i>
November 12, 2010	Bacavalley Energy, Inc. (“ <i>BEI</i> ”)	4 MW renewable energy generation facility powered by landfill gas in San Pedro, Laguna.	Term of two (2) years from the delivery period commencement date. On March 12, 2015, <i>MERALCO</i> and <i>BEI</i> executed a letter of Agreement extending the <i>CSE</i> until March 16, 2016. On March 1, 2016, <i>BEI</i> requested for another extension of the <i>CSE</i> for another two (2) years. In its letter dated April 7, 2016, <i>MERALCO</i> denied <i>BEI</i> ’s request to extend the <i>CSE</i> .
December 12, 2011	South Premiere Power Corporation (“ <i>SPPC</i> ”)	Ilijan Power Plant in Batangas, for the full 1,180 MW net capacities	Under the <i>PSA</i> , <i>MERALCO</i> shall procure power from <i>SPPC</i> until December 25, 2019, with an option to extend the term for another three (3) years.

Date	Power Supplier	Plant/Contracted Capacity	Terms of PSA/CSE
December 21, 2011	Masinloc Power Partners Co., Ltd. (<i>"MPPCL"</i>)	The initial contracted capacity is 330 MW, to increase to 430 MW by December 26, 2015	The PSA is for a period of seven (7) years and can be extended by the parties for another three (3) years. Under the agreement, the terms of the NPC-MERALCO TSC will govern the supply by MPPCL to MERALCO.
December 20, 2011	Sem-Calaca Power Corporation (<i>"Sem-Calaca"</i>)	The initial contracted capacity is 210 MW and will be increased to 420 MW upon the commercial operation of the plant's Unit 1.	Term of seven (7) years, which may be extended by the parties for another three (3) years.
February 29, 2012	Therma Luzon, Inc. (<i>"TLI"</i>)	Pagbilao coal-fired power plant with contracted capacity of 350 MW located in Quezon Province	Term of seven (7) years, which may be extended for three (3) years upon agreement of parties.
May 31, 2012	Pangea Green Energy Philippines, Inc. (<i>"PGEP"</i>)	Biogas power plant methane gas with a total nominal generating capacity of 1 MW.	Term of two (2) years from the delivery period commencement date, unless amended by the parties. On March 2, 2015, MERALCO and PGEP executed a Letter of Agreement extending the CSE until February 29, 2016.
June 26, 2012	San Miguel Energy Corporation (<i>"SMEC"</i>)	Sual coal-fired power plant with initial contracted capacity of 200 MW to increase to 500 MW by December 26, 2012	Term of seven (7) years, which may be extended up to five (5) years upon agreement of parties.
September 27, 2013	Therma Mobile, Inc. (<i>"TMO"</i>)	Output of the barged-mounted, bunker oil-fired diesel engines moored at the Fishport Complex in Novatas, Manila.	Term shall expire on June 25, 2017, which may be extended upon mutual agreement of parties.
April 16, 2014	Montalban Methane Power Corporation (<i>"MPPC"</i>)	8 MW renewable energy generating facility which utilizes landfill gas	"Take and pay" arrangement for two (2) years from ERC approval.
May 15, 2014	Philippine Power and Development Corporation (<i>"PPDC"</i>)	1 MW hydro power plants	Term of five (5) years which may be extended upon mutual agreement of parties.
May 30, 2014	SBPL	Supercritical coal-fired power plant for 455 MW (net) capacity and electrical output	Term of 20 years, extendible for another five (5) years at the option of MERALCO.

Date	Power Supplier	Plant/Contracted Capacity	Terms of PSA/CSE
November 25, 2014	Bacman Geothermal, Inc. (“ <i>BGI</i> ”)	Geothermal power plants for contracted capacity of 50 <i>MW</i>	Term of five (5) years pending approval extendable for another two (2) years upon mutual agreement of the parties.
April 20, 2016	<i>RP Energy</i>	Coal-fired power plant for contracted capacity of 225 <i>MW</i>	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties
April 26, 2016	<i>SRPGC</i>	Coal-fired power plant for contracted capacity of 400 <i>MW</i>	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties
April 26, 2016	<i>A1E</i>	Supercritical coal-fired power plant for contracted capacity of 1,200 <i>MW</i>	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties
April 26, 2016	Central Luzon Premiere Power Corp. (“ <i>CLPPC</i> ”)	Circulating fluidized bed coal-fired power generating facility for contracted capacity of 528 <i>MW</i>	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties
April 26, 2016	<i>MPGC</i>	Circulating fluidized bed coal-fired power generating facility for contracted capacity of 528 <i>MW</i>	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties
April 26, 2016	Panay Energy Development Corp. (“ <i>PEDC</i> ”)	Coal-fired power generating facility for contracted capacity of 70 <i>MW</i>	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties
April 27, 2016	Global Luzon Energy Development Corp. (“ <i>GLEDC</i> ”)	Coal-fired power plant for contracted capacity of 600 <i>MW</i>	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties
September 16, 2016	Powersource First Bulacan Power, Inc. (“ <i>PFBSI</i> ”)	Solar power plant for contracted capacity of 50 <i>MW</i>	Term of 20 years, extendible for another five (5) years
September 16, 2016	Solar Philippine Tanauan Corporation (“ <i>SPTC</i> ”)	Solar power plant for contracted capacity of 50 <i>MW</i>	Term of 20 years, extendible for another five (5) years

BEI

MERALCO signed a *CSE* with *BEI* on November 12, 2010. *BEI* owns and operates a four (4) *MW* renewable energy generation facility powered by landfill gas in San Pedro, Laguna. The *CSE* has a term of two (2) years from the delivery period commencement date.

The terms of the *CSE* with *BEI* are similar to that signed with Montalban Methane Power Corp. (“*MMPC*”). Purchases from *BEI*, an embedded renewable energy generator, are *VAT* zero-rated and exempt from power delivery service charge. *MERALCO* filed an application for the approval of the *CSE* with the *ERC*, for the provisional implementation of the contract on December 15, 2010. In an order dated January 31, 2011, the *ERC* provisionally approved the said application.

After a series of negotiations, *MERALCO* and *BEI* signed the Letter Agreements dated March 1, 2013 and March 5, 2013, extending the *CSE* between said parties for another two (2) years from March 16, 2013, or until March 16, 2015. In its Order dated December 9, 2013, the *ERC* allowed the *CSE* to be extended until March 15, 2015. On March 12, 2015, *MERALCO* and *BEI* executed a Letter of Agreement extending the *CSE* until March 16, 2016. On March 16, 2015, *MERALCO* filed a Manifestation with motion to the *ERC* for approval of the extended term. On March 1, 2016, *BEI* requested for another extension of the *CSE* for another two (2) years. In its letter dated April 7, 2016, *MERALCO* denied *BEI*'s request to extend the *CSE*.

PSAs with Privatized Plants and IPPAs

In separate Decisions dated December 17, 2012, the *ERC* approved with modifications, the *PSAs* of *MERALCO* with *SPPC*, *Sem-Calaca*, *MPPCL*, *TLI* and *SMEC*.

Motions for Reconsideration ("*MR*") were filed regarding the *ERC* decisions on the *PSAs* with *SPPC*, *Sem-Calaca* and *SMEC*. *MERALCO* is awaiting the decision of the *ERC* on the *SPPC* and *Sem-Calaca MRs*. In an Order dated December 16, 2013, the *ERC* denied the Motion for Partial Reconsideration on the *PSA* with *SMEC*. Both *MERALCO* and *SMEC* have filed separation motions with respect to such order and now await *ERC* resolution thereof.

MERALCO entered into separate Supplemental Agreements with *MPPCL* and *TLI* on April 8 and 27, 2016, respectively, for the extension of the term of these *PSAs* for an additional period of three years up to December 25, 2022. Thereafter, relevant Manifestations with Motion for Approval of the Supplemental Agreements were filed with the *ERC*.

Under the *PSAs*, fixed capacity fees and fixed operating maintenance fees are recognized monthly based on their contracted capacities. The annual projection of these payments is shown in the table below:

Year	Contracted Capacity	Fixed Payment Amount
	<i>(In Megawatt)</i>	<i>(In Million)</i>
2017	3,080	₱39,760
2018	2,880	39,481
2019	2,460	34,268
2020	455	8,159
2021	455	8,203
2022-2039	455	157,150

PGEP

On May 31, 2012, *MERALCO* signed a *CSE* with *PGEP*, a biomass power plant located in Payatas, Quezon City using methane gas extracted from the Payatas Landfill as its fuel. Its plant has a total nominal generating capacity of 1,236 kW. The *CSE* has a term of two (2) years from the delivery period commencement date.

On June 15, 2012, *MERALCO* filed an application for approval of the *CSE*. On August 28, 2012, the *ERC* issued an Order provisionally approving the application. On August 29, 2013, the *ERC* extended the provisional authority in its Order dated August 12, 2013. On March 2, 2015, *MERALCO* and *PGEP* executed a Letter of Agreement extending the *CSE* until February 29, 2016. On March 4, 2015, *MERALCO* filed a Manifestation with motion to the *ERC* for approval of the extended term. On September 16, 2015, *MERALCO* received a letter from *PGEP* seeking the termination of the *CSE* effective October 15, 2015. The termination of the *CSE* was thereafter formalized in the Letter Agreement dated October 29, 2015 where the parties agreed to terminate the *CSE* effective October 9, 2015, which was *PGEP*'s Facility Registration Date with the *WESM*. On January 8, 2016, *MERALCO* filed a *Manifestation with Motion* with the *ERC* seeking approval of the extended term of March 4, 2015 until October 9, 2015. As at September 30, 2016, the case is pending decision by the *ERC*.

TMO

On March 4, 2013, *MERALCO* signed an Interconnection Agreement with *TMO* for their 243 MW generating facility at the Navotas Fish Port Complex, Navotas City, which is an interconnection at *MERALCO*'s Grace Park - Malabon 115 kV line. *TMO* is thus an embedded generator. *TMO* shall construct at its own cost, operate and maintain the 115 kV line connecting its generating facility to *MERALCO*'s system. *TMO* and *MERALCO* subsequently signed a Supplement to the Interconnection Agreement dated July 3, 2014 covering the construction of a second line from the connection point at the Grace Park-Malabon 115 kV line to the *TMO* switchyard.

On September 27, 2013, *MERALCO* signed a *PSA* with *TMO* for the output of the barge-mounted, bunker oil-fired diesel engines moored at the Fish port Complex in Navotas, Manila. On September 30, 2013, *MERALCO* filed an application with the *ERC* for the approval of the *PSA*. In an Order dated November 4, 2013, the *ERC* granted the prayer for Provisional Authority. After hearing and submission of the required documents, including the Formal Offer of Evidence ("*FOE*"), the case is now submitted for decision.

On December 17, 2014, *MERALCO* and *TMO* entered into an Amendment to the *PSA* based on the power situation outlook for 2015 and 2016 issued by the *NGCP* that the reserve capacity will be below the Contingency Reserves due to the maintenance shutdowns and forced outages of major power plants in Luzon. The amendment to the *PSA* was filed for approval with the *ERC* on January 21, 2015. In an Order dated April 6, 2015, the *ERC* approved the Amendment in the *PSA* between *MERALCO* and *TMO* with modification. In an Order dated July 1, 2015, the *ERC* clarified that the provisional approval, while not specifically modifying nor stating any condition with respect to the implementation of the outage provisions of the amendment, covers the increase in outage allowance and the minor change in operating procedures.

On June 16, 2015, *MERALCO* received the Omnibus Motion for Partial Reconsideration and Deferment of Implementation of the Order dated April 6, 2015; Urgent Resolution of the Application; and Confidential Treatment filed by *TMO*.

In an Order dated April 5, 2016, the *ERC* ruled that the provisional authority granted to *MERALCO* and *TMO* is extended unless revoked or made permanent.

On June 10, 2016 and July 05, 2016, respectively, *MERALCO* and *TMO* filed a Motion for Clarification of the *ERC* Order dated April 5, 2016. As at September 30, 2016, the case is pending decision by the *ERC*.

PPDC

On May 15, 2014, *MERALCO* and *PPDC* executed a *PSA*. *PPDC* operates three (3) run-of-river hydro power plants, namely: (1) Palakpakin, a 448 kW hydro power plant located at Barangay Prinza, Calauan, Laguna; (2) Calibato, a 75 kW Calibato hydro power plant located at Barangay Sto. Angel, San Pablo City, Laguna; and (3) Balugbog, a 528 kW hydro power plant located at Barangay Palina, Nagcarlan, Laguna. The *PSA* has a term of five (5) years from the delivery period commencement date.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for the approval of its *PSA* with *PPDC*. This *PSA* provides that *MERALCO* shall accept all the energy deliveries of *PPDC* as measured by the latter's billing meter. Hearing on this case have been completed. As at September 30, 2016, the case is submitted for decision by the *ERC*.

SBPL

On May 30, 2014, *MERALCO* signed a long-term *PSA* for a 455 MW net capacity and electrical output with *SBPL*. *SBPL* will be constructing a supercritical coal-fired power plant in Mauban, Quezon.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for approval of its *PSA* with *SBPL*. Following a number of hearings, on May 19, 2015, *MERALCO* received the *ERC* Decision approving with modification the *PSA* between *MERALCO* and *SBPL*.

BGI

On November 25, 2014, *MERALCO* signed a *PSA* with *BGI* for the purchase of up to 50 *MW* capacity and energy from the latter's power plant. The *PSA* shall expire on December 25, 2019, extendible by an additional two (2) years upon mutual agreement of the parties. On March 4, 2015, the Joint Application for approval of said *PSA* was filed with the *ERC*. Hearings have been completed and as at September 30, 2016, the case is submitted for decision.

RP Energy

On April 20, 2016, *MERALCO* signed a 20-year term *PSA* with *RP Energy* for the purchase of 225 *MW* capacity and energy from the 300 *MW* coal-fired power plant that *RP Energy* intends to construct, own, operate, manage and maintain in the Municipality of Subic in the Province of Zambales, within the Subic Bay Freeport Zone. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

A1E

On April 26, 2016, *MERALCO* signed a 20-year term *PSA* with *A1E* for the purchase of 1,200 *MW* of electrical output from the 2 x 600 *MW* supercritical coal-fired power generating facility that *A1E* intends to construct, own, operate, manage and maintain in the Municipality of Atimonan, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

SRPGC

On April 26, 2016, *MERALCO* signed a 20-year term *PSA* with *SRPGC* for the purchase of up to 400 *MW* of electrical output from the 2 x 350 *MW* coal-fired power generating facility that *SRPGC* intends to construct, own, operate, manage and maintain in Calaca, Batangas. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

CLPPC

On April 26, 2016, *MERALCO* signed a 20-year term *PSA* with *CLPPC* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *CLPPC* intends to construct, own and operate in Pagbilao, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

MPGC

On April 26, 2016, *MERALCO* signed a 20-year term *PSA* with *MPGC* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *MPGC* intends to construct, own and operate in Mariveles, Bataan. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

PEDC

On April 26, 2016, *MERALCO* signed a 20-year term *PSA* with *PEDC* for the purchase of up to 70 *MW* of electrical output from the 1 x 150 *MW* coal-fired power generating facility that *PEDC* owns and operates in Brgy. Ingore, La Paz, Iloilo. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

GLEDC

On April 27, 2016, *MERALCO* signed a 20-year term *PSA* with *GLEDC* for the purchase of 600 *MW* of electrical output from the 2 x 335 *MW* coal-fired power generating facility that *GLEDC* intends to construct,

own, operate, manage and maintain in Brgy. Luna, La Union. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

PFBSI

On September 16, 2016, *MERALCO* signed a 20-year term *PSA* with *PFBSI* for the purchase of 50 *MW* of electrical output from its solar plant in San Miguel, Bulacan.

SPTC

On September 16, 2016, *MERALCO* signed a 20-year term *PSA* with *SPTC* for the purchase of 50 *MW* of electrical output from its solar plant in Tanauan, Batangas.

The *PSAs* shall become effective upon approval of the *ERC*.

Interim Power Supply Agreement (“IPSA”)

On April 1, 2014, *MERALCO* signed two separate *IPSAs* with the wholly-owned subsidiaries of *GBPC*, namely: (1) Panay Power Corporation (“*PPC*”) for a 27 *MW* firm output from its 72 *MW* diesel-fired power plant in La Paz, Iloilo City; and (2) Toledo Power Co. (“*TPC*”) for a 28 *MW* firm and 9 *MW* non-firm output from its 40 *MW* diesel-fired power plant in Carmen, Toledo City. Both *IPSAs*, had an initial terms up to June 30, 2014, and were subsequently extended to October 31, 2014, and further up to July 25, 2015. In its various Decisions dated June 2, 2014, July 10, 2014 and March 15, 2015, the *ERC* approved the applications and extensions with modification.

On June 20, 2014, *MERALCO* filed an Urgent Motion for Extension of the term of the *IPSAs*. On July 10, 2014, the *ERC* approved the extension of the *IPSA* with *PPC* and *TPC* until October 31, 2014, subject to the same condition provided in its June 2, 2014 Decision.

Considering that *MERALCO* still needs additional capacity for the period of January 26, 2015 to July 25, 2015, it executed again separate *IPSAs* with *PPC* for 27 *MW* and with *TPC* for 28 *MW* on firm basis and nine (9) *MW* on non-firm basis. The *IPSAs* with *PPC* and *TPC*, both dated November 14, 2014, were filed with the *ERC* for approval on January 8, 2015. Hearings on this case have been completed. On March 16, 2015, the *ERC* approved the *IPSA* with *PPC* and *TPC*.

On April 3, 2014, *MERALCO* signed an *IPSA* with 1590 Energy Corp. for the 140 *MW* output from the Bauang power plant – a 225 *MW* diesel-fired power plant in Bauang, La Union for a term of up to June 30, 2014. This *IPSA* became effective upon the Final Approval of the *ERC* in its Decision dated May 12, 2014.

On June 30, 2014, the *ERC* approved the extension of the *IPSA* with 1590 Energy Corp. until October 31, 2014. A Memorandum of Agreement (“*MOA*”) dated October 30, 2014 was executed with 1590 Energy Corp. extending the *IPSA* until July 25, 2015. Said *MOA* was filed with the *ERC* for approval on October 30, 2014. The *ERC* issued an Order dated December 15, 2014 approving the extension of the *IPSA* under the same terms as approved by the *ERC* in its Decision dated May 12, 2014.

On January 19, 2016, after the conduct of a price challenge in compliance *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed an *IPSA* with 1590 Energy Corporation. The *IPSA* is for the 170 *MW* (firm from February 26 to July 25, 2016; non-firm from July 26, 2016 to February 25, 2017) output from the Bauang power plant – a 225-*MW* diesel-fired power plant in Bauang, La Union. The *IPSA*, with a term until February 25, 2017, was filed for approval by the *ERC* on February 10, 2016 and shall become effective upon the approval by the *ERC*. In an Order dated April 5, 2016, the *ERC* provisionally approved the *IPSA*.

On January 21, 2016, after the conduct of a price challenge in compliance *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed (1) two separate *IPSAs* with *TPC* for the 28 *MW* (firm) output from its 40 *MW* diesel-fired power plant in Carmen, Toledo City; and (2) *PPC* for the 45 *MW* (firm) output from its 72 *MW*

diesel-fired power plant in La Paz, Iloilo City. Both *IPSAs* were filed for approval of the *ERC* on February 10, 2016 and shall become effective upon the approval of the *ERC*.

Interconnection Agreement with Alternergy Wind One Philippine Holdings Corporation (“Alternergy”)

On March 1, 2012, *MERALCO* signed an Interconnection Agreement with Alternergy for the latter’s 90 MW Wind Farm Renewable Energy plant in Pililla, Rizal, which shall interconnect at *MERALCO*’s Malaya-Teresa 115 kV line. Alternergy is an embedded generator. Alternergy shall construct at its own cost, operate and maintain the 115 kV line connecting its generating facility to *MERALCO*’s system. On September 3, 2014, *MERALCO* signed a supplement to the Interconnection Agreement with Alternergy to temporarily connect the latter’s facilities to *MERALCO*’s Malaya-Caliraya 115 kV line until December 31, 2015 and thereafter, proceed to the ultimate connection at the Malaya-Teresa 115 kV line. In its letter to *MERALCO* dated October 30, 2015, Alternergy expressed its intention to extend its use of the 115 kV line until the completion of the construction of the Phase 2 Line or until December 31, 2016. In the Letter Agreement dated December 2, 2015, *MERALCO* and Alternergy formalized their agreement as regards the extended use of said line.

Interconnection Agreement with Maibarara Geothermal, Inc. (“MGI”)

On December 6, 2012, *MERALCO* signed an Interconnection Agreement with *MGI* for the latter’s 20 MW (with max capacity of 40 MW) Geothermal Facility plant in Sto. Tomas, Batangas, which shall interconnect at *MERALCO*’s *FPIP* - Los Baños 115 kV line. *MGI* is an embedded generator. *MGI* shall construct at its own cost, operate and maintain the 115 kV line connecting its generating facility to *MERALCO*’s system. In its Decision dated September 30, 2013, the *ERC* approved *MGI*’s application for authority to develop, own and operate dedicated point-to-point facilities to connect to the distribution system of *MERALCO*.

Interconnection Agreement with ATN Philippines Solar Energy Group, Inc. (“ATN”)

On December 8, 2014, *MERALCO* signed an Interconnection Agreement with *ATN* for the latter’s 25.2 MW solar generating facility in Rodriguez, Rizal, to be connected to *MERALCO*’s Novaliches 44 YJ, Diliman 435 VU and Parang 412 YL circuits. *ATN* is an embedded generator. *ATN* shall construct at its own cost, operate dedicated point-to-point lines and facilities that will connect its generating facility to *MERALCO*’s system.

Industry Restructuring

Under the *EPIRA*, the Philippine power industry continues to undergo fundamental restructuring.

These restructuring measures include:

- The deregulation of, and introduction of competition in, power generation and supply activities and pricing;
- The privatization of the *NPC*’s power generating assets and *IPP* contracts;
- The unbundling of the relative costs of the various segments of the power supply chain and reflecting these in the bills to customers;
- Freedom of consumers to choose electricity suppliers;
- Open and non-discriminatory access in the networks of *DUs*, subject to the fulfillment of certain conditions precedent;
- The implementation of the *WESM*; and
- Removal of inter-grid, intra-grid, and inter-class cross-subsidies.

ELECTRIC POWER INDUSTRY DEVELOPMENTS AND UPDATES

1. Implementation of *PBR*

As *DUs*, *MERALCO* and *CEDC* are subject to the rate-making regulations and regulatory policies of the *ERC*. Billings of *MERALCO* and *CEDC* to customers are itemized or “unbundled” into a number of bill components that reflect the various activities and costs incurred in providing electric service. The adjustment to each bill component is governed by mechanisms promulgated and enforced by the *ERC*, mainly: [i] the “Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities,” which govern the recovery of pass-through costs, including over- or under-recoveries of the bill components, namely, (a) generation charge, (b) transmission charge, (c) *SL* charge, (d) lifeline and inter-class rate subsidies, (e) business taxes such as local franchise tax (“*LFT*”); and [ii] the “Rules for the Setting of Distribution Wheeling Rates”, which govern the determination of the *MERALCO*’s distribution, supply, and metering charges.

The rate-setting mechanism of *CEDC* is likewise in accordance with *ERC* regulations. The following is a discussion of matters related to rate-setting of *MERALCO* and *CEDC*:

PBR

a. MERALCO

MERALCO is among the Group A entrants to the *PBR*, together with two other private *DUs*.

Rate-setting under *PBR* is governed by the *RDWR*. The *PBR* scheme sets tariffs once every *RP* based on the regulated asset base of the *DUs*, and the required operating and capital expenditures to meet operational performance and service level requirements responsive to the needs for adequate, reliable and quality power, efficient service, and growth of all customer classes in the franchise area as approved by the *ERC*. *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

Rate filings and settings are done on a *RP* basis. One (1) *RP* consists of four (4) *RYs*. An *RY* for *MERALCO* begins on July 1 and shall end on June 30 of the following year. The 4th *RP* for Group A began on July 1, 2015 and shall end on June 30, 2019.

Maximum Average Price (“MAP”) for RY 2008 and RY 2009

On May 28, 2009, certain electricity consumer groups filed a Petition with the Court of Appeals (“*CA*”), questioning the decision and Order of the *ERC* on *MERALCO*’s rate translation application for *RY* 2008 and *RY* 2009. On January 29, 2010, the *CA* promulgated a decision denying the Petition. Consequently, the consumer groups brought the case to the *SC*. Comments, responses and respective manifestations have been filed by both parties. In a decision dated October 10, 2016, the *SC* denied the Petition filed by the consumer group.

MAP for RY 2012

On June 21, 2011, *MERALCO* filed an application for the approval of its *MAP* for *RY* 2012 and translation into rate tariffs by customer category. In an order dated October 3, 2011, the *ERC* provisionally approved the *MAP* for *RY* 2012 of ₱1.6012 per *kWh* and the rate translation per customer class was implemented starting October 2011. Hearings for the final approval of the application have been completed and all parties have submitted their respective memoranda. As at September 30, 2016, the application is pending final approval by the *ERC*.

MAP for RY 2013

On March 30, 2012, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2013 and the translation thereof into rate tariffs by customer category. On June 11, 2012, the *ERC* provisionally approved the *MAP* for *RY* 2013 of ₱1.6303 per *kWh*, which was reflected in the customer bills starting July 2012. Hearings on this case have been completed. As at September 30, 2016, the application is pending final approval by the *ERC*.

MAP for RY 2014

On April 1, 2013, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2014 of ₱1.6510 per *kWh* and the translation thereof into rate tariffs by customer category. On June 10, 2013, the *ERC* provisionally approved the *MAP* for *RY* 2014 of ₱1.6474 per *kWh* and the rate translation per customer class. As at September 30, 2016 the application is pending final approval by the *ERC*.

MAP for RY 2015

On March 31, 2014, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the translation thereof into rate tariffs by customer category. On May 5, 2014, the *ERC* provisionally approved *MERALCO*'s *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the rate translation per customer class. As at September 30, 2016, the application is pending final approval by the *ERC*.

4th RP Reset Application

The last year of *MERALCO*'s 3rd *RP* ended on June 30, 2015. The 4th *RP* for Group "A" entrants commenced on July 1, 2015 and ends on June 30, 2019. To initiate the reset process, the *ERC* posted in its website on April 12, 2016, the following draft issuance for comments, to wit:

- a. Draft "Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Operating under Performance Based Regulation, First Entry Group: Fourth Regulatory Period;
- b. Draft "Position Paper: Regulatory Reset for the July 1, 2015 to June 30, 2019 Fourth Regulatory Period for the First Entry Group of Privately Owned Distribution Utilities subject to Performance Based Regulation"; and
- c. Draft "Commission Resolution on the Issues on the Implementation of *PBR* for Privately Owned *DUs* under *RDWR*."

MERALCO has submitted its comments to the draft issuances and is awaiting the final rules of the *ERC*.

Interim Average Rate for RY 2016

On June 11, 2015, *MERALCO* filed its application for the approval of its proposed Interim Average Rate of ₱1.3939 per *kWh* and translation thereof into rate tariffs by customer category. On July 10, 2015, the *ERC* provisionally approved an Interim Average Rate of ₱1.3810 per *kWh* and the rate translation per customer class, which was reflected in the customer bills starting July 2015. On January 7, 2016, *MERALCO* presented its first witness. On August 12, 2016, *MERALCO* presented its evidence. The next hearing for the continuation of *MERALCO*'s presentation of its evidence is scheduled on November 9, 2016.

Capital Expenditures ("CAPEX") for RY 2016

Absent the release by the *ERC* of the final rules to govern the filing of its 4th *RP* Reset Application, and in anticipation of the network system requirements and possible effect of severe weather conditions after June 30, 2015, *MERALCO* filed on February 9, 2015 an application for approval of authority to implement its *CAPEX* program for *RY* 2016 (July 1, 2015 to June 30, 2016) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as the Public Service Act. On June 15, 2016, *MERALCO* received a copy of the *ERC* Decision dated April 12, 2016 which partially approved *MERALCO*'s *CAPEX* program for *RY* 2016 amounting to ₱15.5 billion, subject to certain conditions. An intervenor has filed a *MR* of the Decision which is pending before the *ERC*.

CAPEX for RY 2017

On March 8, 2016, *MERALCO* filed an application for approval of authority to implement its *CAPEX* program, for *RY* 2017 (July 1, 2016 to June 30 2017) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as Public Service Acts. Hearings have been completed and *MERALCO* is

awaiting the final decision of the *ERC*. On July 26 2016, *MERALCO* received the Order dated May 5, 2016, granting *MERALCO* provisional authority to implement the nine (9) major projects and 37 residual projects, subject to certain conditions. *MERALCO* is awaiting the final decision of the *ERC*.

CEDC

CEDC is among the four (4) Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. The first *RP* of *CEDC* began on October 1, 2011 and ended on September 30, 2015. *CEDC* is to undergo the reset process and is awaiting the release by the *ERC* of the final rules to govern the filing of its 2nd *RP* reset application.

2. Application for Recoveries

Applications for the Confirmation of Over/Under-recoveries of Pass-through Charges

On July 13, 2009, the *ERC* issued Resolution No. 16, Series of 2009, adopting the “Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities.” These rules govern the recovery of pass-through costs, including under- or over-recoveries with respect to the following bill components: generation charge, transmission charge, *SL* charge, lifeline and inter-class rate subsidies, *LFT* and business tax. On October 18, 2010, the *ERC* promulgated *ERC* Resolution No. 21, Series of 2010, amending the system loss true-up formula contained in Resolution No. 16, Series of 2009, and setting March 31, 2011 (covering adjustments implemented until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) as the new deadlines for *DUs* in Luzon to file their respective applications. Subsequent filings shall be made every three (3) years thereafter. On December 15, 2010, the *ERC* promulgated Resolution No. 23, Series of 2010 to govern the recovery of Senior Citizen Discounts and specified that post-verification shall coincide with the timeframes in Resolution No. 16, Series of 2009, as amended by Resolution No. 21, Series of 2010.

On March 31, 2011, *MERALCO* filed an application with the *ERC* to confirm its under- or over-recoveries accumulated from June 2003 to December 2010 in compliance with Resolution No. 16, Series of 2009, as subsequently amended by Resolution No. 21, Series of 2010. On December 8, 2011, *MERALCO* filed a Manifestation with Omnibus Motion praying, among other things, for the admission of the Supplemental Application, which was admitted by the *ERC* in an Order dated December 12, 2011. The filing includes net generation charge under-recoveries of ₱1,000 million, net transmission charge over-recoveries of ₱111 million, net lifeline subsidy under-recoveries of ₱9 million and net *SL* over-recoveries of ₱425 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*’s application for the confirmation of its over/under-recoveries in its pass-through costs for the period June 2003 to December 2010. The Decision directed *MERALCO* to collect net under recoveries of ₱909 million, without carrying charges, starting the next billing cycle until such time that the full amount has been collected. As at September 30, 2016, a total of ₱141 million has been billed to the customers.

On July 6, 2012, *MERALCO* filed an application with the *ERC* to confirm its under- or over-recoveries for the calendar year 2011. The filing includes net generation charge under-recoveries of ₱1,826 million, net transmission charge under-recoveries of ₱253 million, net lifeline subsidy under-recoveries of ₱39 million and *SL* over-recoveries of ₱445 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*’s application for the confirmation of its over/under-recoveries in its pass-through costs for the period January to December 2011. The Decision directed *MERALCO* to collect net under-recoveries of ₱1,535 million, without any carrying charges, starting the next billing cycle until such time that the amount have been collected. As at September 30, 2016, a total of ₱1,015 million has been billed to the customers.

On March 31, 2014, *MERALCO* filed an application with the *ERC* to confirm its under- or over-recoveries of net generation charge under-recoveries of ₱559 million, transmission charge over-recoveries of ₱639 million, net lifeline subsidy over-recoveries of ₱75 million, *SL* over-recoveries of ₱502 million from January 2012 to October 2013, and net Senior Citizen Discount over-recoveries of ₱0.4 million from February 2011 to October 2013, excluding proposed carrying charges. Under- or over-recoveries from November and December 2013 supply months were excluded in the meantime, in view of the pending *SC* and *ERC* cases

involving pass-through costs for these months. Hearings are ongoing and the next scheduled hearing is on November 21, 2016.

On January 29, 2016, *MERALCO* filed its application to confirm its under-recoveries of generation charge of ₱250.7 million, excluding carrying charge, covering the period March 2007 to December 2011. As at September, 2016, *MERALCO* is still waiting for the approval of *ERC*.

Application for the Recovery of Differential Generation Costs

On February 17, 2014, *MERALCO* filed for the recovery of the unbilled generation cost for December 2013 supply month amounting to ₱11,075 million. An amended application was filed on March 25, 2014 to adjust the unbilled generation cost for recovery to ₱1,310 million following the receipt of *WESM* billing adjustments based on regulated Luzon *WESM* prices. The first hearing was conducted on May 26, 2014. The *ERC* suspended the proceedings, pending resolution of issues in related cases involving generation costs for the November and December 2013 supply months and the regulated *WESM* prices for the said period.

2nd Generation Rate Adjustment Mechanism ("2nd GRAM")

The *ERC*'s approval of *MERALCO*'s 2nd GRAM was questioned before the *SC*, for failure by *MERALCO* and the *ERC* to comply with Section 4 (e) Rule 3 of *EPIRA*'s *IRR*, which required publication, notice, and hearing of an application prior to issuance of an Order. On August 16, 2006, the *SC* ruled with finality that strict compliance with the requirements under the *IRR* of the *EPIRA* is jurisdictional and applies to any adjustment to the retail rate, including those for pass-through costs. Beginning September 2006, the *AGRA* was suspended and *MERALCO* could adjust generation and other pass-through charges only after the filing and approval by the *ERC* of an appropriate application.

On November 12, 2010, *MERALCO* filed an application with the *ERC* for the recovery of the total generation costs refunded under the 2nd GRAM, plus any additional amount that it will still refund to its customers pursuant to the *SC* Resolution dated August 16, 2006, and the corresponding carrying charges. In a Decision dated June 1, 2015, the *ERC* approved the application with modification and directed *MERALCO* to recover its unrecovered generation costs incurred for the period from November 2003 to January 2004 amounting to ₱746 million equivalent to ₱0.0207 per kWh and carrying costs amounting to ₱198 million, equivalent to ₱0.0013 per kWh. As at September 30, 2016, a total of ₱944 million has been billed to the customers.

Deferred Purchased Price Adjustment ("Deferred PPA")

On October 12, 2009, the *ERC* released its findings on *MERALCO*'s implementation of the collection of the approved pass-through cost under-recoveries for the period June 2003 to January 2007. The *ERC* directed *MERALCO* to refund to its customers ₱268 million of *Deferred PPA* transmission line costs related to *QPPL* and deferred accounting adjustments incurred along with ₱184 million in carrying charges, or an equivalent of ₱0.0169 per kWh. *MERALCO* implemented the refund beginning November 2009 until September 2010. However, the *ERC* has yet to rule on *MERALCO*'s *Deferred PPA* under-recoveries of ₱106 million, which is not transmission line fee. On November 4, 2009, *MERALCO* filed an *MR* with the *ERC*. As at September 30, 2016, the *MR* is still pending resolution by the *ERC*.

Application for Recovery of LFT

On March 25, 2011, *MERALCO* filed with the *ERC* an application for recovery of *LFT* paid but not yet billed to customers for the period beginning the first quarter of 1993 up to the second quarter of 2004 for five (5) provinces, namely: Bulacan, Batangas, Cavite, Laguna and Rizal; and 14 cities, namely: San Jose Del Monte, Batangas, San Pablo, Tagaytay, Lucena, Mandaluyong, Marikina, Quezon, Caloocan, Pasay, Las Piñas, Manila, Pasig and Calamba. The *LFT* is recognized as a valid and reasonable *DU* pass through cost in the *ERC*'s unbundling decision.

In a Decision dated February 27, 2012, the *ERC* approved with modifications *MERALCO*'s application. The *ERC* approved the recovery of *LFT* amounting to ₱1,571 million plus carrying charges of ₱730 million. As

directed by the *ERC*, the recovery was reflected as a separate item in the *MERALCO* billing statement to its customers beginning April 2012. As September 30, 2016, a total of ₱2,200 million *LFT* and carrying charges have been billed to affected customers. The amount recoverable within 12 months is included in the “Trade and other receivables” account while the long-term portion is included in the “Other noncurrent assets” account.

On June 13, 2014, *MERALCO* filed an application with the *ERC* for authority to collect *LFT* in the City of Trece Martires, with prayer for provisional authority, beginning the date of effectivity of “*The 2012 Revenue Code of Trece Martires City*” on July 1, 2012. In its Decision dated April 28, 2014, the *ERC* approved said application, with modification, and authorized *MERALCO* to recover the new *LFT* at the rate of 82.5% of 1%, prospectively, or effective its next billing cycle. With respect to the difference between the previous and the new *LFT* rates from the time said revenue code took effect, the *ERC* stated in its Decision that the same shall be considered in a separate application to be filed by *MERALCO* in accordance with the tax recovery adjustment charges (“*TRAC*”) Formula under *ERC* Resolution No. 16 Series of 2009. On July 24, 2014, *MERALCO* filed a motion seeking the partial reconsideration of the Decision insofar as the filing of a separate application for *LFT* for the prior years is concerned. On October 29, 2014, the *ERC* released its Order dated September 24, 2014 denying *MERALCO*’s motion. In said Order, the *ERC* maintained its position that it shall consider in a separate application the difference between the previous and the new *LFT* rates from the time said revenue code took effect. On February 23, 2015, *MERALCO* has paid the full amount of said *LFT* to the local treasurer of City of Martires.

On July 3, 2015, *MERALCO* filed the application for authority to recover the difference between the previous and new *LFT* rate for the calendar year 2012 to 2014 in the City of Trece Martires, under the *TRAC* Formula with prayer for provisional authority, where it prayed for authority to collect from the customers in said City the *LFT* amounting to ₱2 million for 2012 to 2014 which it has previously paid to City of Trece Martires and the corresponding carrying cost. Hearings have concluded and on September 29, 2015, *MERALCO* filed its *FOE* with Manifestation and Compliance and thereby submitted the case for resolution. In a decision dated May 10, 2016, the *ERC* approved the application with modification.

3. Benefit Sharing Scheme to Lower System Loss

On January 26, 2011, *MERALCO*, together with Private Electric Power Operators Association, Inc. (“*PEPOA*”) and Philippine Rural Electric Cooperative Association (“*PHILRECA*”), filed a joint petition to the *ERC* to initiate rule-making to adopt the *Proposed Guidelines for the Implementation of an Incentive Scheme to Lower the System Losses of Private Distribution Utilities and Electric Cooperatives to Level Below the System Loss Cap, for the Benefit of End-Users*. This was aimed to encourage the *DUs* to reduce *SL* levels below the cap set by the *ERC* and benefit the end-users through lower system loss charges. Public hearings were conducted and completed on June 15, 2011.

On December 11, 2012, the *ERC* posted on its website the second draft of the *Rules to Govern the Implementation of a Benefit Sharing to Lower the System Losses of Electric Distribution Utilities*. As at September 30, 2016, the Joint Petition is pending further action or decision by the *ERC*.

4. *RCOA*

The transition period for *RCOA* commenced on December 26, 2012 in accordance with the joint statement released by the *ERC* and the *DOE* on September 27, 2012 and the Transitory Rules for the Implementation of *RCOA* (*ERC* Resolution No. 16, Series of 2012). The commercial operation of *RCOA* started on June 26, 2013.

On March 31, 2014, the *ERC* issued a resolution on the Withdrawal of the Rules on Customer Switching and the Retention of the Code of Conduct for Competitive Retail Market Participants. On the same date, *ERC* also issued a resolution adopting the Rules on the Establishment of Customer Information by the Central Registration Body (“*CRB*”) and Reportorial Requirements. The resolution mandates all *DUs* to submit to the *ERC* and *CRB* information on end-users with (1) monthly average peak demand of at least 1 *MW* for the preceding 12 months; and (2) monthly average peak demand of 750 *kW* but not greater than 999 *kW*. The *ERC* will use these information in issuing the certificates of contestability.

On October 22, 2014, the *ERC* issued a resolution suspending the issuance of *RES* licenses. Under the resolution, the *ERC* resolves to hold in abeyance the evaluation of *RES* license applications and suspend the issuance of such licenses until such time that the amendments to the Rules for the issuance of *RES* licenses have been made by the *ERC*.

On July 1, 2015, the *DOE* published Department Circular No. DC2015-06-0010 “Providing Policies to Facilitate the Full Implementation of *RCOA* in the Philippine Electric Power Industry.” The salient points of the circular are as follows:

- a. All contestable customers with average demand of 1 *MW* and above are mandated to secure their respective Retail Supply Contracts (“*RSC*”) no later than June 25, 2016.
- b. All contestable customers with an average demand ranging from 750 *kW* to 999 *kW* for the proceeding 12-month period are mandated to secure their *RSCs* no later than June 25, 2016.
- c. Aggregators with aggregated demand not lower by 750 *kW* shall be allowed to compete with *RES*, generation companies and prospective generation companies effective June 26, 2016.
- d. Any electric end user with an average demand ranging from 501 *kW* to below 750 *kW* for the preceding 12 months may be allowed to choose their respective *RES* effective June 26, 2018 subject to the determination of the *ERC* on the basis of its evaluation on the performance of the retail market.
- e. Any *DU* which may incur displaced contract capacity/energy (“*DCC/E*”) shall inform the *ERC* of its impending *DCC/E*.

On March 8, 2016, the *ERC* promulgated Resolution No. 05 Series of 2016 entitled “*A Resolution Adopting the 2016 Rules Governing the Issuance of Licenses to Retail Electricity Suppliers (RES) and Prescribing the Requirements and Conditions Therefor*”. The Resolution removed the term Local *RES* as one of the entities that may engage in the business of supplying electricity to the Contestable Market without need of obtaining a license therefor from the *ERC*. Moreover, while an affiliate of a *DU* is allowed to become a *RES*, the allowance is “subject to restrictions imposed by the *ERC* on market share limits and the conduct of business activities”.

On May 27, 2016, *MERALCO* filed a Petition before Pasig *RTC*, praying that: (a) a *TRO* and subsequently a Writ of Preliminary Injunction (“*WPI*”) enjoining the *DOE* and *ERC* from implementing the Assailed Rules be issued; and the Assailed Rules be declared null and void for being contrary to the *EPIRA* and its *IRR*. In an Order dated June 13, 2016, *RTC-Pasig* Branch 157 granted a 20-day *TRO*, which became effective on June 16, 2016. In an Order dated July 13, 2016, *RTC-Pasig* granted a *WPI*, which became effective on July 14, 2016, and shall be effective for the duration of the pendency of the Petition. It enjoined *DOE* and *ERC* from implementing the Assailed Rules insofar as:

- it prohibits *DUs* from engaging in the Supply Business and correspondingly requires Local *RESs* to wind down their operations within the required three (3) year period;
- it imposes market caps/limitations;
- it imposes restrictions and requirements on *DUs*, such as but not limited to the two (2) year term limit for *RSCs* and the reportorial requirements to be submitted by *DUs* in respect of end users with at least a monthly average peak demand of 500 *KW*; and
- it requires Mandatory Contestability and imposes penalties for Contestable Customers that fail to enter into *RSCs* within the set 60 day period.

Hearings are ongoing at the *RTC-Pasig* case on the main case.

Meanwhile, *ERC* filed a Petition for Certiorari and Prohibition with prayer for *TRO* and/or *WPI* before the *SC* (“*SC* Petition”), which asserted that *RTC-Pasig* has no jurisdiction to take cognizance of *MERALCO*’s Petition, citing Sec. 78 of the *EPIRA*.

On October 10, 2016, the SC, in relation to the Petition filed by *DOE*, issued a *TRO* that restrained, *MERALCO*, the *RTC* Pasig, their representatives, agents or other persons acting on their behalf from continuing the proceedings before the *RTC* Pasig, and from enforcing all orders, resolutions and decisions rendered in Special Civil Action No. 4149 until the petition before the SC is finally resolved.

On November 2, 2016, *MERALCO* received a Resolution from the SC partially granting the *ERC* Petition. The SC ruled that the *RTC*-Pasig's exercise of jurisdiction over the petition for declaratory relief is proper. The SC also ruled that the *RTC*-Pasig does not have jurisdiction to issue any order or resolution enjoining the *DOE/ERC* issuances relating to *EPIRA*. The SC ordered that the Injunction issued by the *RTC*-Pasig be vacated. Nonetheless, the held that *RTC*-Pasig can proceed with the principal case of declaratory relief.

5. Interim Pre-Emptive Mitigating Measure in the *WESM*

On May 5, 2014, the *ERC* issued Resolution No 8, Series of 2014, setting an interim pre-emptive mitigating measure in the *WESM*, which established a price threshold in the *WESM* applied over a 72-hour period, which is determined through a rolling average Generated Weighted Average Price or *GWAP* of ₱8,186 per *MWh*. Also, a secondary cap amounting to ₱6,245 per *MWh* is imposed upon a breach of the threshold, or Secondary Cap mechanism. Such interim measure aims to mitigate sustained high prices in the *WESM* during the May and June 2014 supply months. On June 16, 2014, the *ERC* issued another resolution extending the effectivity of the pre-emptive mitigating measure for 45 days from expiration or until August 9, 2014. Public consultation and a subsequent focus group discussion were held on July 23 and 25, 2014, respectively. On August 5, 2014, the *ERC* resolved to (1) adopt a permanent pre-emptive mitigating measure that will be applied in the *WESM*; (2) direct all interested stakeholders to submit their proposed measures within 20 days from effectivity of such Resolution; and (3) extend the effectivity of the Secondary Cap mechanism for a period of 120 days from August 10, 2014 or until the establishment by the *ERC* of a permanent pre-emptive mitigating measure in the *WESM*, whichever comes earlier.

On September 29, 2014, the *ERC* conducted a public consultation on the proposed permanent pre-emptive mitigating measures in the *WESM*. Parties were then given an additional period until October 7, 2014 to file their additional comments, if any.

On October 24, 2014, the *WESM* Tripartite Committee issued a Joint Resolution to further extend the interim offer price cap in the *WESM* for 120 days starting October 24, 2014 to harmonize with the finalization of the permanent pre-emptive mitigating measure to apply in the *WESM*. On February 20, 2015, the *WESM* Tripartite Committee issued a joint resolution which extended further the imposition of the interim *WESM* offer price cap at its current level until September 30, 2015.

In December 2014, in its Resolution No. 20, Series of 2014, the *ERC* adopted and established a permanent pre-emptive mitigation measure in the *WESM*. The *ERC* set a Cumulative Price Threshold or *CPT* amounting to an average spot price of ₱9,000 per *MWh* over a rolling day 7-day period or 168-hour trading interval. Once this *CPT* for said period is breached, it triggers the imposition of a price cap amounting to ₱6,245 per *MWh*. The price cap shall be imposed until after a determination that succeeding *GWAP* rolling average is already below the *CPT*. The pre-emptive measure has taken effect beginning January 9, 2015.

The imposition of the mitigating measure was questioned by the Philippine Independent Power Producers Association ("*PIPPA*") in the *RTC* of Pasig through a Petition for Declaratory Relief with Application for *TRO* and/or Writ of Preliminary Injunction. The Petition prayed for, among others, that the *ERC* Resolutions pertaining to the Secondary Cap mechanism be declared void *ab initio*. The original petition was subsequently amended to reflect the promulgation of the subsequent *ERC* resolutions extending the effectivity of the *WESM* price cap. On July 21, 2014, *MERALCO* filed its Motion for Leave to Intervene and to Admit Attached Comment-in-Intervention. The *RTC*-Pasig admitted *MERALCO*'s intervention and comment in its Order dated October 28, 2014. The case had already been submitted for decision. However, in a Motion for Leave to Admit Supplement Petition, *PIPPA* moved for leave to file a supplemental petition to include *ERC* Resolution No. 20, Series of 2014 which provides for a permanent mitigating measure in the *WESM*. In an Order dated May 5, 2015, the *RTC* denied the Motion for Leave to File and Admit Supplemental Petition. *PIPPA* filed a

Motion for Partial Reconsideration which was denied by the *RTC* in its Resolution dated September 10, 2015. *PIPPA* filed a Petition for Certiorari with the Court of Appeals.

On September 29, 2015, the *WESM* Tripartite Committee issued a joint resolution further extending the interim offer price cap of ₱32,000 per *MWh* until December 31, 2015. In its Joint Resolution No. 3, Series of 2015, the *WESM* Tripartite Committee resolved to set the *WESM* offer price cap at ₱32,000 per *MWh* and the *WESM* offer price floor of negative ₱10,000 per *MWh* effective January 2016, provided that an annual review shall be undertaken considering the relevant costs assumptions at the time of the review.

6. Philippine Economic Zone Authority (“*PEZA*”) – *ERC* Jurisdiction

On September 13, 2007, *PEZA* issued “Guidelines in the Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones” and “Guidelines for the Supply of Electric Power in Ecozones.” Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *DUs* which are under the legislatively-authorized regulatory jurisdiction of the *ERC*. The Guidelines are the subject of an injunction case filed by the *DUs* at the *RTC*-Pasig.

On February 4, 2015, the Court issued an Order setting a clarificatory hearing on April 15, 2015. During the said hearing *MERALCO* manifested that it previously filed a Motion to Withdraw as Plaintiff on the basis of letter agreements between *MERALCO* and *PEZA*, which is pending before the Court. *MERALCO* submitted the Tripartite Agreement among *PEZA*, *PEPOA* and *MERALCO* for approval of the Court. In a Decision dated July 3, 2015, the *RTC* approved the Compromise Agreement between *PEZA*, *PEPOA* and *MERALCO*. In the hearing on February 10, 2015, the *RTC* dismissed the petition upon motion by *PEZA*. The *ERC* filed a motion for reconsideration which is pending resolution by the *RTC*.

7. Decision on the ₱0.167 per *kWh* Refund

Following the *SC*’s final ruling that directed *MERALCO* to refund affected customers ₱0.167 per *kWh* for billings made from February 1994 to April 2003, the *ERC* approved the release of the refund in four phases. On December 18, 2015, *MERALCO* filed a Motion seeking the *ERC*’s approval for the continuation of the implementation of the refund to eligible accounts or customers under Phases I to IV, three (3) years from January 1, 2016 or until December 31, 2018. In said Motion, *MERALCO* likewise manifested to the *ERC* that, in order to give eligible customers the opportunity to claim their refund, and, so as not to disrupt the *SC* Refund process, *MERALCO* shall continue implementing the refund even after the December deadline, until and unless the *ERC* directs otherwise.

8. *MERALCO*’s *POP* Program

On November 15, 2012, *MERALCO* filed an application with the *ERC* for the approval of its revised *TOU* rates program, also known as the *POP* Program. The *POP* is a rate program being offered by *MERALCO* to customers whose load characteristics can benefit from *TOU* rates as well as to those that can shift their loads from peak to off-peak hours. The proposed revised *POP* Rate aims to provide better savings to avalees by providing them with a *TOU* program that has a wider pricing difference between peak and off-peak rates.

In an Order dated December 17, 2012, the *ERC* provisionally approved the *POP* Program. *MERALCO* started implementing the program on February 1, 2013.

9. Purchase of Subtransmission Assets (“*STAs*”)

On April 17, 2012, *MERALCO* and National Transmission Corporation (“*TransCo*”) filed a joint application for the approval of the Batch 4 contract to sell with the *ERC*. On April 22, 2013, the *ERC* issued a Decision on *MERALCO*’s joint application for the acquisition of the Batch 4 contract to sell. On June 21, 2013 and July 3, 2013, *MERALCO* and *Transco* filed a Motion for Partial Reconsideration and Motion for Reconsideration, respectively, regarding the exclusion of certain facilities for acquisition.

On May 22, 2014, *MERALCO* and *TransCo* received an *ERC* Order dated May 5, 2014 denying *MERALCO* and *TranCo*’s Motions. On June 5, 2014, *MERALCO* filed a clarificatory motion and a motion for

reconsideration of the May 5, 2014, *ERC* Order, which was denied by the *ERC* through an Order dated June 16, 2014. On October 10, 2014, *MERALCO* filed a Motion to Reopen Proceedings for the reception of new evidence to support *MERALCO*'s position on the acquisition of excluded *STAs*. The Motion was heard by the *ERC* on October 17, 2014. After the parties have submitted their respective comments and pleadings, the *ERC* conducted another hearing on February 23, 2015.

During the hearing, *NGCP* was given three (3) days from the said date to file its Comment on the subsequent pleadings filed, after which the case is deemed submitted for resolution.

In an Order dated March 4, 2015, the *ERC* considered but denied the new and substantive allegations in *MERALCO*'s Motion to Reopen Proceedings. *MERALCO* then filed a Petition for Review with the *CA* to question the Orders of the *ERC*. In a Resolution dated September 21, 2015, the *CA* required the parties to submit their respective memoranda. Thereafter, the case is submitted for decision.

On March 20, 2015, *MERALCO* filed a case for "Interpleader with Consignation and Specific Performance" against *Transco* and the Municipality of Labrador, Pangasinan ("*Labrador*") with the *RTC* -Branch 155 of Pasig, praying for the Court to: accept and approved the consignation of the amount of ₱194.1 million; declare *MERALCO* to have paid in full the purchase price of the sale of *Transco*'s assets; direct *Transco* to execute the corresponding Deeds of Absolute Sale; and direct *Labrador* and *Transco* to interplead their respective claims. On April 14 and 20, 2015, *Labrador* and *Transco* filed their respective Motions to dismiss on the ground of impropriety of the filing of the Interpleader and on the ground of *litis pendentia*. *MERALCO* received an Order from Branch 155, *RTC*-Pasig granting the Motions to Dismiss of both *Transco* and *Labrador*. *MERALCO* filed a Motion for Reconsideration which is pending resolution.

On December 12, 2011, *MERALCO* signed various agreements for the acquisition of certain sub-transmission assets of *TransCo* within the *MERALCO* franchise area for its sole account, as well as through a consortium with Batangas II Electric Cooperative, Inc., ("*BATELEC II*") and First Bay Power Corporation ("*FBPC*"). On September 18, 2012, an amended consortium agreement was executed between *MERALCO* and *FBPC*. On October 17, 2012, *MERALCO* signed two separate amended consortium agreements with *BATELEC II*, and with *FBPC* and *BATELEC II*. These amended consortium agreements superseded the agreements signed on December 12, 2011. On December 27 and 28, 2012, the Contract to Sell and Consortium Agreements, respectively, covering these sub-transmission assets were filed with the *ERC* for approval.

The applications for approval of the Consortium Agreement between *MERALCO* and *BATELEC II* and the Contract to Sell among *TRANSCO*, *MERALCO* and *BATELEC II* are submitted for resolution of the *ERC*.

10. Feed-in-Tariff ("*FiT*")

Pursuant to Republic Act No. 9513, or the Renewable Energy Act of 2008 ("*RE Act*"), the *ERC* issued Resolution No. 16, Series of 2010, Adopting the *FiT* Rules, on July 23, 2010. As defined under the *FiT* Rules, the *FiT* system is as a renewable energy policy that offers a guaranteed payments on a fixed per kilowatt-hour for electricity from wind, solar, ocean, hydropower and biomass energy sources, excluding any generation for own use.

On May 16, 2011, the National Renewable Energy Board ("*NREB*") filed its Petition to Initiate Rule Making for the Adoption of *FiT*. The Petition proposed a specific *FIT* Rate for each emerging renewable resource. On July 27, 2012, after undergoing several public consultations and public hearings, the *ERC* approved *FiT* Rates lower than the rates applied by the *NREB*.

To fund the *FiT* payments to eligible *RE* developers, a *FiT*-Allowance ("*FiT-All*") charge will be imposed on all end-users. The *FiT-All* will be established by the *ERC* upon petition by *TransCo*, which had been designated as the *FiT* Fund Administrator.

On February 5, 2014, the *ERC* released the *FiT*-All Disbursement and Collection Guidelines to supplement the *FiT* rules. This set of guidelines will govern how the *FiT*-All will be calculated using the formulae provided. It will also outline the process of billing and collecting the *FiT*-All from the electricity consumers,

the remittance to a specified fund, the disbursement from the *FiT*-All fund and the payment to eligible *RE* developers.

On July 30, 2014, *TransCo* filed its Application for Approval of the *FiT*-All for calendar years 2014 and 2015. On October 7, 2014, the *ERC* provisionally approved a *FiT*-All of ₱0.0406 per *kWh* effective in the January 2015 billing as a separate line item in the bills of end consumers. In its letter to *MERALCO* dated December 18, 2014, the *ERC* clarified that the January 2015 billing covers consumption of customers for the period December 26, 2014 to January 25, 2015.

On December 23, 2014, *MERALCO* received a copy of a Petition for Prohibition and Certiorari filed with the *SC* against the *ERC*, *DOE*, *TransCo*, *NREB* and *MERALCO*. The Petition seeks (i) the issuance of a Temporary Restraining Order (“*TRO*”) and/or Writ of Preliminary Injunction, and after giving due course to the Petition, a Writ of Prohibition to enjoin the respondents from implementing the *FiT*-All, the *FiT* Rules and *FiT* Guidelines; and (ii) the annulment of the *FiT* Rules and *FiT* Guidelines. Through a Notice dated March 17, 2015, the *SC* required the adverse parties to submit their comments within ten (10) days from receipt. The *ERC* and *DOE* filed a Consolidated Comment dated July 23, 2015 while the *NREB* filed its Comment dated July 14, 2015.

On April 30, 2014, the *DOE* issued a Certification revising the installation target for solar from 50 *MW* to 500 *MW*, an additional capacity of 450 *MW*. In its Certification, the *DOE* stated that “solar energy generation projects given their short installation period can greatly contribute in providing additional generating and reserve capacity in the summer seasons of 2015 and 2016”.

On January 28, 2015, the *ERC* conducted a public consultation on the increase of the installation target for solar renewable energy generation (additional 450 *MW*) and the *FiT* Rate for the additional solar capacity. In the said hearing, it was clarified that the additional 450 *MW* installation capacity for solar is already approved by the *DOE*. On April 28, 2015, *ERC* issued a Decision dated March 27, 2015 setting the new Solar *FiT* Rate at ₱8.69 per *kWh*, which shall apply prospectively.

On April 7, 2015, the *DOE* issued a Certification revising the installation target for wind from 200 *MW* to 400 *MW*. On April 13, 2015, the *ERC* initiated the review of the *FiT* for wind technology. In a letter dated April 15, 2015, the *ERC* directed the *NREB* to submit a proposal regarding the review of *FiT* for wind technology beyond the original 200 *MW* installation target. The *NREB* proposed a Wind *FiT* of ₱8.49 per *kWh*. On July 30, 2015, the *ERC* conducted a public consultation on the new proposed Wind *FiT*. In a Decision dated October 6, 2015, the *ERC* set the Wind *FiT* at ₱7.40 per *kWh*. *MERALCO* filed a Motion for Reconsideration of the Decision.

On December 22, 2015, *TransCo* filed its Application for Approval of the *FiT*-All for calendar year 2016. In an Order dated February 16, 2016, The *ERC* provisionally approved a *FiT*- Allowance of ₱0.1240 per *kWh* effective in the succeeding billing period after *TransCo* received the Order. The *FiT*-All was implemented starting April 2016 billing month.

11. Net Metering Program

The *RE* Act mandates the *DUs* to provide the mechanism for the “physical connection and commercial arrangements necessary to ensure the success of the *RE* programs”, specifically the Net Metering Program. The *RE* Act defines Net Metering as “a system, appropriate for distributed generation, in which a distribution grid user has a two-way connection to the grid and is only charged for his net electricity consumption and is credited for any overall contribution to the electricity grid”. By their nature, net metering installations will be small (less than 100 *kW*) and will likely be adopted by households and small business end-users of *DUs*.

After consultations with stakeholders, the *ERC* issued on July 3, 2013 its Resolution No. 09, Series of 2013, entitled, “A Resolution Adopting the Rules enabling the Net Metering Program for Renewable Energy”. The rules will govern the *DUs*’ implementation of the Net Metering Program. Included in the Rules are the Interconnection Standards that shall provide technical guidance to address engineering, electric system reliability, and safety concerns for net metering interconnections. The final pricing methodology, however, will be addressed in another set of rules and will be endorsed to the *ERC* in due course. In the meantime, the *DUs*’ blended generation cost equivalent to the generation charge, shall be used as the preliminary reference price in the net metering agreement. The rules took effect on July 24, 2013. As at September 30, 2016,

MERALCO has already installed 647 meters and energized 573 Net Metering customers. *MERALCO* is the first *DU* in the country which implemented the Net Metering Program.

12. Interruptible Load Program (“*ILP*”)

In an *ERC* Order dated April 11, 2014, the *ERC* approved with modification *MERALCO*’s request that it be allowed to adopt and implement the “Rules to Govern the Interruptible Load Program of Distribution Utilities” promulgated under Resolution No. 08, Series of 2010, as amended by Resolution No. 08, Series of 2013 and Resolution No. 05, Series of 2015.

MERALCO is working with the *DOE*, the *ERC* and other stakeholders on the mechanics to implement the expanded *ILP* to cover not only captive customers but also contestable customers with demand of one (1) *MW* or higher who have standby generating units. A forum in coordination with the *DOE* and Retail Electricity Suppliers Association was conducted last March 30, 2016 to provide an update on the Luzon power situation outlook and to refresh participants on the *ILP* protocols.

As of September 30, 2016, there are 221 companies with a total generating capacity of 792.70 *MW* that have signed up with *MERALCO*, *MPower* and with other retail electricity supplier as *ILP* participants.

13. Long-term Indebtedness Application

On June 25, 2015, *MERALCO* filed an Application, with prayer for provisional authority, for continuing authority to (a) issue bonds or other evidence of indebtedness for as long as it maintains 50:50 long-term debt to equity ratio; and (b) Whenever necessary, to mortgage, pledge or encumber any of its property to any creditor in connection with its authority to issue bonds or any other evidence of long-term indebtedness. The hearing on the application was conducted on October 6, 2015. The *ERC* directed *MERALCO* to submit additional documents in support of its Application Which *MERALCO* complied with. However, due to changes in the financial climate which may affect the terms and conditions of any financial borrowings, *MERALCO* has filed a motion to withdraw the application without prejudice to its refiling at a later date. In an Order dated March 22, 2016, the *ERC* granted *MERALCO*’s motion to withdraw but still required *MERALCO* to submit certain documents. *MERALCO* filed a Motion for Partial Reconsideration questioning the requirement.

14. Prepaid Retail Electricity Service (“*PRES*”)

On December 12, 2014, *MERALCO* filed an application for authority to offer and provide *PRES* to its customers as well as the applicable rules to govern *PRES*. In a Decision dated April 27, 2015, the *ERC* approved the application with modification. As at September 30, 2016, there are 35,074 customer availing of *PRES*.

15. Competitive Selection Process (“*CSP*”) for *PSAs*

As early as February 2013, the *ERC* posted the first draft of rules on *PSA* Approval, solicited comments from stakeholders thereon and conducted various focused group discussions. The said draft required *DUs* to undergo *CSP* in their supply procurement, required a specific procedure for such and prescribed a *PSA* template.

Meanwhile, in October 2014, the *DOE* issued for comments its draft Circular on Demand Aggregation and Supply Auctioning Policy (“*DASAP*”). This was likewise subjected to public consultations.

In June 2015, *DOE* promulgated *DOE* Circular No. 2015-06-0008 “Providing Policies for Further Enhancement of the *WESM* Design and Operations,” prescribing *DUs* to procure all its uncontracted demand through *CSP*, through the participation of a Third Party and which may be done by *DUs* on an aggregated basis. The *DOE* Circular gave *DOE* and *ERC* 120 days to issue the necessary Implementing Guidelines (“*IG*”). Instead of issuing an *IG*, in a Joint Resolution dated October 20, 2015, it was agreed by the *DOE* and the *ERC* that the latter shall be the one to issue the relevant *CSP* regulations. On even date, the *ERC* promulgated Resolution No. 13, Series of 2015.

ERC Resolution No. 13, Series of 2015 included the following provisions:

- a) All *DUs* are required to undergo *CSP*. Pending the *ERC*'s issuance of a prescribed process, *DUs* may adopt any accepted form of *CSP*, provided that the terms of reference shall include, among others, the following – (a) contract capacity or energy volume, (b) generation source, (c) method of fuel procurement, (d) contract period, (e) tariff structure, (f) Philippine peso or foreign currency denominated payment, (g) penalties, (h) applicable transmission projects, and (i) other key parameters.
- b) A *CSP* is successful if there are at least two (2) qualified bids. Should there be at least two (2) failed bids, then a *DU* can proceed with direct negotiation.
- c) The *CSP* requirement shall apply to *PSAs* that although executed, have not yet been filed for approval before the *ERC*.

On March 15, 2016, *ERC* released Resolution No. 1 Series of 2016 entitled, “A Resolution Clarifying the Effectivity of *ERC* Resolution No. 13, Series of 2015”. In this new Resolution, *ERC* clarified that after judicious study and due consideration of views raised by different industry stakeholders, it has resolved that:

The effectivity of *ERC* Resolution No. 13, Series of 2015 is hereby restated to be April 30, 2016.

On the other forms of *CSP* referred to in Section 2 of the *ERC* Resolution No. 13, Series of 2015, these should likewise comply with the minimum terms of reference and the requirement of at least two qualified bids for the *CSP* to be considered successful.

In reference to *PSAs* with provisions allowing the automatic renewal or extension of their term, *PSAs* that were previously approved by the *ERC* or filed with the *ERC* before the effectivity of this Resolution may have one (1) automatic renewal or extension for a period not exceeding one (1) year from the end of their respective terms. However, upon effectivity of this Resolution, automatic renewal clauses or extension of *PSAs* shall no longer be permitted.

OTHER QUANTITATIVE AND QUALITATIVE DISCLOSURES

- (i) **Any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in *MERALCO*'s liquidity increasing or decreasing in any material way.**

Not applicable

- (ii) **Any events that will trigger direct or indirect contingent financial obligation that is material to *MERALCO*, including any default or acceleration of an obligation.**

1. Mediation with *NPC*

The *NPC* embarked on a Power Development Program (“*PDP*”) which consisted of contracting generating capacities and the construction of its own, as well as private sector, generating plants, following a crippling power supply crisis. To address the concerns of the creditors of *NPC*, namely, Asian Development Bank and the World Bank, the *DOE* required that *MERALCO* enter into a long-term supply contract with *NPC*.

Accordingly, on November 21, 1994, *MERALCO* entered into a 10-year *CSE* with *NPC* to commence on January 1, 1995. The *CSE* and the rates and amounts charged to *MERALCO* therein were approved by the *BOD* of *NPC* and the then Energy Regulatory Board, respectively.

Separately, the *DOE* further asked *MERALCO* to provide a market for half of the output of the Camago-Malampaya gas field to enable its development and production of natural gas, which was to generate significant revenues for the Philippine Government and equally significant foreign exchange savings for the country to the extent of the fuel imports which the domestic volume of natural gas will displace.

MERALCO's actual purchases from *NPC* exceeded the contract level in the first seven years of the *CSE*. However, the 1997 Asian crisis resulted in a significant curtailment of energy demand.

While the events were beyond the control of *MERALCO*, *NPC* did not honor *MERALCO*'s good faith notification of its off-take volumes. A dispute ensued and both parties agreed to enter into mediation.

The mediation resulted in the signing of a Settlement Agreement (SA) between the parties on July 15, 2003. The SA was approved by the respective *BODs* of *NPC* and *MERALCO*. The net settlement amount of ₱14,320 million was agreed upon by *NPC* and *MERALCO* and manifested before the *ERC* through a Joint Compliance dated January 19, 2006. The implementation of the SA is subject to the approval of *ERC*.

Subsequently, the Office of the Solicitor General ("*OSG*") filed a "Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between *NPC* and *MERALCO*." As a result, *MERALCO* sought judicial clarification with the *RTC-Pasig*. Pre-trials were set, which *MERALCO* complied with and attended. However, the *OSG* refused to participate in the pre-trial and opted to seek a *TRO* from the *CA*.

In a Resolution dated December 1, 2010, the *CA* issued a *TRO* against the *RTC-Pasig*, *MERALCO* and *NPC* restraining the respondents from further proceeding with the case. Subsequently, in a Resolution dated February 3, 2011, the *CA* issued a *WPI* enjoining the *RTC-Pasig* from conducting further proceedings pending resolution of the Petition. In a Decision dated October 14, 2011, the *CA* resolved to deny the Petition filed by the *OSG* and lifted the injunction previously issued. The said Decision likewise held that the *RTC-Pasig* committed no error in finding the *OSG* in default due to its failure to participate in the proceedings. The *RTC-Pasig* was thus ordered to proceed to hear the case *ex-parte*, as against the *OSG*, and with dispatch. The *OSG* filed a motion for reconsideration which was denied by the *CA* in its Resolution dated April 25, 2012. The *OSG* filed a Petition for Review on Certiorari with the *SC*. *MERALCO*'s Comment was filed on October 29, 2012.

Subsequently, a Decision dated December 11, 2013 was rendered by the First Division of the *SC* denying the Petition for Review on Certiorari by the *OSG* and affirming the decision promulgated by the *CA* on October 14, 2011.

With the dismissal of the petition filed by the *OSG* with the *CA*, *MERALCO* filed a motion for the reception of its evidence *ex-parte* with the *RTC-Pasig* pursuant to the ruling of the *CA*. In a Decision dated May 29, 2012, the *RTC-Pasig* declared the SA, independent of the pass-through for the settlement amount which is reserved for the *ERC*, valid and binding. The *OSG* has filed a Notice of Appeal with the *RTC-Pasig* on June 19, 2012. After both parties filed their respective appeal briefs, the *CA* rendered a Decision dated April 15, 2014 denying the appeal and affirming the *RTC* Decision, which declared the SA as valid and binding. The *OSG* filed a Petition for Review with the *SC*. On November 10, 2014, *MERALCO* filed its comment to the Petition. In a Resolution dated July 8, 2015, the *SC* resolved to serve anew its Resolutions requiring *NPC* to comment on the Petition. In a Compliance, *NPC* submitted its Comment dated September 8, 2015. *MERALCO* submitted its Motion for Leave to File and to Admit Attached Reply on October 12, 2015. Pursuant to the *SC* Resolution dated November 11, 2015, the *OSG* filed a Consolidated Reply to the comments filed by *NPC*, *MERALCO* and *PSALM*. *MERALCO* then filed a Motion for Leave to File and to Admit the Attached Rejoinder. As of September 30, 2016, *MERALCO* is awaiting further action of the *SC* on the matter.

2. Sucat-Araneta-Balintawak Transmission Line

The Sucat-Araneta-Balintawak transmission line is a two-part transmission line, which completed the 230 kV line loop within Metro Manila. The two main parts are the Araneta to Balintawak leg and, the Sucat to Araneta leg, which cuts through Dasmariñas Village, Makati City.

On March 10, 2000, certain residents along Tamarind Road, Dasmariñas Village, Makati City or plaintiffs, filed a case against *NPC* with the *RTC-Makati*, enjoining *NPC* from further installing high voltage cables near the plaintiffs' homes and from energizing and transmitting high voltage electric current through said cables because of the alleged health risks and danger posed by the same. Following its initial status quo Order issued on March 13, 2000, *RTC-Makati* granted on April 3, 2000 the preliminary injunction sought

for by the plaintiffs. The decision was affirmed by the SC on March 23, 2006, which effectively reversed a decision of the CA to the contrary. The *RTC-Makati* subsequently issued a writ of execution based on the Order of the SC. *MERALCO*, in its capacity as an intervenor, was constrained to file an Omnibus Motion to maintain status quo because of the significant effect of a de-energization of the Sucat-Araneta line to the public and economy. Shutdown of the 230 kV line will result in widespread and rotating brownouts within *MERALCO*'s franchise area with certain power plants unable to run at their full capacities.

On September 8, 2009, the *RTC-Makati* granted the motions for intervention filed by intervenors *MERALCO* and *NGCP* and dissolved the *WPI* issued, upon the posting of the respective counter bonds by defendant *NPC*, intervenors *MERALCO* and *NGCP*, subject to the condition that *NPC* and intervenors pay all damages, which the plaintiffs may incur as a result of the Writ of Preliminary Injunction.

In its Order dated February 5, 2013, the *RTC-Makati* granted plaintiffs' motion and directed the re-raffle of the case to another court after the judicial dispute resolution failed.

This case remains pending and is still at the pre-trial stage. During the pre-trial stage, plaintiffs filed a Manifestation stating that they are pursuing the deposition of Dr. Martin Blank, a supposed expert in electromagnetic field, through oral examination without leave of court in late January or early February 2016 or on such date as all the parties may agree amongst themselves at the Consulate Office of the Philippines in Vancouver, Canada. *NPC* and intervenors filed their Opposition and Counter-Manifestation. Intervenor *NGCP* filed a Motion to Prohibit the Taking of the Deposition of Dr. Blank. Intervenor *MERALCO* intends to file its Comment/Opposition in due course.

3. Real Property Tax ("RPT") Assessment

Several *LGUs* assessed *MERALCO* for deficiency *RPT* on certain assets of *MERALCO*. The assets include electric transformers, distribution wires, insulators, and poles, collectively referred to as *TWIP*. Of these *LGUs*, one has secured a favorable decision from the CA. Such decision was appealed by *MERALCO* to the SC for the benefit of *MERALCO* customers. On October 22, 2015, *MERALCO* received a copy of the SC Decision promulgated on August 5, 2015 declaring, among others, that the transformers, electric posts, transmission lines, insulators, and electric meters of *MERALCO* are not exempted from *RPT* under the LGU. *MERALCO* did not appeal said SC Decision. The cases of the other *LGUs* are pending with their respective administrative bodies or government offices.

MERALCO also filed a case against the City of Manila before *RTC-Pasig* to enjoin the collection of *RPT* on *MERALCO*'s *TWIP* and nullify *RPT* assessments made thereon based on the argument that these are not within the ambit of the definition of real property under the Local Government Code ("*LGC*"). The case is set for mediation after the City of Manila filed its comment on *MERALCO*'s petition. *MERALCO* has started presenting its evidence without prejudice to possible out-of-court settlement in light of the SC Decision in the case of Lucena City. Subsequently, the court has granted the motion jointly filed by *MERALCO* and the City of Manila for the withdrawal of the case subject to the terms and conditions set forth in the motion.

MERALCO will file for the recovery of any resulting *RPT* payments from customers in the relevant *LGU* through a separate application with the *ERC*. In 2016, *MERALCO* is in the process of settlement with various local governments.

4. LFT Assessments of Municipalities

Certain municipalities have served assessment notices on *MERALCO* for local franchise taxes. As provided in the *LGC*, only cities and provincial governments may impose taxes on establishments doing business in their localities. On the basis of the foregoing, *MERALCO* and its legal counsel believe that *MERALCO* is not subject or liable for such assessments.

5. SC Decision on Unbundling Rate Case

On May 30, 2003, the *ERC* issued an Order approving *MERALCO*'s unbundled tariffs that resulted in an increase of ₱0.17 per *kWh* over the May 2003 tariff levels. However, on August 4, 2003, *MERALCO* received a Petition for Review of the *ERC*'s ruling filed by certain consumer and civil society groups before the *CA*. On July 22, 2004, the *CA* set aside the *ERC*'s ruling on *MERALCO*'s rate unbundling and remanded the case to the *ERC*. Further, the *CA* opined that the *ERC* should have asked the Commission on Audit or *COA*, to audit the books of *MERALCO*. The *ERC* and *MERALCO* subsequently filed separate motions asking the *CA* to reconsider its decision. As a result of the denial by the *CA* of the motions on January 24, 2005, the *ERC* and *MERALCO* elevated the case to the *SC*.

In an En Banc decision promulgated on December 6, 2006, the *SC* set aside and reversed the *CA* ruling saying that a *COA* audit was not a prerequisite in the determination of a utility's rates. However, while the *SC* affirmed *ERC*'s authority in rate-fixing, the *SC* directed the *ERC* to request *COA*'s assistance to undertake a complete audit of the books, records and accounts of *MERALCO*. In compliance with the directive of the *SC*, the *ERC* requested *COA* to conduct an audit of the books, records and accounts of *MERALCO* using calendar years 2004 and 2007 as test years.

The *COA* audit, which began in September 2008, was completed with the submission to the *ERC* of its report on November 12, 2009.

On February 15, 2010, the *ERC* issued its Order directing *MERALCO* and all intervenors in the case to submit, within 15 days from receipt of the Order, their respective comments on the *COA*'s report.

On June 21, 2011, the *ERC* maintained and affirmed its findings and conclusions in its Order dated March 20, 2003. The *ERC* stated that the *COA* recommendation to apply disallowances under *PBR* to rate unbundling violates the principle against retroactive rate-making. An intervenor group filed a Motion for Reconsideration or *MR* of the said Order. On September 5, 2011, *MERALCO* filed its comment on the intervenor's motion for reconsideration. On February 4, 2013, the *ERC* denied the intervenor's *MR*. The intervenor filed a Petition for Review before the *CA* and *MERALCO* filed its comment thereon on May 29, 2014. In compliance with the *CA* directive, *MERALCO* filed its Memorandum in August 2015. In a Resolution dated September 29, 2015, the *CA* acknowledged receipt of the respective Memoranda from parties and declared the case submitted for decision. In a Decision dated February 29, 2016, the *CA* dismissed the Petition for Review and affirmed the orders dated June 21, 2011 and February 4, 2013 of the *ERC*.

- (iii) **All material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of *MERALCO* with unconsolidated entities or other persons created during the reporting period.**

2016 Capital Expenditure Requirements (in millions)

Electric capital projects	₱15,485
Non-electric projects and other capitalized items	10,232
Total capital expenditures	₱25,717

MERALCO has a management-approved capital expenditure budget of ₱25,717 million for the year ended December 31, 2016, of which about 60% represents planned expenditures for the electric projects of the power distribution business. The capital expenditure budget shall address requirements in areas with large concentration of core customers, correct normal deficiencies in the system, stretch loading limits of *MERALCO* facilities and initiate practical and cost-effective projects to correct system deficiencies.

Absent the release by the *ERC* of the final rules to govern the filing of its 4th *RP* Reset Application, and in anticipation of the network system requirements and possible effect of severe weather conditions after June 30, 2015, *MERALCO* filed on February 9, 2015 an application for approval of authority to implement its *CAPEX* program for RY 2016 (July 1, 2015 to June 30, 2016) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as the Public Service Act.

- (iv) **Any known trends, events or uncertainties that have had or that are reasonably expected to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations should be described.**

1. Retail Competition

See related preceding discussions under *RCOA*.

2. Petition for Dispute Resolution against *PEMC*, *TransCo*, *NPC* and *PSALM*

On September 9, 2008, *MERALCO* filed a Petition for Dispute Resolution, against *PEMC*, *TransCo*, *NPC* and *PSALM* with the *ERC* as a result of the congestion in the transmission system of *TransCo* arising from the outages of the San Jose-Tayabas 500 kV Line 2 on June 22, 2008, and the 500 kV 600 Mega Volt-Ampere (“MVA”) Transformer Bank No. 2 of *TransCo*’s San Jose, Bulacan substation on July 11, 2008. The Petition seeks to, among others, direct *PEMC* to adopt the *NPC-TOU* rate or the new price determined through the price substitution methodology of *PEMC* as approved by the *ERC*, as basis for its billing during the period of the congestion and direct *NPC* and *PSALM* to refund the transmission line loss components of the line rentals associated with *NPC/PSALM* bilateral transactions from the start of *WESM* operation on June 26, 2006.

In a Decision dated March 10, 2010, the *ERC* granted *MERALCO*’s petition and ruled that there is double charging of the Transmission Line Costs billed to *MERALCO* by *NPC* for the Transition Supply Contract (“TSC”) quantities to the extent of 2.98% loss factor, since the start of the TSC in November 2006. Thus, *NPC* was directed to refund/collect line rental adjustment to/from *MERALCO*. In the meantime, the *ERC* issued an Order on May 4, 2011 allowing *PEMC* to submit an alternative methodology for the segregation of line rental into congestion cost and line losses from the start of the *WESM*. *PEMC* has filed its compliance submitting its alternative methodology.

On September 8, 2011, *MERALCO* received a copy of *PEMC*’s compliance to *ERC*’s directive and on November 11, 2011, *MERALCO* filed a counter-proposal which effectively simplifies *PEMC*’s proposal.

In an Order of the *ERC* dated June 21, 2012, *MERALCO* was directed to submit its computation of the amount of the double charging of line loss on a per month basis from June 26, 2006 up to June 2012. On July 4, 2012, *MERALCO* filed its Compliance to the said Order. Thereafter, the *ERC* issued an Order directing the parties to comment on *MERALCO*’s submissions.

Hearings were conducted on October 2, 2012 and October 16, 2012 to discuss the parties proposal and comments.

In an Order dated March 4, 2013, the *ERC* approved the methodology proposed by *MERALCO* and *PEMC* in computing the double charged amount on line losses by deducting 2.98% from the *NPC-TOU* amount. Accordingly, the *ERC* determined that the computed double charge amount to be collected from *NPC* is ₱5.2 billion, covering the period November 2006 to August 2012 until actual cessation of the collection of the 2.98% line loss charge in the *NPC-TOU* rates imposed on *MERALCO*. In this regard, *NPC* was directed by the *ERC* to refund said amount by remitting to *MERALCO* the equivalent amount of ₱73.9 million per month until the over-recoveries are fully refunded. In said Order, the *ERC* likewise determined that the amount to be collected from the Successor Generating Companies (“SGCs”) is ₱4.7 billion. Additionally, *MERALCO* was directed to file a petition against the following SGCs: *MPPCL*, Aboitiz Power Renewables, Inc. or *APRI*, *TLI*, *SMEC* and *Sem-Calaca*, within 30 days from receipt thereof, to recover the line loss collected by them. On April 19, 2013, *MERALCO* filed a Motion for Clarification with the *ERC* regarding the directives contained in the March 4, 2013 Order. On April 30, 2013 and May 8, 2013, *PSALM* and *NPC*, respectively, filed motions seeking reconsideration of the March 4, 2013 Order. *MERALCO* filed a motion seeking for an additional 15 days from its receipt of the *ERC*’s Order resolving its Motion for Clarification, within which to file its Petition against the SGCs.

In an Order dated July 1, 2013, the *ERC* issued the following clarifications/resolutions:

- 1) *SPPC* should be included as one of the *SGCs* against whom a petition for dispute resolution should be filed by *MERALCO*;
- 2) Amount to be refunded by *NPC* is not limited to the ₱5.2 billion but should include all subsequent payments it received from *MERALCO* beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates;
- 3) Petition to be filed by *MERALCO* against the *SGCs* should not only be for the recovery of the amount of ₱4.7 billion but also all payments beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates;
- 4) “*SCPC Ilijan*” pertains to *SPPC* instead. Thus, the refundable amount of ₱706 million pertaining to “*SCPC Ilijan*” should be added to *SPPC*’s refundable amount of ₱1.1 billion;
- 5) Grant the Motion for Extension filed by *MERALCO* within which to file a petition against the following *SGCs*: *MPPCL*, *APRI*, *TLI*, *SMEC*, *Sem-Calaca* and *SPPC*; and
- 6) Deny the respective *MR* filed by *NPC* and *PSALM*.

On September 12, 2013, *MERALCO* filed a Manifestation with Motion with the *ERC* seeking approval of its proposal to offset the amount of ₱73.9 million per month against some of its monthly remittances to *PSALM*. *PSALM* and *NPC* filed their comments *Ad Cautelam* and Comment and Opposition *Ad Cautelam*, respectively, on *MERALCO*’s Manifestation and Motion. On November 4, 2013, *MERALCO* filed its reply. As at September 30, 2016, *MERALCO*’s Manifestation and Motion is still pending resolution by the *ERC*.

On October 24, 2013, *MERALCO* received *PSALM*’s Petition for Review on Certiorari with the *CA* (With Urgent *TRO* and/or Writ of Preliminary Mandatory Injunction Applications) questioning the March 4, 2013 and July 1, 2013 Orders of the *ERC*.

On February 3, 2014, *MERALCO* filed a Comment with Opposition to the Application for *TRO* or *WPI* dated January 30, 2014. *PEMC* filed a Comment and Opposition Re: Petition for Certiorari with Urgent *TRO* and/or Writ of Preliminary Mandatory Injunction dated January 6, 2014. On June 4, 2014, the *CA* issued a Resolution declaring that *PSALM* is deemed to have waived the filing of a Reply to the comment and opposition of *MERALCO* and *PEMC* and directing the parties to submit their simultaneous memoranda within 15 days from notice. On December 1, 2014, the *CA* issued a decision dismissing the Petition for Certiorari filed by *PSALM* against the *ERC*, *MERALCO* and *PEMC* and affirming *ERC*’s ruling on the refund of the ₱5.2 billion of transmission line losses double charged by *PSALM* and *NPC*. On January 30, 2015, *PSALM* filed its Motion for Reconsideration of the December 1, 2014 Decision of the *CA*. *MERALCO* has filed its Opposition to the Motion for Reconsideration. In a Resolution dated August 11, 2015, the *CA* denied *PSALM*’s Motion for Reconsideration. On October 27, 2015, *MERALCO* received *PSALM*’s Petition for Review with the *SC*. *MERALCO* is waiting further action of the *SC* on the Petition.

3. *Petition for Dispute Resolution Against SPPC, MPPCL, APRI, TLI, SMEC and Sem-Calaca*

On August 29, 2013, *MERALCO* filed a Petition for Dispute Resolution against *SPPC*, *MPPCL*, *APRI*, *TLI*, *SMEC* and *Sem-Calaca*. Said Petition seeks the following:

- 1) Refund of the 2.98% transmission line losses in the amount of ₱5.4 billion, inclusive of the ₱758 million line loss for the period September 2012 to June 25, 2013, from said *SGCs*; and
- 2) Approval of *MERALCO*’s proposal to correspondingly refund to its customers the aforementioned line loss amounts, as and when the same are received from the *SGCs*, until such time that the said over-recoveries are fully refunded, by way of automatic deduction of the amount of refund from the computed monthly generation rate. On September 20, 2013, *MERALCO* received the *SGCs*’ Joint Motion to Dismiss. On October 7, 2013, *MERALCO* filed its Comment on the said Joint Motion.

On October 8, 2013, *MERALCO* received the *SGC*'s Manifestation and Motion, which sought, among other things, the cancellation of the scheduled initial hearing of the case, including the submission of the parties respective Pre-trial Briefs, until the final resolution of the *SGC*'s Joint Motion to Dismiss. On October 11, 2013, *MERALCO* filed its Pre-trial Brief. On October 14, 2013, *MERALCO* filed its Opposition to the *SGC*'s Manifestation and Motion. On October 24, 2013, *MERALCO* received the *SGC*'s Reply to its Comment on the Joint Motion to Dismiss. On October 29, 2013, *MERALCO* filed its Rejoinder. Thereafter, the *SGC*'s filed their Sur-Rejoinder dated November 4, 2013. As at September 30, 2016, the Joint Motion to Dismiss is pending resolution by the *ERC*.

4. *PSALM* versus *PMC* and *MERALCO*

Due to the significant increases in *WESM* prices during the 3rd and 4th months of the *WESM* operations, *MERALCO* raised concerns with the *PEMC* to investigate whether *WESM* rules were breached or if anti-competitive behavior had occurred.

While resolutions were initially issued by the *PEMC* directing adjustments of *WESM* settlement amounts, a series of exchanges and appeals with the *ERC* ensued. *ERC* released an order directing that the *WESM* settlement price for the 3rd and 4th billing months be set at *NPC-TOU* rates, prompting *PSALM* to file a Motion for Partial Reconsideration, which was denied by the *ERC* in an Order dated October 20, 2008. *PSALM* filed a Petition for Review before the *CA*, which was dismissed on August 28, 2009, prompting *PSALM* to file an *MR*, which was likewise denied by the *CA* on November 6, 2009. In December 2009, *PSALM* filed a Petition for Review on Certiorari with the *SC*. *MERALCO* has filed its comments on the Petition and its Memorandum.

As at September 30, 2016, *PSALM*'s Petition for Review is pending resolution by the *SC*.

5. Petition for Dispute Resolution with *NPC* on Premium Charges

On June 2, 2009, *MERALCO* filed a Petition for Dispute Resolution against *NPC* and *PSALM* with respect to *NPC*'s imposition of premium charges for the alleged excess energy it supplied to *MERALCO* covering the billing periods May 2005 to June 2006. The premium charges amounting to ₱315 million during the May-June 2005 billing periods have been paid but are the subject of a protest by *MERALCO*, and premium charges of ₱318 million during the November 2005, February 2006 and April to June 2006 billing periods are being disputed and withheld by *MERALCO*. *MERALCO* believes that there is no basis for the imposition of the premium charges. As at September 30, 2016, the petition is pending resolution by the *ERC*.

6. *SC TRO* on *MERALCO*'s December 2013 Billing Rate Increase

On December 9, 2013, the *ERC* gave clearance to the request of *MERALCO* to implement a staggered collection over three (3) months covering the December 2013 billing month for the increase in generation charge and other bill components such as *VAT*, *LFT*, transmission charge, and *SL* charge. The generation costs for the November 2013 supply month increased significantly because of the aberrant spike in the *WESM* charges on account of the non-compliance with *WESM* Rules by certain plants resulting in significant power generation capacities not being offered and dispatched, and the scheduled and extended shutdowns, and the forced outages, of several base load power plants, and the use of the more expensive liquid fuel or bio-diesel by the natural gas-fired power plants that were affected by the Malampaya Gas Field or *Malampaya*, shutdown from November 11 to December 10, 2013.

On December 19, 2013, several party-list representatives of the House of Representatives filed a Petition against *MERALCO*, *ERC* and the *DOE* before the *SC*, questioning the *ERC* clearance granted to *MERALCO* to charge the resulting price increase, alleging the lack of hearing and due process. It also sought for the declaration of the unconstitutionality of the *EPIRA*, which essentially declared the generation and supply sectors competitive and open, and not considered public utilities. A similar petition was filed by a consumer group and several private homeowners associations challenging also the legality of the *AGRA* that the *ERC* had promulgated. Both petitions prayed for the issuance of *TRO*, and a Writ of Preliminary Injunction.

On December 23, 2013, the SC consolidated the two (2) Petitions and granted the application for *TRO* effective immediately and for a period of 60 days, which effectively enjoined the *ERC* and *MERALCO* from implementing the ₱4.15 per *kWh* price increase. The SC also ordered *MERALCO*, *ERC* and *DOE* to file their respective comments to the Petitions. Oral Arguments were conducted on January 21, 2014, February 4, 2014 and February 11, 2014. Thereafter, the SC ordered all the Parties to the consolidated Petitions to file their respective Memorandum on or before February 26, 2014 after which the Petitions will be deemed submitted for resolution of the SC. *MERALCO* complied with said directive and filed its Memorandum on said date.

On February 18, 2014, acting on the motion filed by the Petitioners, the SC extended for another 60 days or until April 22, 2014, the *TRO* that it originally issued against *MERALCO* and *ERC* last December 23, 2013. The *TRO* was also similarly applied to the generating companies, specifically *MPPCL*, *SMEC*, *SPPC*, *FGPC*, and the *NGCP*, and the *PEMC* (the administrator of *WESM* and market operator) who were all enjoined from collecting from *MERALCO* the deferred amounts representing the ₱4.15 per *kWh* price increase for the November 2013 supply month. In the meantime, on January 30, 2014, *MERALCO* filed an Omnibus Motion with Manifestation with the *ERC* for the latter to direct *PEMC* to conduct a re-run or recalculation of the *WESM* prices for the supply months of November to December 2013. Subsequently, on February 17, 2014, *MERALCO* filed with the *ERC* an Application for the recovery of deferred generation costs for the December 2013 supply month praying that it be allowed to recover the same over a six (6)-month period.

On March 3, 2014, the *ERC* issued an Order voiding the Luzon *WESM* prices during the November and December 2013 supply months on the basis of the preliminary findings of its Investigating Unit that these are not reasonable, rational and competitive, and imposing the use of regulated rates for the said period. *PEMC* was given seven (7) days upon receipt of the Order to calculate these regulated prices and implement the same in the revised *WESM* bills of the concerned *DUs* in Luzon. *PEMC*'s recalculated power bills for the supply month of December 2013 resulted in a net reduction of the December 2013 supply month bill of the *WESM* by ₱9.3 billion. Due to the pendency of the *TRO*, no adjustment was made to the *WESM* bill of *MERALCO* for the November 2013 supply month. The timing of amounts to be credited to *MERALCO* is dependent on the reimbursement of *PEMC* from associated generator companies. However, several generating companies, including *MPPCL*, *SN Aboitiz Power, Inc.*, *Team Energy*, *Panasia Energy, Inc.*, and *SMEC*, have filed *MR* questioning the Order dated March 3, 2014. *MERALCO* has filed a consolidated comment to these motions for reconsideration. In an Order dated October 15, 2014, the *ERC* denied the motions for reconsideration. The generating companies have appealed the Orders with the *CA* where the petitions are pending and have been consolidated. *MERALCO* has filed a Consolidated Motion for leave, to intervene and to admit consolidated comment in intervention. In a Resolution dated October 9, 2015, the *CA* required the generators to file their comments on *MERALCO*'s consolidated motion. *MERALCO* is awaiting the resolution of the Consolidated Motion.

In view of the pendency of the various submissions before the Commission and mindful of the complexities in the implementation of *ERC*'s Order dated March 3, 2014, the *ERC* directed *PEMC* to provide the market participants an additional period of 45 days to comply with the settlement of their respective adjusted *WESM* bills. In an Order dated May 9, 2014, the parties were then given an additional non-extendible period of 30 days from receipt of the Order within which to settle their *WESM* bills. However, in an Order dated June 6, 2014 and acting on an intervention filed by Angeles Electric Corporation, the *ERC* deemed it appropriate to hold in abeyance the settlement of *PEMC*'s adjusted *WESM* bills by the market participants.

On April 22, 2014, the SC extended indefinitely the *TRO* issued on December 23, 2013 and February 18, 2014 and directed generating companies, *NGCP* and *PEMC* not to collect from *MERALCO*. As at September 30, 2016, the SC has yet to resolve the various petitions filed against *MERALCO*, *ERC*, and *DOE*.

7. ERC Investigating Unit (“IU”) Complaint

On December 26, 2013, the *ERC* constituted the *IU* under its Competition Rules to investigate possible anti-competitive behavior by the industry players and possible collusion that transpired in the *WESM* during the supply months of November 2013 and December 2013. *MERALCO* participated in the proceedings and submitted a Memorandum.

An investigating officer of the *IU* filed a Complaint dated May 9, 2015 against *MERALCO* and *TMO* for alleged anti-competitive behavior constituting economic withholding in violation of Section 45 of the *EPIRA* and Rule 11, Section 1 and 8(e) of the *EPIRA IRR*. In an Order dated June 15, 2015 the *ERC* directed *MERALCO* to file its comment on the Complaint. *MERALCO* and *TMO* have filed their respective answers to the Complaint.

In an Order dated September 1, 2015, the *ERC* directed the investigating officer to file his reply to *MERALCO*. In a Manifestation and Motion to set the case for hearing dated November 9, 2015, the investigating officer manifested that he would no longer file a reply and that the case be set for hearing.

On May 24, 2016, the *ERC* promulgated Resolution No. 14, Series of 2016, which resolved to divide the Commission into two core groups for the conduct of hearings and to designate the commissioners to act as presiding officers in anti-competition cases. The raffle pursuant to said Resolution was conducted on June 15, 2016.

In a Notice of Pre-Trial Conference dated June 16, 2016, the *ERC* set the pre-trial conference on August 18, 2016 and required *MERALCO* and *TMO* to submit their respective pre-trial briefs. However, on July 27, 2016, the complainant filed two (2) omnibus motions for the consolidation and deferment of the pre-trial conferences. Hence, in an Order dated August 1, 2015, the respondents were given ten days to submit their comments on the motion for consolidation with the complainant given five (5) days to file his reply. As such, the pre-trial conferences as scheduled were deferred until further notice and all parties were granted a period of 20 days to submit their respective pre-trial briefs.

In the meantime, *MERALCO* likewise filed an Urgent Motion to Dismiss with Motion to Suspend Proceedings which was adopted by *TMO* in its Manifestation and Motion filed on July 28, 2016.

On August 23, 2016, *MERALCO* filed an Urgent Motion Ad Cautelam for suspension of proceeding including period to file pre-trial brief and judicial affidavit.

In a Motion dated August 25, 2016, complainant filed a Motion to defer the submission of the Complainant’s pre-trial brief and judicial affidavit.

8. *SPPC* vs. *PSALM*

SPPC and *PSALM* are parties to an Independent Power Producer Administration (“*IPPA*”) Agreement covering the Ilijan Power Plant. On the other hand, *MERALCO* and *SPPC* have a *PSA* covering the sale of electricity from the Ilijan Power Plant to *MERALCO*. In a letter dated September 8, 2015, *SPPC* informed *MERALCO* that due to an ongoing dispute with *PSALM* arising from difference in interpretation of the provisions of the *IPPA* Agreement, the latter terminated said Agreement. *SPPC* filed a complaint with *RTC-Mandaluyong* to nullify the termination notice for lack of factual and legal basis. On said date, the Executive of Judge of *RTC Mandaluyong* issued a 72-hour *TRO*. In an Order dated September 11, 2015, the *RTC Mandaluyong* Branch 208 extended the *TRO* by an additional 17 days. In an Order dated September 28, 2015, the *RTC* granted the prayer for preliminary injunction. *PSALM* has filed an *MR* to question the Orders.

MERALCO filed a Motion for Leave to Intervene with Motion to Admit Attached Complaint-in-Intervention. In an Order dated October 19, 2015, the *RTC Mandaluyong* allowed *MERALCO*’s intervention in the proceedings and admitted its Complaint-in-Intervention. *PSALM* filed a Motion for Reconsideration dated November 6, 2015 of the Order admitting *MERALCO*’s intervention.

(v) Any significant elements of income or loss that did not arise from the registrant’s continuing operations.

None

(vi) Any seasonal aspects that had a material effect on the financial condition or results of operations.

Seasonality of Operations and Growth Drivers

Approximately 96% of *MERALCO Group's* operating revenues pertain to sale of electricity distributed by *MERALCO* and *CEDC*.

The electricity sales of *MERALCO* and *CEDC* exhibit a degree of quarterly seasonality. The *kWh* sales in the first quarter is lower than the average of the year as this period is characterized by cooler temperature and softer consumer demand following heightened consumer spending in the last quarter of the year. The second quarter is marked by higher than average *kWh* sales. This is due to a number of factors, including: increased consumption of households and commercial establishments due the summer season; increased production of industries to replenish stocks and in preparation for the opening of classes; and, heightened construction activity to take advantage of the sunny weather. In the third quarter of the year, manufacturing industries that cater to the export market have their peak production schedule at this time as they rush to meet shipping deadlines to foreign markets. Industries catering to the domestic market are also now starting production in preparation for the Christmas season. Lastly, the fourth quarter performance is about the average of the year. Industrial production winds down while households and commercial establishments also cut down on their cooling loads. Given this perspective on the seasonality of *kWh* sales, a higher proportion of the *MERALCO's* and *CEDC's* revenues are earned on the second half of the year.

Aside from the quarterly seasonal pattern, *kWh* sales on a year-on-year basis adjust as a result of a number of factors. Sales of electricity normally increase in periods of economic growth, low inflation and electricity rates, and in periods of high temperatures over extended period of time, e.g. the “*El Niño*” episodes.

The following table sets forth *MERALCO Group's* quarterly sales in *GWh*.

Period	2016
First Quarter	9,077
Second Quarter	10,640
Third Quarter	10,386
Fourth Quarter	-
Total	30,103

The businesses of all other subsidiaries are not highly seasonal.

(i) Any known trends, demands, commitments, events or uncertainties that will have a material impact of the issuer's liquidity.

The Management is not aware of any known trends, demands, commitments, events or uncertainties that may deem potentially have a material impact on *MERALCO Group's* liquidity as at September 30, 2016.

(ii) Discussion of *MERALCO's* and its majority-owned subsidiaries top five (5) key performance indicators. It shall include a discussion of the manner by which *MERALCO* calculates or identifies the indicators presented on a comparable basis.

Listed hereunder are *MERALCO's* five major subsidiaries namely *CEDC*, *Mgen*, *MIESCOR*, *e-MVI* and *CIS*. The following table summarizes their key financial performance and indicators as at and for the nine months ended September 30, 2016 and 2015.

Financial Highlights and Ratios¹¹ of Major Subsidiaries
As at and for the Nine Months Ended September 30, 2016 and 2015
(Amounts in million pesos except for financial ratios and % change)

	<i>CEDC</i>			<i>MGen</i>			<i>MIESCOR</i>			<i>e-MVI</i>			<i>CIS</i>		
	2016	2015	% change	2016	2015	% change	2016	2015	% change	2016	2015	% change	2016	2015	% change
Percentage of ownership	65%	65%		100%	100%		99%	99%		100%	100%		100%	100%	
Condensed Statements of Financial Position															
Total assets	2,098	1,769	19	18,979	19,248	(1)	3,936	4,830	(19)	1,721	1,349	28	1,530	1,316	13
Current assets	1,329	1,050	27	8,002	6,012	33	3,057	4,186	(27)	629	393	60	1,415	1,295	9
Cash and cash equivalents	864	654	32	2,375	475	400	583	604	(3)	387	158	145	700	520	35
Equity	1,218	1,030	18	18,932	19,213	(1)	1,242	1,080	15	1,377	1,089	26	822	663	24
Total debt ¹²	-	-	-	-	-	-	476	421	13	-	-	-	-	-	-
Current liabilities	494	431	15	12	11	9	2,434	3,483	(30)	292	223	31	676	682	(1)
Financial Ratios															
Debt-to-equity ratio	-	-	-	-	-	-	0.38	0.39	(2)	-	-	-	-	-	-
Current ratio	2.69	2.44	10	666.83	546.55	22	1.26	1.20	5	2.15	1.76	22	2.09	1.90	10
Condensed Statements of Income															
Revenues	2,491	2,349	6	-	-	-	2,727	3,977	(31)	653	527	24	990	875	13
Costs and expenses	2,280	2,142	6	375	267	40	2,573	3,806	(32)	341	325	5	732	644	14
Net income (loss)	203	216	(6)	(169)	(220)	(23)	144	135	7	252	126	100	179	166	8
Financial Ratios															
Profit margin	8.1%	9.2%	(11)	-	-	-	5.3%	3.4%	56	38.6%	23.9%	61	18.1%	19.0%	(5)
Return on equity	16.7%	21.0%	(21)	(0.9%)	(1.1%)	(22)	11.6%	12.5%	(7)	18.3%	11.6%	58	21.8%	25.0%	(13)
Asset turnover	1.19	1.33	(11)	-	-	-	0.69	0.82	(16)	0.38	0.39	(3)	0.65	0.64	1

¹² The manner of computing the financial ratios for subsidiaries is the same with that of MERALCO's as presented in *Financial Highlights and Key Performance Indicators*.

¹² Total Debt is composed of notes payable and interest-bearing long-term financial liabilities, current and non-current portions.

ANNEX – Aging of Trade and Other Receivables

As at September 30, 2016 (Unaudited)

(Amounts in millions)

	<u>T o t a l</u>	<u>1 - 30 days</u>	<u>31 - 60 days</u>	<u>61 - 90</u> <u>days</u>	<u>Over</u> <u>90 days</u>
Trade receivables					
A) Billed trade receivables					
Residential	₱9,269	₱6,103	₱488	₱167	₱2,510
Commercial	7,346	5,892	205	63	1,186
Industrial	3,033	2,633	20	6	373
Flat Streetlights	280	114	16	4	146
Total billed trade receivables	19,928	14,743	729	241	4,215
B) Unbilled trade receivables	3,779	3,779	–	–	–
Total trade receivables	23,707	18,522	729	241	4,215
Other trade receivables	3,936	1,566	117	63	2,190
Gross trade receivables	27,643	20,088	846	304	6,405
Non-trade receivables	1,415	852	150	34	379
Total receivables	29,058	20,940	996	338	6,784
Allowance for doubtful accounts	(3,509)	–	–	–	(3,509)
Net receivables	₱25,549	₱20,940	₱996	₱338	₱3,275

Manila Electric Company and Subsidiaries

Consolidated Financial Statements As at September 30, 2016 (Unaudited),
December 31, 2015 (Audited)

and For the Nine Months Ended September 30, 2016 and 2015 (Unaudited)

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	<i>Note</i>	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>			
ASSETS			
Noncurrent Assets			
Utility plant and others	7, 10 and 15	₱126,826	₱124,913
Investments in associates and interests in joint ventures	8 and 23	12,290	13,603
Investment properties	9 and 15	1,514	1,538
Deferred tax assets - net	28	13,150	11,296
Other noncurrent assets	2, 7, 10, 12, 27, 29 and 30	55,049	35,594
Total Noncurrent Assets		208,829	186,944
Current Assets			
Cash and cash equivalents	11 and 27	36,581	50,840
Trade and other receivables	10, 12, 18 and 27	25,549	26,761
Inventories	13 and 25	2,838	2,273
Other current assets	10, 14, 23 and 27	12,775	15,421
Total Current Assets		77,743	95,295
Total Assets		₱286,572	₱282,239

EQUITY AND LIABILITIES

Equity Attributable to Equity Holders of the Parent			
Common stock	15	11,273	11,273
Additional paid-in capital		4,111	4,111
Excess of acquisition cost over carrying value of non-controlling interest acquired		(328)	(328)
Employee stock purchase plan	16	1,049	1,049
Unrealized fair value gains on available-for-sale (AFS) financial assets	10	783	102
Cumulative translation adjustments of subsidiaries and associates	8	487	(72)
Share in remeasurement adjustments on associates' retirement liabilities	8	(12)	(12)
Remeasurement adjustments on retirement and other post-employment liabilities	26	918	935
Treasury shares	15	(11)	(11)
Retained earnings:	15		
Appropriated		—	11,000
Unappropriated		50,637	52,229
Equity Attributable to Equity Holders of the Parent		68,907	80,276
Non-controlling Interests		736	585
Total Equity		69,643	80,861

(Forward)

		September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	Note		
(Amounts in millions)			
Noncurrent Liabilities			
Interest-bearing long-term financial liabilities - net of current portion	17, 25 and 27	₱27,004	₱27,370
Customers' deposits - net of current portion	18, 22 and 27	23,772	23,584
Long-term employee benefits	26	4,617	3,620
Provisions	19, 22 and 29	20,430	21,014
Refundable service extension costs - net of current portion	22 and 27	4,784	4,234
Deferred tax liabilities - net	28	19	17
Other noncurrent liabilities	2, 5, 7, 24 and 29	37,788	28,324
Total Noncurrent Liabilities		118,414	108,163
Current Liabilities			
Notes payable	21, 25 and 27	11,236	1,043
Trade payables and other current liabilities	15, 17, 18, 19, 22, 23, 24, 27 and 29	77,779	79,557
Customers' refund	2, 20 and 27	5,078	5,550
Income tax payable		2,548	1,883
Current portion of long-term employee benefits	26	—	3,287
Current portion of interest-bearing long-term financial liabilities	17, 25 and 27	1,874	1,895
Total Current Liabilities		98,515	93,215
Total Liabilities		216,929	201,378
Total Liabilities and Equity		₱286,572	₱282,239

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF INCOME

		Unaudited			
		For the Nine Months Ended September 30		For the Three Months Ended September 30	
	Note	2016	2015	2016	2015
<i>(Amounts in millions, except per share data)</i>					
REVENUES					
Sale of electricity	23, 24, 30 and 32	₱189,135	₱191,496	₱64,366	₱61,207
Sale of other services	9 and 23	6,029	5,551	1,994	1,832
		195,164	197,047	66,360	63,039
COSTS AND EXPENSES					
Purchased power	24 and 30	144,423	147,537	48,985	46,972
Salaries, wages and employee benefits	25 and 26	9,393	9,343	3,101	3,161
Provision for probable losses and expenses from claims	19, 24 and 29	6,894	5,562	3,289	3,129
Depreciation and amortization	7, 9 and 10	5,206	5,035	1,740	1,792
Contracted services		4,067	3,464	1,430	1,011
Taxes, fees and permits		733	438	242	110
Provision for doubtful accounts - net	12	199	501	(23)	179
Other expenses	23 and 25	4,026	3,465	1,338	1,201
		174,941	175,345	60,102	57,555
OTHER INCOME (EXPENSES)					
Interest and other financial income	2 and 25	1,528	1,069	558	297
	7, 17, 18, 21 and 25	(984)	(904)	(369)	(302)
Interest and other financial charges		477	801	424	641
Foreign exchange gains					
Equity in net losses of associates and joint ventures	8	(133)	(144)	(158)	(94)
Others	2, 23 and 30	880	430	267	198
		1,768	1,252	722	740
INCOME BEFORE INCOME TAX		21,991	22,954	6,980	6,224
PROVISION FOR (BENEFIT FROM) INCOME TAX					
	28				
Current		8,008	8,859	2,972	2,903
Deferred		(1,837)	(2,121)	(937)	(1,105)
		6,171	6,738	2,035	1,798
NET INCOME		₱15,820	₱16,216	₱4,945	₱4,426
Attributable To					
Equity holders of the Parent	31	₱15,676	₱16,149	₱4,908	₱4,402
Non-controlling interests		144	67	37	24
		₱15,820	₱16,216	₱4,945	₱4,426
Earnings Per Share Attributable to Equity Holders of the Parent					
	31				
Basic		₱13.91	₱14.33	₱4.35	₱3.91
Diluted		13.91	14.33	4.35	3.91

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF
COMPREHENSIVE INCOME

		Unaudited			
		For the Nine Months Ended September 30		For the Three Months Ended September 30	
	Note	2016	2015	2016	2015
(Amounts in millions)					
NET INCOME		₱15,820	₱16,216	₱4,945	₱4,426
OTHER COMPREHENSIVE INCOME (LOSS)					
Items that will be reclassified to profit or loss in subsequent period:					
Unrealized fair value gain on available-for-sale financial assets	10	757	83	(136)	77
Income tax effect		(76)	(1)	13	—
		681	82	(123)	77
Cumulative translation adjustments of subsidiaries and associates	8	559	235	99	137
Items that will not be reclassified to profit or loss in subsequent period:					
Remeasurement adjustments on retirement and other post-employment liabilities	26	(24)	(3)	—	—
Income tax effect		7	1	—	—
		(17)	(2)	—	—
OTHER COMPREHENSIVE LOSS, NET OF INCOME TAX		1,223	315	(24)	214
TOTAL COMPREHENSIVE INCOME, NET OF INCOME TAX		₱17,043	₱16,531	₱4,921	₱4,640
Total Comprehensive Income Attributable To					
Equity holders of the Parent		₱16,899	₱16,464	₱4,884	₱4,616
Non-controlling interests		144	67	37	24
		₱17,043	₱16,531	₱4,921	₱4,640

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

Equity Attributable to Equity Holders of the Parent														
										Remeasure-ment				
										Unrealized Fair Value Gains on AFS Financial Assets (Note 10)	Share in Remeasure-ment Adjustments of Associates' Retirement Liabilities (Note 8)	Cumulative Translation Adjustments of Subsidiaries and Associates (Note 8)	Adjustments on Retirement and Other Post-Employment Liabilities (Note 26)	Treasury Shares (Note 15)
Common Stock (Note 15)	Subscription Receivable	Additional Paid-in Capital	Excess of Acquisition Cost Over Carrying Value of Non-controlling Interest Acquired	Employee Stock Purchase Plan (Note 16)	Unrealized Fair Value Gains on AFS Financial Assets (Note 10)	Share in Remeasure-ment Adjustments of Associates' Retirement Liabilities (Note 8)	Cumulative Translation Adjustments of Subsidiaries and Associates (Note 8)	Adjustments on Retirement and Other Post-Employment Liabilities (Note 26)	Treasury Shares (Note 15)	Appropriated Retained Earnings (Note 15)	Unappropriated Retained Earnings (Note 15)	Equity Attributable to Equity Holders of the Parent	Non-controlling Interests (Note 6)	Total Equity
(Amounts in millions)														
At January 1, 2016	₱-	₱4,111	(₱328)	₱1,049	₱102	(₱12)	(₱72)	₱935	(₱11)	₱11,000	₱52,229	₱80,276	₱585	₱80,861
Net income	-	-	-	-	-	-	-	-	-	-	15,676	15,676	144	15,820
Other comprehensive income (loss)	-	-	-	-	681	-	559	(17)	-	-	-	1,223	-	1,223
Total comprehensive income (loss)	-	-	-	-	681	-	559	(17)	-	-	15,676	16,899	144	17,043
Dividends	-	-	-	-	-	-	-	-	-	-	(28,268)	(28,268)	7	(28,261)
Reversal of appropriation	-	-	-	-	-	-	-	-	-	(11,000)	11,000	-	-	-
At September 30, 2016	₱-	₱4,111	(₱328)	₱1,049	₱783	(₱12)	₱487	₱918	(₱11)	₱-	₱50,637	₱68,907	₱736	₱69,643
At January 1, 2015	(₱8)	₱4,111	(₱328)	₱1,049	₱112	(₱20)	₱355	₱1,302	(₱11)	₱11,000	₱50,319	₱79,154	₱320	₱79,474
Net income	-	-	-	-	-	-	-	-	-	-	16,149	16,149	67	16,216
Other comprehensive income (loss)	-	-	-	-	82	-	235	(2)	-	-	-	315	-	315
Total comprehensive income (loss)	-	-	-	-	82	-	235	(2)	-	-	16,149	16,464	67	16,531
Collection of subscriptions receivable	-	8	-	-	-	-	-	-	-	-	-	8	-	8
Dividends	-	-	-	-	-	-	-	-	-	-	(17,188)	(17,188)	175	(17,013)
At September 30, 2015	₱-	₱4,111	(₱328)	₱1,049	₱194	(₱20)	₱590	₱1,300	(₱11)	₱11,000	₱49,280	₱78,438	₱562	₱79,000
See accompanying Notes to Unaudited Interim Consolidated Financial Statements.														

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
UNAUDITED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

		Unaudited	
		For the Nine Months Ended	
		September 30	
	<i>Note</i>	2016	2015
<i>(Amounts in millions)</i>			
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax		₱21,991	₱22,954
Adjustments for:			
Depreciation and amortization	<i>7, 9 and 10</i>	5,206	5,035
Provision for probable losses and expenses			
from claims - net	<i>19, 24 and 29</i>	6,793	5,562
Interest and other financial income	<i>25</i>	(1,528)	(1,069)
Interest and other financial charges	<i>25</i>	984	904
Provision for doubtful accounts	<i>12</i>	199	501
Equity in net losses of associates and joint ventures	<i>8</i>	133	144
Others		(221)	(256)
Operating income before working capital changes		35,557	33,775
Decrease (increase) in:			
Trade and other receivables		186	2,262
Inventories		(565)	(388)
Other current assets		669	(3,468)
Increase (decrease) in:			
Trade payables and other current liabilities		(2,589)	(94)
Customers' refund		(472)	(366)
Customers' deposits		2,979	3,439
Long-term employee benefits		(2,319)	1,027
Cash generated from operations		31,446	36,187
Income tax paid		(5,352)	(4,979)
Net cash provided by operating activities		26,094	31,208
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to:			
Available-for-sale investments	<i>10</i>	(13,522)	(11,497)
Utility plant and others	<i>7</i>	(7,397)	(7,298)
Held-to-maturity investments	<i>10</i>	(6,694)	(19,147)
Investments in associates and interests			
in joint ventures	<i>8 and 14</i>	(1,402)	—
Intangible assets	<i>10</i>	(112)	(484)
Investment properties		—	(2)
Proceeds from disposal of interest in an associate		3,151	—
Interest and other financial income received		822	585
Increase in minority interest due to acquisition of a subsidiary		7	175
Proceeds from disposal of utility plant and others		354	142
Dividends received from associates		82	23
Decrease (increase) in other noncurrent assets		396	(858)
Return on capital		—	31
Net cash used in investing activities		(24,315)	(38,330)

(Forward)

Unaudited			
For the Nine Months Ended			
September 30			
	<i>Note</i>	2016	2015
<i>(Amounts in millions)</i>			
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from availment of notes payable	21	₱10,222	₱526
Collection of subscriptions receivable		–	8
Payments of:			
Dividends	15	(28,110)	(17,090)
Interest and other financial charges		(951)	(950)
Interest-bearing long-term financial liabilities		(405)	(391)
Notes payable	21	(29)	(286)
Increase in other noncurrent liabilities		3,235	757
Net cash used in financing activities		(16,038)	(17,426)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(14,259)	(24,548)
CASH AND CASH EQUIVALENTS			
AT BEGINNING OF PERIOD		50,840	69,469
CASH AND CASH EQUIVALENTS			
AT END OF PERIOD	11	₱36,581	₱44,921

See accompanying Notes to Unaudited Interim Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Corporate Information

Manila Electric Company (“*MERALCO*”) holds a congressional franchise under Republic Act (“*RA*”) No. 9209 effective June 28, 2003. *RA* No. 9209 grants *MERALCO* a 25-year franchise valid through June 28, 2028 to construct, operate, and maintain the electric distribution system in the cities and municipalities of Bulacan, Cavite, Metro Manila, and Rizal and certain cities, municipalities and barangays in the provinces of Batangas, Laguna, Pampanga, and Quezon. On October 20, 2008, the Energy Regulatory Commission (“*ERC*”) granted *MERALCO* a consolidated Certificate of Public Convenience and Necessity for the operation of electric service within its franchise coverage, effective until the expiration of *MERALCO*’s congressional franchise. *MERALCO*’s participation in retail electricity supply (“*RES*”) is through its local *RES* unit, *MPower*.

The power segment, primarily power distribution, consists of operations of *MERALCO* and its subsidiary, Clark Electric Distribution Corporation (“*CEDC*”). *CEDC* is a registered private distribution utility granted by Clark Development Corporation (“*CDC*”) a franchise to own, operate and maintain a power distribution system and to distribute power exclusively within its franchise area, which includes the Clark Freeport Zone and the sub-zone as determined pursuant to Presidential Decree No. 66 and the Joint Venture Agreement executed between *CDC* and Meralco Industrial Engineering Services Corporation (“*MIESCOR*”) dated February 19, 1997.

MERALCO has a minority equity interest in a power generating company, Global Business Power Corporation (“*GBPC*”). Separately, it is developing power generation plants through its wholly owned subsidiary, Meralco PowerGen Corporation (“*MGen*”). Through several subsidiaries in the services segment, *MERALCO* provides engineering, design, construction and consulting services, bill collection services, distribution and energy management services, and communications, information systems and technology services.

MERALCO manages electric distribution facilities of Pampanga Electric Cooperative II (“*PELCO II*”) through Comstech Integration Alliance, Inc. (“*Comstech*”) under an Investment Management Agreement (“*IMC*”). *MERALCO* also manages electric distribution facilities in the Cavite Economic Zone (“*CEZ*”) under a 25-year concession agreement with Philippine Economic Zone Authority (“*PEZA*”).

MERALCO is owned directly by two (2) major stockholder groups, Beacon Electric Asset Holdings, Inc. (“*Beacon Electric*”) and JG Summit Holdings, Inc. (“*JG Summit*”). *Beacon Electric* is a joint venture between Metro Pacific Investments Corporation (“*Metro Pacific*”) and *PLDT* Communications and Energy Ventures Inc. *Metro Pacific*, First Philippine Holdings Corporation (“*First Holdings*”) and First Philippine Utilities Corporation, also have direct equity ownership in *MERALCO*. The balance of *MERALCO*’s common shares is held by institutional investors and the public.

The common shares of *MERALCO* are listed on and traded in the Philippine Stock Exchange (“*PSE*”) with ticker symbol, *MER*.

The registered office address of *MERALCO* is Lopez Building, Ortigas Avenue, Barangay Ugong, Pasig City, Metro Manila, Philippines.

2. Rate Regulations

As distribution utilities (“DUs”), *MERALCO* and *CEDC* are subject to the rate-making regulations and regulatory policies of the *ERC*. Billings of *MERALCO* and *CEDC* to customers are itemized or “unbundled” into a number of bill components that reflect the various activities and costs incurred in providing electric service. The adjustment to each bill component is governed by mechanisms promulgated and enforced by the *ERC*, mainly: [i] the “Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities”, which govern the recovery of pass-through costs, including over- or under-recoveries of the bill components, namely, (a) generation charge, (b) transmission charge, (c) system loss (“*SL*”) charge, (d) lifeline and inter-class rate subsidies, and (e) local business taxes, such as, franchise tax (“*LFT*”); and [ii] the “Rules for the Setting of Distribution Wheeling Rates” (“*RDWR*”), as modified by the *ERC* on December 1, 2009, which govern the determination of *MERALCO*’s distribution, supply, and metering charges.

The rate-setting mechanism of *CEDC* is likewise in accordance with the *ERC* regulations. The following is a discussion of matters related to rate-setting of *MERALCO* and *CEDC*:

Performance-Based Regulations (“PBR”)

MERALCO

MERALCO is among the Group A entrants to the *PBR*, together with two other private *DUs*.

Rate-setting under *PBR* is governed by the *RDWR*. The *PBR* scheme sets tariffs once every Regulatory Period (“*RP*”) based on the regulated asset base of the *DUs*, and the required operating and capital expenditures to meet operational performance and service level requirements responsive to the needs for adequate, reliable and quality power, efficient service, and growth of all customer classes in the franchise area as approved by the *ERC*. *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

Rate filings and settings are done on a *RP* basis. One (1) *RP* consists of four (4) Regulatory Years (“*RYs*”). An *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. The fourth (“4th”) *RP* for Group “A” *DUs* began on July 1, 2015 and shall end on June 30, 2019.

Maximum Average Price (“MAP”) for RY 2008 and RY 2009

On May 28, 2009, certain electricity consumer groups filed a Petition with the Court of Appeals, (“*CA*”), questioning the decision and Order of the *ERC* on *MERALCO*’s rate translation application for *RY* 2008 and *RY* 2009. On January 29, 2010, the *CA* promulgated a decision denying the Petition. Consequently, the consumer groups brought the case to the Supreme Court (“*SC*”). Comments, responses and respective manifestations have been filed by both parties. In a decision dated October 10, 2016, the *SC* denied the petition filed by the consumer groups.

MAP for RY 2012

On June 21, 2011, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2012 and translation into rate tariffs by customer category. In an order dated October 3, 2011, the *ERC* provisionally approved the *MAP* for *RY* 2012 of ₱1.6012 per kilowatt hour (“*kWh*”) and the rate translation per customer class was implemented starting October 2011. Hearings for the final approval of the application have been completed and all parties have submitted their respective memoranda. As at September 30, 2016, the application is pending final approval by the *ERC*.

MAP for RY 2013

On March 30, 2012, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2013 and the translation thereof into rate tariffs by customer category. On June 11, 2012, the *ERC* provisionally approved the *MAP* for *RY* 2013 of ₱1.6303 per *kWh*, which was reflected in the customer bills starting July 2012. Hearings on this case have been completed. As at September 30, 2016, the application is pending final approval by the *ERC*.

MAP for RY 2014

On April 1, 2013, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2014 of ₱1.6510 per *kWh* and the translation thereof into rate tariffs by customer category. On June 10, 2013, the *ERC* provisionally approved the *MAP* for *RY* 2014 of ₱1.6474 per *kWh* and the rate translation per customer class. As at September 30, 2016, the application is pending final approval by the *ERC*.

MAP for RY 2015

On March 31, 2014, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the translation thereof into rate tariffs by customer category. On May 5, 2014, the *ERC* provisionally approved *MERALCO*'s *MAP* for *RY* 2015 of ₱1.5562 per *kWh* and the rate translation per customer class. As at September 30, 2016, the application is pending final approval by the *ERC*.

4th RP Reset Application

The last year of *MERALCO*'s 3rd *RP* ended on June 30, 2015. The 4th *RP* for Group "A" entrants commenced on July 1, 2015 and shall end on June 30, 2019. To initiate the reset process, the *ERC* posted in its website on April 12, 2016, the following draft issuance for comments, to wit:

- a. Draft "Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Operating under Performance Based Regulation, First Entry Group: Fourth Regulatory Period;
- b. Draft "Position Paper: Regulatory Reset for the July 1, 2015 to June 30, 2019 Fourth Regulatory Period for the First Entry Group of Privately Owned Distribution Utilities subject to Performance Based Regulation"; and
- c. Draft "Commission Resolution on the Issues on the Implementation of *PBR* for Privately Owned *DUs* under the *RDWR*".

The deadline for submission of comments is on May 13, 2016. However, due to the various issues to be responded to, on May 6, 2016, *MERALCO* filed a letter requesting that the period for the submission of comments be extended until July 12, 2016. Moreover, it is further requested that public consultations and focus group discussions be conducted so that all issues raised in the draft issuances be discussed by all stakeholders. *MERALCO* has submitted its comments to the draft issuances and is awaiting the final rules of the *ERC*.

Interim Average Rate for RY 2016

On June 11, 2015, *MERALCO* filed its application for the approval of its proposed Interim Average Rate of ₱1.3939 per *kWh* and translation thereof into rate tariffs by customer category. On July 10, 2015, the *ERC* provisionally approved an Interim Average Rate of ₱1.3810 per *kWh* and the rate translation per customer class, which was reflected in the customer bills starting July 2015. On January 7, 2016, *MERALCO* presented its first witness with the *ERC*. On August 12, 2016, *MERALCO* presented its evidence. The next hearing for the continuation of *MERALCO*'s presentation of its evidence is scheduled on November 9, 2016.

Capital Expenditures ("CAPEX") for RY 2016

Absent the release by the *ERC* of the final rules to govern the filing of its 4th *RP* Reset Application, and in anticipation of the network system requirements and possible effect of severe weather conditions after June 30, 2015, *MERALCO* filed on February 9, 2015 an application for approval of authority to implement its *CAPEX* program for RY 2016 (July 1, 2015 to June 30, 2016) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as the Public Service Act. On June 15, 2016, *MERALCO* received a copy of the *ERC* Decision dated April 12, 2016 which partially approved *MERALCO*'s *CAPEX* program for RY 2016 amounting to ₱15.5 billion, subject to certain conditions. An intervenor has filed a Motion for Reconsideration of the Decision which is pending before the *ERC*. On July 25, 2016, *MERALCO* has filed its opposition to the motion for consideration.

CAPEX for RY 2017

On March 8, 2016, *MERALCO* filed an application for approval of authority to implement its *CAPEX* program for RY 2017 (July 1, 2016 to June 30, 2017) pursuant to Section 20(b) of Commonwealth Act No. 146, as amended, otherwise known as the Public Service Act. Hearings have been completed and *MERALCO* is awaiting the final decision of the *ERC*. On July 26 2016, *MERALCO* received the Order dated May 5, 2016, granting *MERALCO* provisional authority to implement the nine (9) major projects and 37 residual projects, subject to certain conditions.

CEDC

CEDC is among the four (4) Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. The first *RP* of *CEDC* began on October 1, 2011 and ended on September 30, 2015. *CEDC* is to undergo the reset process and is awaiting the release by the *ERC* of the final rules to govern the filing of its 2nd *RP* reset application.

SC Decision on Unbundling Rate Case

On May 30, 2003, the *ERC* issued an Order approving *MERALCO*'s unbundled tariffs that resulted in a total increase of ₱0.17 per *kWh* over the May 2003 tariff levels. However, on August 4, 2003, *MERALCO* received a Petition for Review of the *ERC*'s ruling filed by certain consumer and civil society groups before the *CA*. On July 22, 2004, the *CA* set aside the *ERC*'s ruling on *MERALCO*'s rate unbundling and remanded the case to the *ERC*. Further, the *CA* opined that the *ERC* should have asked the Commission on Audit ("*COA*") to audit the books of *MERALCO*. The *ERC* and *MERALCO* subsequently filed separate motions asking the *CA* to reconsider its decision. As a result of the denial by the *CA* of the motions on January 24, 2005, the *ERC* and *MERALCO* elevated the case to the *SC*.

In an En Banc decision promulgated on December 6, 2006, the SC set aside and reversed the CA ruling saying that a COA audit was not a prerequisite in the determination of a utility's rates. However, while the SC affirmed ERC's authority in rate-fixing, the SC directed the ERC to request COA's assistance to undertake a complete audit of the books, records and accounts of MERALCO. In compliance with the directive of the SC, the ERC requested COA to conduct an audit of the books, records and accounts of MERALCO using calendar years 2004 and 2007 as test years.

The COA audit, which began in September 2008, was completed with the submission to the ERC of its report on November 12, 2009.

On February 15, 2010, the ERC issued its Order directing MERALCO and all intervenors in the case to submit, within 15 days from receipt of the Order, their respective comments on the COA's report.

On June 21, 2011, the ERC maintained and affirmed its findings and conclusions in its Order dated March 20, 2003. The ERC stated that the COA recommendation to apply disallowances under PBR to rate unbundling violates the principle against retroactive rate-making. An intervenor group filed a Motion for Reconsideration ("MR") of the said Order. On September 5, 2011, MERALCO filed its comment on the intervenor's MR. On February 4, 2013, the ERC denied the intervenor's MR. The intervenor filed a Petition for Review before the CA and MERALCO filed its comment thereon on May 29, 2014. In compliance with the CA's directive, MERALCO filed its Memorandum in August 2015. In a Resolution dated September 29, 2015, the CA acknowledged receipt of the respective Memoranda from parties and declared the case submitted for decision. In a Decision dated February 29, 2016, the CA dismissed the Petition for Review and affirmed the orders dated June 21, 2011 and February 4, 2013 of the ERC.

On March 22, 2016, the intervenors filed a Motion for Reconsideration of the CA Decision dated February 29, 2016. The same was denied by the CA through a Resolution dated August 8, 2016.

On October 11, 2016, MERALCO received a Petition for Review on Certiorari filed by the intervenors before the SC appealing the dismissal of its Petition

MERALCO is awaiting further action of the SC on the Petition.

*Applications for the Confirmation of Over/Under-recoveries of
Pass-through Charges*

On July 13, 2009, the ERC issued Resolution No. 16, Series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities." These rules govern the recovery of pass-through costs, including under- or over-recoveries with respect to the following bill components: generation charge, transmission charge, SL charge, lifeline and inter-class rate subsidies, LFT and business tax. On October 18, 2010, the ERC promulgated ERC Resolution No. 21, Series of 2010, amending the SL true-up formula contained in Resolution No. 16, Series of 2009, and setting March 31, 2011 (covering adjustments implemented until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) as the new deadlines for DUs in Luzon to file their respective applications. Subsequent filings shall be made every three (3) years thereafter. On December 15, 2010, the ERC promulgated Resolution No. 23, Series of 2010 to govern the recovery of Senior Citizen Discounts and specified that post-verification shall coincide with the timeframes in Resolution No. 16, Series of 2009, as amended by Resolution No. 21, Series of 2010.

On March 31, 2011, *MERALCO* filed its application with the *ERC* to confirm its under- or over-recoveries accumulated from June 2003 to December 2010 in compliance with Resolution No. 16, Series of 2009, as subsequently amended by Resolution No. 21, Series of 2010. On December 8, 2011, *MERALCO* filed a Manifestation with Omnibus Motion praying, among other things, for the admission of the Supplemental Application, which was admitted by the *ERC* in an Order dated December 12, 2011. The filing includes net generation charge under-recoveries of ₱1,000 million, net transmission charge over-recoveries of ₱111 million, net lifeline subsidy under-recoveries of ₱9 million and net *SL* over-recoveries of ₱425 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*'s application for the confirmation of its over- or under-recoveries in its pass-through costs for the period June 2003 to December 2010. The Decision directed *MERALCO* to collect net under-recoveries of ₱909 million, without any carrying charges, starting the next billing cycle until such time that the full amount has been collected. As at September 30, 2016, a total of ₱141 million has been billed to the customers.

On July 6, 2012, *MERALCO* filed its application with the *ERC* to confirm its under- or over-recoveries for the calendar year 2011. The filing includes net generation charge under-recoveries of ₱1,826 million, net transmission charge under-recoveries of ₱253 million, net lifeline subsidy under-recoveries of ₱39 million and *SL* over-recoveries of ₱445 million, excluding proposed carrying charges. On June 1, 2015, the *ERC* approved with modification *MERALCO*'s application for the confirmation of its over- or under-recoveries in its pass-through costs for the period January to December 2011. The Decision directed *MERALCO* to collect net under-recoveries of ₱1,535 million, without any carrying charges, starting the next billing cycle until such time that the full amount has been collected. As at September 30, 2016, a total of ₱1,015 million has been billed to the customers.

On March 31, 2014, *MERALCO* filed its application with the *ERC* to confirm its under- or over-recoveries of net generation charge under-recoveries of ₱559 million, transmission charge over-recoveries of ₱639 million, net lifeline subsidy over-recoveries of ₱75 million, *SL* over-recoveries of ₱502 million from January 2012 to October 2013, and net senior citizen discount over-recoveries of ₱0.4 million from February 2011 to October 2013, excluding proposed carrying charges. Under- or over-recoveries from November and December 2013 supply months were excluded in the meantime, in view of the pending *SC* and *ERC* cases involving pass-through costs for these months. Hearings are ongoing and the next scheduled hearing is on November 21, 2016.

On January 29, 2016, *MERALCO* filed its application to confirm its under-recoveries of generation charge of 250.7 million, excluding carrying charge, covering the period March 2007 to December 2011. As at September 30, 2016, *MERALCO* is still waiting for the approval of *ERC*.

Application for the Recovery of Differential Generation Costs

On February 17, 2014, *MERALCO* filed for the recovery of the unbilled generation cost for December 2013 supply month amounting to ₱11,075 million. An amended application was filed on March 25, 2014 to adjust the unbilled generation cost for recovery to ₱1,310 million, following the receipt of Wholesale Electricity Spot Market ("*WESM*") billing adjustments based on regulated Luzon *WESM* prices. The first hearing was conducted on May 26, 2014. The *ERC* suspended the proceedings, pending resolution of issues of related cases by the *SC* involving generation costs for the November and December 2013 supply months and the regulated *WESM* prices for the said period.

2nd Generation Rate Adjustment Mechanism ("2nd GRAM")

The *ERC*'s approval of *MERALCO*'s 2nd *GRAM* filing was questioned before the *SC*, for failure by *MERALCO* and the *ERC* to comply with Section 4 (e) Rule 3 of Electric Power Industry Reform Act ("*EPIRA*") Implementing Rules and Regulations ("*IRR*"), which required publication, notice, and hearing of an application prior to issuance of an Order. On August 16, 2006, the *SC* ruled with finality that strict compliance with the requirements under the *IRR* of the *EPIRA* is jurisdictional and applies to any adjustment to the retail rate, including those for pass-through costs. Beginning September 2006, the Automatic Generation Rate Adjustment ("*AGRA*") was suspended and *MERALCO* could adjust generation and other pass-through charges only after the filing and approval by the *ERC* of an appropriate application.

On November 12, 2010, *MERALCO* filed its application with the *ERC* for the recovery of the total generation costs refunded under the 2nd *GRAM*, plus any additional amount that it will still refund to its customers pursuant to the *SC* Resolution dated August 16, 2006, and the corresponding carrying charges. In a Decision dated June 1, 2015, the *ERC* approved the application with modification and directed *MERALCO* to recover its generation costs incurred for the period from November 2003 to January 2004 amounting to ₱746 million, or an equivalent of ₱0.0207 per *kWh*, and carrying costs amounting to ₱198 million, or an equivalent of ₱0.0013 per *kWh*. As at September 30, 2016, a total of ₱944 million has been billed to the customers.

Deferred Purchased Price Adjustment ("Deferred PPA")

On October 12, 2009, the *ERC* released its findings on *MERALCO*'s implementation of the collection of the approved pass-through cost under-recoveries for the period June 2003 to January 2007. The *ERC* directed *MERALCO* to refund to its customers ₱268 million of deferred *PPA* transmission line costs related to Quezon Power (Philippines) Limited Company ("*QPPL*") and deferred accounting adjustments incurred along with ₱184 million in carrying charges, or an equivalent of ₱0.0169 per *kWh*. *MERALCO* implemented the refund beginning November 2009 until September 2010. However, the *ERC* has yet to rule on *MERALCO*'s deferred *PPA* under-recoveries of ₱106 million, which is not a transmission line fee. On November 4, 2009, *MERALCO* filed an *MR* with the *ERC*. As at September 30, 2016, the *MR* is still pending resolution by the *ERC*.

Application for Recovery of LFT

On March 25, 2011, *MERALCO* filed with the *ERC* its application for recovery of *LFT* paid but not yet billed to customers for the period beginning the first quarter of 1993 up to the second quarter of 2004 for five (5) provinces, namely: Bulacan, Batangas, Cavite, Laguna and Rizal; and 14 cities, namely: San Jose Del Monte, Batangas, San Pablo, Tagaytay, Lucena, Mandaluyong, Marikina, Quezon, Caloocan, Pasay, Las Piñas, Manila, Pasig and Calamba. The *LFT* is recognized as a valid and reasonable *DU* pass-through cost in the *ERC*'s unbundling decision.

In a Decision dated February 27, 2012, the *ERC* approved with modifications *MERALCO*'s application. The *ERC* approved the recovery of *LFT* amounting to ₱1,571 million plus carrying charges of ₱730 million. As directed by the *ERC*, the recovery was reflected as a separate item in the *MERALCO* billing statement to its customers beginning April 2012. As at September 30, 2016, a total of ₱2,200 million *LFT* and carrying charges have been billed to affected customers. The amount recoverable within 12 months is included in the "Trade and other receivables" account while the long-term portion is included in the "Other noncurrent assets" account.

On June 13, 2013, *MERALCO* filed an application with the *ERC* for authority to collect the new *LFT* in the City of Trece Martires, with prayer for provisional authority, beginning the date of effectivity of “*The 2012 Revenue Code of Trece Martires City*” on July 1, 2012. In its Decision dated April 28, 2014, the *ERC* approved said application, with modification, and authorized *MERALCO* to recover the new *LFT* at the rate of 82.5% of 1%, prospectively, or effective its next billing cycle. With respect to the difference between the previous and the new *LFT* rates from the time said revenue code took effect, the *ERC* stated in its Decision that the same shall be considered in a separate application to be filed by *MERALCO* in accordance with the tax recovery adjustment charges (“*TRAC*”) Formula under *ERC* Resolution No. 16 Series of 2009. On July 24, 2014, *MERALCO* filed a motion seeking the partial reconsideration of the Decision in so far as the filing of a separate application for *LFT* for the prior years is concerned. On October 29, 2014, the *ERC* released its Order dated September 24, 2014 denying *MERALCO*’s motion. In said Order, the *ERC* maintained its position that it shall consider in a separate application the difference between the previous and the new *LFT* rates from the time said revenue code took effect. On February 23, 2015, *MERALCO* paid the full amount of said *LFT* to the City Treasurer of Trece Martires.

On July 3, 2015, *MERALCO* filed the application for authority to recover the difference between the previous and new *LFT* rate for the calendar years 2012 to 2014 in the City of Trece Martires, under the *TRAC* formula with prayer for provisional authority, where it prayed for authority to collect from the customers in the City of Trece Martires the *LFT* amounting to ₱2 million for 2012 to 2014, which it has previously paid to City of Trece Martires and the corresponding carrying cost. Hearings have concluded and on September 29, 2015, *MERALCO* filed its *FOE* with Manifestation and Compliance and thereby submitted the case for resolution. In a decision dated May 10, 2016, the *ERC* approved the application with modification.

SC Decision on the ₱0.167 per kWh Refund

Following the *SC*’s final ruling that directed *MERALCO* to refund affected customers ₱0.167 per *kWh* for billings made from February 1994 to April 2003, the *ERC* approved the release of the refund in four (4) phases. On December 18, 2015, *MERALCO* filed a Motion seeking the *ERC*’s approval for the continuation of the implementation of the refund to eligible accounts or customers under Phases I to IV, three (3) years from January 1, 2016 or until December 31, 2018. In said Motion, *MERALCO* likewise manifested to the *ERC* that, in order to give eligible customers the opportunity to claim their refund, and, so as not to disrupt the *SC* Refund process, *MERALCO* shall continue implementing the refund even after the December 2015 deadline, until and unless the *ERC* directs otherwise.

See Note 20 – Customers’ Refund.

3. Basis of Preparation and Statement of Compliance

Basis of Preparation

The accompanying consolidated financial statements have been prepared on a historical cost basis, except for *MERALCO*’s utility plant and others and investment properties acquired before January 1, 2004, which are carried at deemed cost, and available-for-sale (“*AFS*”) financial assets, which are measured at fair value. *AFS* financial assets are included as part of “Other noncurrent assets” account in the consolidated statement of financial position.

All values are rounded to the nearest million peso, except when otherwise indicated.

Statement of Compliance

The consolidated financial statements of *MERALCO* and its subsidiaries have been prepared in compliance with Philippine Financial Reporting Standards (“*PFRS*”).

Basis of Consolidation

The consolidated financial statements comprise the financial statements of *MERALCO* and its directly and indirectly owned subsidiaries, collectively referred to as the *MERALCO Group*. The following table presents such subsidiaries and the respective percentage of ownership as at September 30, 2016 and December 31, 2015.

Subsidiaries	Place of Incorporation	Principal Business Activity	2016	2015		
			Percentage of Ownership			
			Direct	Indirect	Direct	Indirect
Corporate Information Solutions, Inc. (“CIS”)	Philippines	e-Transactions	100	–	100	–
CIS Bayad Center, Inc. (“Bayad Center”)	Philippines	Bills payment collection	–	100	–	100
Customer Frontline Solutions, Inc. (“CFSI”)	Philippines	Teller services	–	100	–	100
Fieldtech Specialist, Inc. (“Fieldtech”)	Philippines	Bills payment collection	–	51	–	51
Meralco Energy, Inc. (“MEI”)	Philippines	Energy systems management	100	–	100	–
eMERALCO Ventures, Inc. (“e-MVT”)	Philippines	e-Business development	100	–	100	–
Paragon Vertical Corporation	Philippines	Information technology (“IT”) and multi-media services	–	100	–	100
Radius Telecoms, Inc.	Philippines	IT and multi-media services	–	100	–	100
MGen	Philippines	Development of power generation plants	100	–	100	–
Calamba Aero Power Corporation ¹	Philippines	Power generation	–	100	–	100
Atimonan Land Ventures Development Corporation	Philippines	Real estate	–	100	–	100
Atimonan One Energy, Inc. (“AIE”) ²	Philippines	Power generation	–	100	–	100
MPG Holdings Phils., Inc.	Philippines	Holding company	–	100	–	100
MPG Asia Limited (“MPG Asia”)	British Virgin Island	Holding company	–	100	–	100
Meralco Financial Services Corporation (“Finserve”)	Philippines	Financial services provider	100	–	100	–
Republic Surety and Insurance Company, Inc. (“RSIC”)	Philippines	Insurance	100	–	100	–
Lighthouse Overseas Insurance Limited (“LOIL”)	Bermuda	Insurance	100	–	100	–
MRail, Inc. (“MRail”)	Philippines	Engineering, construction and maintenance of mass transit system	100	–	100	–
Meridian Atlantic Light Company Limited ³	Nigeria	Management of power distribution	100	–	100	–
MSpectrum, Inc. (“MSpectrum”) ⁴	Philippines	Renewable energy	100	–	–	–
MIESCOR	Philippines	Engineering, construction and consulting services	99	–	99	–
Miescor Builders Inc. (“MBI”)	Philippines	Electric transmission and distribution operation and maintenance services	–	99	–	99
Miescor Logistics Inc. (“MLI”)	Philippines	General services, manpower/maintenance	–	99	–	99
CEDC	Philippines	Power distribution	65	–	65	–
Comstech	Philippines	Management of power distribution	60	–	60	–

¹ Incorporated on February 15, 2011 and has not started commercial operations as at September 30, 2016.

² Incorporated on January 11, 2013 and has not started commercial operations as at September 30, 2016.

³ Incorporated on October 2, 2013 and has not started commercial operations as at September 30, 2016.

⁴ Incorporated on January 21, 2016.

Control is achieved when the *MERALCO Group* is exposed, or has the right, to variable returns from its involvement with the investee. Specifically, the *MERALCO Group* controls an investee if and only if the *MERALCO Group* has (a) power over the investee; (b) exposure, or rights, to variable returns from its involvement with the investee; and (c) the ability to use its power over the investee to affect its returns.

When the *MERALCO Group* has less than majority of the voting or similar rights of an investee, it considers all relevant facts and circumstances in assessing whether it has power over an investee, including (a) the contractual arrangement with the other vote holders of the investee;

(b) rights arising from other contractual arrangements; and (c) the *MERALCO Group*'s voting rights and potential voting rights.

The *MERALCO Group* re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three (3) elements of control. Consolidation of a subsidiary begins when the *MERALCO Group* obtains control over the subsidiary and ceases when it loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date it gains control until the date it ceases to control the subsidiary.

The consolidated financial statements are prepared using uniform accounting policies for like transactions and other events with similar circumstances. All intra-group balances, income and expenses, unrealized gains and losses and dividends resulting from intra-group transactions are eliminated in full.

Non-controlling interests represent the portion of profit or loss and net assets in *MIESCOR* and its subsidiaries, *CEDC*, *Comstech* and *Fieldtech* not held by *MERALCO* and are presented separately in the consolidated statement of income, consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from equity attributable to equity holders of the parent.

Total comprehensive income within a subsidiary is attributed to the non-controlling interest even if such results in a deficit.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction.

If the *MERALCO Group* loses control over a subsidiary, it: (a) derecognizes the assets (including goodwill) and liabilities of the subsidiary; (b) derecognizes the carrying amount of any non-controlling interest; (c) derecognizes the cumulative translation adjustments deferred in equity; (d) recognizes the fair value of the consideration received; (e) recognizes the fair value of any investment retained; (f) recognizes any surplus or deficit in profit or loss; and (g) reclassifies *MERALCO*'s share of components previously recognized in the consolidated statement of comprehensive income to the consolidated statement of income.

On January 21, 2016, *MERALCO* subscribed to 100% of the common shares of *MSpectrum* with the primary purpose of harnessing renewable energy ("RE") such as but not limited to, solar, wind, biomass, geothermal and/or hydropower.

4. Significant Accounting Policies, Changes and Improvements

Changes in Accounting Policies and Disclosures

The accounting policies adopted in the preparation of the consolidated financial statements are consistent with those of the previous financial years except with respect to the adoption of the following amendments and improvements to existing standards, which were effective beginning January 1, 2016.

PAS 16 and PAS 38, Clarification of Acceptable Methods of Depreciation and Amortization (Amendments)

The amendments clarify the principle in *PAS 16* and *PAS 38* that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortize intangible assets. These amendments have no significant impact on the *MERALCO Group's* consolidated financial statements since the *MERALCO Group* has not used a revenue-based method to depreciate its noncurrent assets.

PAS 16 and PAS 41, Agriculture - Bearer Plants (Amendments)

The amendments change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of *PAS 41*. Instead, *PAS 16* will apply. After initial recognition, bearer plants will be measured under *PAS 16* at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce that grows on bearer plants will remain in the scope of *PAS 41* measured at fair value less costs to sell. For government grants related to bearer plants, *PAS 20, Accounting for Government Grants and Disclosure of Government Assistance*, will apply. These amendments have no significant impact on the *MERALCO Group's* consolidated financial statements as the *MERALCO Group* does not have any bearer plants.

PAS 27, Separate Financial Statements - Equity Method in Separate Financial Statements (Amendments)

The amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying *PFRS* and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively. For first-time adopters of *PFRS* electing to use the equity method in its separate financial statements, they will be required to apply this method from the date of transition to *PFRS*. The *MERALCO Group* shall consider the amendments in the preparation of its annual separate financial statements.

PAS 10 and PAS 28, Investment in Associates - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments)

The amendments address an acknowledged inconsistency between the requirements in *PFRS 10* and those in *PAS 28* (2011) in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The amendments require that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. The amendments have no significant impact on the *MERALCO Group's* consolidated financial statements.

PFRS 11, Joint Arrangements - Accounting for Acquisitions of Interests in Joint Operations (Amendments)

The amendments require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business must apply the relevant *PFRS 3* principles for business combinations accounting. The amendments also clarify

that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to *PFRS 11* to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation. The amendments have no significant impact on the *MERALCO Group's* consolidated financial statements.

PFRS 14, Regulatory Deferral Accounts

PFRS 14 is an optional standard that allows an entity, whose activities are subject to rate-regulation, to continue applying most of its existing accounting policies for regulatory deferral account balances upon its first-time adoption of *PFRS*. Entities that adopt *PFRS 14* must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of profit or loss and Other Comprehensive Income (“OCI”). The standard requires disclosures on the nature of, and risks associated with, the entity’s rate-regulation and the effects of that rate-regulation on its financial statements. Since the *MERALCO Group* is an existing *PFRS* preparer, this standard does not apply.

Annual Improvements to PFRSs (2012-2014 cycle)

PFRS 5, Non-current Assets Held for Sale and Discontinued Operations - Changes in Methods of Disposal (Amendment)

PFRS 5 clarifies that changing from a disposal through sale to a disposal through distribution to owners and vice-versa should not be considered to be a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in *PFRS 5*. The amendment also clarifies that changing the disposal method does not change the date of classification. The amendment is applied prospectively.

PFRS 7, Financial Instruments: Disclosures - Servicing Contracts (Amendment)

The amendment requires an entity to provide disclosures for any continuing involvement in a transferred asset that is derecognized in its entirety. The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and arrangement against the guidance in *PFRS 7* in order to assess whether the disclosures are required. The amendment is to be applied such that the assessment of which servicing contracts constitute continuing involvement will need to be done retrospectively. However, comparative disclosures are not required to be provided for any period beginning before the annual period in which the entity first applies the amendment.

PFRS 7, Applicability of the Amendments to PFRS 7 to Condensed Interim Financial Statements (Amendment)

The amendment clarifies that the disclosures on offsetting of financial assets and financial liabilities are not required in the condensed interim financial report unless they provide a significant update to the information reported in the most recent annual report. This amendment is applied retrospectively.

PAS 19, Employee Benefits - Regional Market Issue Regarding Discount Rate (Amendment)

The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. This amendment is applied prospectively.

PAS 34, Interim Financial Reporting - Disclosure of Information 'Elsewhere in the Interim Financial Report' (Amendment)

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the greater interim financial report (e.g., in the management commentary or risk report). The amendment is applied retrospectively.

The *Annual Improvements to PFRS (2012-2014 cycle)* have no material impact on the *MERALCO Group's* consolidated financial statements.

Future Changes in Accounting Policies and Disclosures

The following are the new and revised accounting standards and interpretation that are already issued but will become effective subsequent to December 31, 2016.

Effective 2018

PFRS 9, Financial Instruments

PFRS 9, as issued, reflects all phases of the financial instruments project and replaces *PAS 39* and all previous versions of *PFRS 9*. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. *PFRS 9* is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of *PFRS 9* is permitted if the date of initial application is before February 1, 2015.

The adoption of *PFRS 9* will have an effect on the classification and measurement of the *MERALCO Group's* financial assets but will have no impact on the classification and measurement of the *MERALCO Group's* financial liabilities. The adoption will not have any effect on the *MERALCO Group's* application of hedge accounting. The *MERALCO Group* is currently assessing the impact of adopting this standard.

Deferred effectivity

Philippine Interpretation *IFRIC 15, Agreements for the Construction of Real Estate*, covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. The Philippine Securities and Exchange Commission ("*SEC*") and Philippine Financial Reporting Standards Council ("*FRSC*") have deferred the effectivity of this interpretation until the final Revenue standard is issued by the International Accounting Standards Board or *IASB* and an evaluation of the requirements of the final Revenue standard against the practices of the Philippine real estate industry is completed. This interpretation is not applicable to the *MERALCO Group*.

The following new standard issued by the *IASB* has not yet been adopted by the Philippine *FRSC*:

IFRS 15, Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a five (5)-step model to account for revenue arising from contracts with customers. Under *IFRS 15*, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The new revenue standard will supersede all current revenue recognition requirements under *IFRS*. Either a full or a modified retrospective application is required for annual periods beginning on or after January 1, 2018, with early adoption permitted.

IFRS 16, Leases

IFRS 16 was issued in January 2016 and sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the entity. *IFRS 16* is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply *IFRS 15* at or before the date of initial application of *IFRS 16*.

Amendments to International Accounting Standards (IAS) 12, Income Taxes - Recognition of Deferred Tax Assets for Unrealized Losses

In January 2016, the *IASB* issued the amendments to *IAS 12* which clarify how to account for deferred tax assets related to debt instruments measured at fair value. They also address the diversity in practice regarding the recognition of deferred tax assets for unrealized losses. The amendments are effective for annual periods beginning on or after January 1, 2017, with early application permitted.

The *MERALCO Group* is currently assessing the impact of *IFRS 15*, *IFRS 16* and amendments to *IAS 12* and shall adopt the new standard on the required effective date once adopted locally.

Significant Accounting Policies

The principal accounting policies adopted in the preparation of the consolidated financial statements are as follows:

Utility Plant and Others

Utility plant and others, except land, are stated at cost, net of accumulated depreciation and amortization and accumulated impairment losses, if any. Costs include the cost of replacing part of such utility plant and other properties when such cost is incurred, if the recognition criteria are met. All other repair and maintenance costs are recognized as incurred in the consolidated statement of income. The present value of the expected cost for the decommissioning of the asset after use is included in the cost of the respective asset if the recognition criteria for a provision are met.

Land is stated at cost less any impairment in value.

The *MERALCO Group*'s utility plant and others are stated at deemed cost. The revalued amount recorded as at January 1, 2004 was adopted as deemed cost as allowed by the transitional

provisions of *PFRS 1*. The balance of revaluation increment was closed to retained earnings.

See *Note 15 – Equity* for the related discussion.

Depreciation and amortization of utility plant and others are computed using the straight-line method over the following estimated useful lives:

Asset Type	Estimated Useful Lives
Subtransmission and distribution	10-40 years, depending on the life of the significant parts
Buildings and improvements	15-40 years
Communication equipment	5-10 years
Office furniture, fixtures and other equipment	5-20 years
Transportation equipment	5-10 years
Others	5-20 years

An item of utility plant and others is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising as a result of the derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of income in the period the asset is derecognized.

The asset's residual values, useful lives and methods of depreciation and amortization are reviewed, and adjusted prospectively if appropriate, at each reporting date to ensure that the residual values, periods and methods of depreciation and amortization are consistent with the expected pattern of economic benefits from items of utility plant and others.

Construction in Progress

Construction in progress is stated at cost, which includes cost of construction, plant and equipment, capitalized borrowing costs and other direct costs. Construction in progress is not depreciated until such time that the relevant assets are substantially completed and available for their intended use.

Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Capitalization of borrowing costs commences when the activities necessary to prepare the qualifying asset for its intended use or sale have been undertaken and expenditures and borrowing costs have been incurred. Borrowing costs are capitalized until the asset is substantially completed and available for its intended use.

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, as well as any exchange differences arising from any foreign currency denominated borrowings used to finance the projects, to the extent that they are regarded as an adjustment to interest costs.

All other borrowing costs are expensed as incurred.

Asset Retirement Obligations

Under the terms of certain lease contracts, the *MERALCO Group* is required to dismantle the installations made in leased sites and restore such sites to their original condition at the end of the term of the lease. The *MERALCO Group* recognizes a liability measured at the present value of the estimated costs of these obligations and capitalizes such costs as part of the balance of the related item of utility plant and others and investment properties. The amount of asset retirement obligations is accreted and such accretion is recognized as interest expense.

Assets Funded by Customers

In accordance with the Distribution Services and Open Access Rule (“*DSOAR*”), the costs of non-standard connection facilities to connect the customers to *MERALCO*’s distribution network and to provide the customers with ongoing access to the supply of electricity are funded by the customers. *MERALCO* assesses whether the constructed or acquired non-standard connection facilities meet the definition of an asset in accordance with *PAS 16*. If the definition of an asset is met, *MERALCO* recognizes such asset at its acquisition or construction cost with an equivalent credit to the liability account. Such liability to the customers is included under “Other noncurrent liabilities” account in the consolidated statement of financial position, and is recognized as income over the expected useful life of the underlying asset. Assets funded by customers do not form part of *MERALCO*’s regulatory asset base.

Investments in Associates and Interests in Joint Ventures

An associate is an entity where *MERALCO Group* has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but has no control or joint control over those policies.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The considerations made in determining significant influence or joint control are similar to those necessary to determine control over subsidiaries.

Investments in associates and interests in joint ventures are accounted for using the equity method of accounting and are initially recognized at cost.

Under the equity method, the investment in an associate or interest in a joint venture is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in the *MERALCO Group*’s share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment.

The consolidated statement of income reflects the *MERALCO Group*’s share of the results of operations of the associate or joint venture. Any change in *OCI* of those investees is presented as part of the *MERALCO Group*’s *OCI*. In addition, when there has been a change recognized directly in the equity of the associate or joint venture, the *MERALCO Group* recognizes its share of any changes, when applicable, in the consolidated statement of changes in equity. Unrealized gains and losses resulting from transactions between the *MERALCO Group* and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

The aggregate of the *MERALCO Group*'s share in profit or loss of an associate and a joint venture is shown on the face of the consolidated statement of income outside operating income and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate or joint venture.

The financial statements of the associate or joint venture are prepared for the same reporting period as the *MERALCO Group*. When necessary, adjustments are made to bring the accounting policies in line with those of the *MERALCO Group*.

After application of the equity method, the *MERALCO Group* determines whether it is necessary to recognize an impairment loss on its investment in its associate or interest in joint venture. At each reporting date, the *MERALCO Group* determines whether there is objective evidence that the investment in the associate or joint venture is impaired. If there is such evidence, the *MERALCO Group* calculates the amount of impairment as the difference between the recoverable amount of the investment in associate or interest in joint venture and its carrying value, then recognizes the loss as equity in net earnings of an associate and a joint venture in the consolidated statement of income.

Upon loss of significant influence over the associate or joint control over the joint venture, the *MERALCO Group* measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the investment in associate or interest in joint venture upon loss of significant influence or joint control and the fair value of the retained investment and proceeds from disposal is recognized in profit or loss.

Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition-date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the *MERALCO Group* elects whether to measure the non-controlling interest in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs in a business combination are expensed.

When a business is acquired, an assessment is made of the identifiable assets acquired and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic and other pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquirer's previously held equity interest in the acquiree is remeasured at fair value as at acquisition date and any resulting gain or loss is recognized in profit or loss.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration, which is deemed to be an asset or liability will be recognized in accordance with *PAS 39*, either in profit or loss or *OCI*. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred, any non-controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the previously held equity interest in the acquiree, over

the fair value of net identifiable assets acquired. If the difference is negative, such difference is recognized as gain in the consolidated statement of income.

If the initial accounting for a business combination is incomplete by the end of the reporting date in which the business combination occurs, the provisional amounts of the items for which the accounting is incomplete are reported in the consolidated financial statements. During the measurement period, which shall be no longer than one (1) year from the acquisition date, the provisional amounts recognized at acquisition date are retrospectively adjusted to reflect new facts and circumstances obtained that existed as at the acquisition date and, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, additional assets or liabilities are also recognized if new information is obtained about facts and circumstances that existed as at the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as at that date.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from acquisition date, allocated to each of the cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units, beginning on the acquisition date.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in such circumstance is measured based on relative values of the operation disposed and the portion of the cash-generating unit retained.

Business combinations involving entities under common control are accounted for similar to the pooling-of-interest method. The assets and liabilities of the combining entities are reflected at their carrying amounts reported in the consolidated financial statements of the controlling holding company. Any difference between the consideration paid and the share capital of the “acquired” entity is reflected within equity as additional paid-in capital. The consolidated statement of income reflects the results of the combining entities for the full period, irrespective of when the combination takes place. Comparatives are presented as if the entities had always been combined since the date the entities were under common control.

Investment Properties

Investment properties, except land, are stated at cost, net of accumulated depreciation and accumulated impairment loss, if any. The carrying amount includes transaction costs and costs of replacing part of an existing investment property at the time such costs are incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property.

Investment properties include properties that are being constructed or developed for future use.

Land classified as investment property is carried at cost less any impairment in value.

The *MERALCO Group*’s investment properties acquired before January 1, 2004 are stated at deemed cost. See *Note 15 – Equity* for the related discussions.

Investment properties, except land, are being depreciated on a straight-line basis over the useful life of 40 years.

Investment properties are derecognized either when they have been disposed of or when these are permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss from the derecognition of the investment properties is recognized in the consolidated statement of income in the period these are disposed or retired.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by the end of owner-occupation or the commencement of an operating lease to another party. If owner-occupied property becomes an investment property, the *MERALCO Group* accounts for such property in accordance with the policy stated under utility plant and others up to the date of the change in use. Transfers are made from investment property when, and only when, there is a change in use, evidenced by the commencement of owner-occupation or the commencement of development with a view to sale. Transfers from investment property are recorded using the carrying amount of the investment property as at the date of change in use.

Intangible Assets

Intangible assets acquired separately are initially measured at cost. Following initial recognition, intangible assets are carried at cost less accumulated amortization and any accumulated impairment loss. The useful lives of intangible assets are assessed at the individual asset level as having either finite or indefinite useful lives.

Intangible assets with finite lives are amortized over the useful economic lives of five (5) to 10 years using the straight-line method and assessed for impairment whenever there is an indication that the intangible assets may be impaired. At a minimum, the amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at each reporting date. Changes in the expected useful life or the expected consumption pattern of future economic benefit embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and treated as change in accounting estimates. The amortization expense of intangible assets with finite lives is recognized in the consolidated statement of income.

Intangible assets with indefinite useful lives are not amortized, but are assessed for impairment annually either individually or at the cash-generating unit level. The assessment of indefinite useful life is done annually at every reporting date to determine whether such indefinite useful life continues to exist. Otherwise, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognized in the consolidated statement of income.

Intangible assets generated within the business are not capitalized and expenditures are charged to profit or loss in the period these are incurred.

Fair Value Measurement

The *MERALCO Group* measures financial instruments at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transactions between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either (a) in the principal market for the asset or liability, or (b) in the absence

of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible to the *MERALCO Group*.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a nonfinancial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The *MERALCO Group* uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- i. Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities;
- ii. Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable; and
- iii. Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the *MERALCO Group* determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

For the purpose of fair value disclosures, the *MERALCO Group* has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy.

Impairment of Nonfinancial Assets

The *MERALCO Group* assesses at each reporting date whether there is an indication that a nonfinancial asset (utility plant and others, investment properties, investments in associates and interests in joint ventures, receivable from the Bureau of Internal Revenue ("*BIR*"), intangible assets and unbilled receivables), other than goodwill and intangible assets with indefinite useful life, may be impaired. If any such indication exists, the *MERALCO Group* makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an individual asset's or a cash generating unit's fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The fair value is the amount obtainable from the sale of the asset in an arm's-length transaction. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation factors/parameters, quoted share prices for publicly traded securities or other available fair value indicators. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in the consolidated statement of income.

An assessment is also made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If any such indication exists, the *MERALCO Group* estimates the individual asset's or cash generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If a reversal of impairment loss is to be recognized, the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income. After such reversal, the depreciation and amortization expense are adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Intangible assets with indefinite useful lives are tested for impairment annually at every reporting date or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired, either individually or at the cash generating unit level, as appropriate. The amount of impairment is calculated as the difference between the recoverable amount of the intangible asset and its carrying amount. The impairment loss is recognized in the consolidated statement of income. Impairment losses relating to intangible assets may be reversed in future periods.

Goodwill is reviewed for impairment annually at every reporting date or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of the cash generating unit or group of cash generating units, to which the goodwill relates. Where the recoverable amount of the cash generating unit or group of cash generating units is less than the carrying amount of the cash generating unit or group of cash generating units to which goodwill has been allocated, an impairment loss is recognized. Impairment losses relating to goodwill shall not be reversed in future periods.

If the allocation of goodwill acquired in a business combination to cash generating units or group of cash generating units is incomplete, an impairment testing of goodwill is only carried out when impairment indicators exist. Where impairment indicators exist, impairment testing of goodwill is performed at a level at which the acquirer can reliably test for impairment.

Financial Assets

Initial Recognition

Financial assets are classified as at fair value through profit or loss ("*FVPL*"), loans and receivables, held-to-maturity ("*HTM*") investments, *AFS* financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The classification of financial assets is determined at initial recognition and, where allowed and appropriate, re-evaluated at each reporting date.

Financial assets are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets, except for financial instruments measured at *FVPL*.

Purchases or sales of financial assets that require delivery of assets within a timeframe established by regulation or convention in the market place (regular way purchase) are recognized on the trade date, which is the date the *MERALCO Group* commits to purchase or sell the asset.

The *MERALCO Group*'s financial assets include cash and cash equivalents, trade and non-trade receivables, advance payments to a supplier, investments in Unit Investment Trust Funds (“*UITFs*”), investments in government securities and quoted and unquoted equity securities.

Subsequent Measurement

The subsequent measurement of financial assets depends on the classification as follows:

Financial Assets at FVPL

Financial assets at *FVPL* include financial assets held-for-trading and financial assets designated upon initial recognition as at *FVPL*. Financial assets are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Derivative assets, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments.

Financial assets may be designated at initial recognition as at *FVPL* if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on them on a different basis; (ii) the financial assets are part of a group of financial assets, which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial assets contain one (1) or more embedded derivatives that would need to be recorded separately.

Financial assets at *FVPL* are carried in the consolidated statement of financial position at fair value with gains or losses on fair value changes recognized in the consolidated statement of income under “Interest and other financial income” or “Interest and other financial charges” accounts. Interest earned and dividends received from investment at *FVPL* are also recognized in the consolidated statement of income under “Interest and other financial income” account.

Derivatives embedded in host contracts are accounted for as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value. These embedded derivatives are measured at fair value with gains and losses arising from changes in fair value recognized in the consolidated statement of income. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such financial assets are carried at amortized cost using the effective interest method. This method uses an effective interest rate that discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset. Gains or losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as when these are amortized. Interest earned or incurred is recorded in “Interest and other financial income” or “Interest and other financial charges” accounts, in the consolidated statement of income. Assets in this category are included under current assets except for assets with maturities beyond 12 months from reporting date, which are classified as noncurrent assets.

HTM Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as *HTM* when the *MERALCO Group* has the positive intention and ability to hold these

assets to maturity. After initial measurement, *HTM* investments are measured at amortized cost using the effective interest method. Gains or losses are recognized in the consolidated statement of income. Assets in this category are included in the current assets except for maturities beyond 12 months from the reporting date, which are classified as noncurrent assets.

AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as *AFS* or are not classified in any of the three (3) foregoing categories. They are purchased and held indefinitely and may be sold in response to liquidity requirements or changes in market conditions. After initial measurement, *AFS* financial assets are measured at fair value with unrealized gains or losses recognized in other comprehensive income or *OCI* until the investment is derecognized, at which time the cumulative gain or loss recorded in *OCI* is recognized in the consolidated statement of income, or determined to be impaired, at which time the cumulative loss recorded in *OCI* is recognized in the consolidated statement of income. Interest earned from *AFS* debt securities is included under "Interest and other financial income" account in the consolidated statement of income. Dividends earned from *AFS* equity are likewise recognized in the consolidated statement of income under "Interest and other financial income" account when the right of the payment has been established. These are included under noncurrent assets unless there is an intention to dispose of the investment within 12 months from the reporting date.

Financial Liabilities

Initial Recognition

Financial liabilities are classified as financial liabilities at *FVPL*, other financial liabilities, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The classification of the financial liability is determined at initial recognition.

Financial liabilities are recognized initially at fair value inclusive of directly attributable transaction costs, except for financial liabilities at *FVPL*.

The *MERALCO Group's* financial liabilities include notes payable, interest-bearing long-term financial liabilities, trade payables and other current liabilities (excluding output value added tax ("*VAT*"), accrued taxes, reinsurance liabilities and deferred lease income), customers' deposits, refundable service extension costs, and customers' refund.

Subsequent Measurement

The subsequent measurement of financial liabilities depends on their classification as follows:

Financial Liabilities at FVPL

Financial liabilities at *FVPL* include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as at *FVPL*. Financial liabilities are classified as held-for-trading if they are incurred for the purpose of repurchasing in the near term. Derivative liabilities, including separated embedded liabilities are also classified as held-for-trading unless they are designated as effective hedging instruments. Financial liabilities at *FVPL* are carried in the consolidated statement of financial position at fair value with gains or losses recognized in the consolidated statement of income under "Interest and other financial income" or "Interest and other financial charges" accounts. Interest incurred on financial liabilities designated as at *FVPL* is

recognized in the consolidated statement of income under “Interest and other financial charges” account.

Financial liabilities may be designated at initial recognition as at *FVPL*, if any of the following criteria is met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognizing gains or losses on them on a different bases; (ii) the financial liabilities are part of a group of financial liabilities which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial liabilities contain one (1) or more embedded derivatives that would need to be recorded separately.

The *MERALCO Group* does not have financial liabilities designated as at *FVPL* as at September 30, 2016 and December 31, 2015.

Other Financial Liabilities

After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as when these are amortized. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are integral part of the effective interest rate. The effective interest amortization is included under “Interest and other financial charges” account in the consolidated statement of income.

Derivative Financial Instruments

Initial Recognition and Subsequent Measurement

Derivative instruments, including separated embedded derivatives, are initially recognized at fair value on the date at which a derivative transaction is entered into or separated, and are subsequently re-measured at fair value. Changes in fair value of derivative instruments, other than those accounted for as effective hedges, are recognized immediately in the consolidated statement of income. Changes in fair value of derivative instruments accounted for as effective hedges are recognized in *OCI*. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The *MERALCO Group* does not have derivatives accounted for under hedge accounting.

An embedded derivative is separated from the hybrid or combined contract if all the following conditions are met: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (c) the hybrid instrument is not recognized as at *FVPL*.

Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed.

See *Note 27 – Financial Assets and Financial Liabilities*.

Offsetting of Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if, and only if, there is currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

Amortized Cost of Financial Instruments

Amortized cost is computed using the effective interest method less any allowance for impairment and principal repayment, plus or minus the cumulative amortization of premium or discount. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of effective interest.

'Day 1' Profit or Loss

Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the *MERALCO Group* recognizes the difference between the transaction price and fair value (a 'Day 1' profit or loss) in the consolidated statement of income, unless it qualifies for recognition as some other type of asset or liability. In cases where data used are not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the *MERALCO Group* determines the appropriate method of recognizing the 'Day 1' profit or loss amount.

Impairment of Financial Assets

The *MERALCO Group* assesses at each reporting date whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtor or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial Assets Carried at Amortized Cost

For financial assets carried at amortized cost, the *MERALCO Group* first assesses whether objective evidence of impairment exists individually. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment based on historical loss experience. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. *MERALCO* and *CEDC* consider termination or disconnection of service and significant financial difficulties of debtors as objective evidence that a financial asset or group of financial assets is impaired. For both specific and collective assessments, any deposits, collateral and credit enhancement are considered in determining the amount of impairment loss.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). If a loan is subject to variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The carrying amount of the asset is reduced either directly or through the use of an allowance account and the amount of the loss is recognized in the consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. The financial asset together with associated allowance is written off when there is no realistic prospect of future recovery and all collateral or deposits has been realized or has been transferred to the *MERALCO Group*.

If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If an asset written off is recovered, the recovery is recognized in the consolidated statement of income. Any reversal of an impairment loss is recognized in the consolidated statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

AFS Financial Assets

In the case of equity instruments classified as *AFS*, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. When a decline in the fair value of an *AFS* financial asset has been recognized in *OCI* and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in *OCI* is reclassified from equity to profit or loss even though the financial asset has not been derecognized. The amount of the cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on the financial asset previously recognized in profit or loss. Impairment losses recognized in profit or loss for investment in equity instruments are not reversed in the consolidated statement of income. Subsequent increases in fair value after impairment are recognized directly in *OCI*.

In the case of debt instruments classified as *AFS*, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of "Interest and other financial income" in the consolidated statement of income. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed in the consolidated statement of income.

Assets Carried at Cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Derecognition of Financial Instruments

Financial Assets

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the right to receive cash flows from the asset has expired;
- the *MERALCO Group* has transferred its right to receive cash flows from the asset or has assumed an obligation to receive cash flows in full without material delay to a third party under a “pass-through” arrangement; and
- either the *MERALCO Group* (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the *MERALCO Group* has transferred its right to receive cash flows from an asset or has entered into a “pass-through” arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, a new asset is recognized to the extent of the *MERALCO Group*’s continuing involvement in the asset.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the *MERALCO Group* could be required to repay.

Financial Liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or has expired.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the carrying amount of a financial liability extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed is recognized in the consolidated statement of income.

Redeemable Preferred Stock

MERALCO’s peso-denominated redeemable preferred stock has characteristics of a liability and is thus recognized as a liability in the consolidated statement of financial position. The corresponding dividends on those shares are recognized as part of “Interest and other financial charges” account in the consolidated statement of income. Dividends no longer accrue when such shares have been called for redemption.

Inventories

Inventories are stated at the lower of cost or net realizable value. Costs of acquiring materials and supplies including costs incurred in bringing each item to their present location and condition are accounted using the moving average cost method. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost to sell or the current replacement cost of the asset.

VAT

Input *VAT* pertains to the 12% indirect tax paid in the course of trade or business on purchases of goods or services.

Output *VAT* pertains to the 12% tax due on the local sale of goods or services.

If at the end of any taxable month, the output *VAT* exceeds the input *VAT*, the outstanding balance is included under "Trade payables and other current liabilities" account. If the input *VAT* exceeds the output *VAT*, the excess shall be carried over to the succeeding months and included under "Other current assets" account.

Provisions

Provisions are recognized when the *MERALCO Group* has a present obligation, legal or constructive, as a result of a past event, and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the *MERALCO Group* expects a provision, or a portion, to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liabilities.

Retirement Benefits

MERALCO and certain subsidiaries have distinct, funded, noncontributory defined benefit retirement plans covering all permanent employees. *MERALCO*'s retirement plan provides for post-retirement benefits in addition to a lump sum payment to employees hired as at December 31, 2003. Retirement benefits for employees of *MERALCO* hired commencing January 1, 2004 were amended to provide for a defined lump sum payment only. *MERALCO* also has a contributory provident plan introduced in January 2009 whereby employees hired commencing January 1, 2004 may elect to participate.

The net defined benefit liability or asset of the retirement plan is the aggregate of the present value of the defined benefit obligation at the end of the reporting period reduced by the fair value of plan assets (if any), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit plans is actuarially determined using the projected unit credit method.

Defined benefit costs comprise of (i) service costs; (ii) net interest on the net defined benefit liability or asset; and (iii) remeasurements of the net defined benefit liability or asset.

Service costs, which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in the consolidated statement of income. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuaries.

Net interest on the net defined benefit liability or asset is the change during the period in the net defined benefit liability or asset that arises from the passage of time, which is determined by applying the discount rate based on government bonds to the net defined benefit liability or asset. Net interest on the net defined benefit liability or asset is recognized as expense or income in the consolidated statement of income.

Remeasurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in *OCI* in the period in which they arise. Remeasurements are not reclassified to profit or loss in subsequent periods.

Plan assets are assets that are held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the creditors of the *MERALCO Group*, nor can they be paid directly to the *MERALCO Group*. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations). If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The *MERALCO Group*'s right to be reimbursed for some or all of the expenditures required to settle a defined benefit obligation is recognized as a separate asset at fair value when, and only when, reimbursement is virtually certain.

The retirement costs under the defined contribution plan are recorded based on *MERALCO*'s contribution to the defined contribution plan as services are rendered by the employee.

Termination Benefits

Termination benefits are employee benefits provided in exchange for the severance of an employee's employment as a result of either an entity's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept an offer of benefits in exchange for the termination of employment.

A liability and expense for a termination benefit is recognized at the earlier of when the entity can no longer withdraw the offer of those benefits and when the entity recognizes related restructuring costs. Initial recognition and subsequent changes to termination benefits are measured in accordance with the nature of the employee benefit, as either post-employment benefits, short-term employee benefits, or other long-term employee benefits.

Employee Leave Entitlements

Employee entitlements to annual leave are recognized as a liability when they are accrued to the employees. The undiscounted liability for leave expected to be settled wholly before 12 months after the end of the annual reporting period is recognized for services rendered by employees up to the end of the reporting period.

Long-term Incentive Plan

The liability relating to the long-term incentive plan comprises the present value of the defined benefit obligation at the end of the reporting date.

Equity

Common stock is measured at par value for all shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown as a deduction from equity, net of any related tax. The amount of proceeds and/or fair value of consideration received, net of incremental costs incurred directly attributable to the issuance of new shares in excess of par value, is recognized as additional paid-in capital.

Employee stock purchase plan cost represents the cumulative compensation expense recognized based on the amount determined using an option pricing model. The 14th and last Employee Stock Purchase Plan (“*ESPP*”), which was awarded in 2009 fully vested in October 2012.

Change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction and presented as “Excess of acquisition cost over carrying value of non-controlling interest acquired” in the consolidated statements of financial position.

OCI comprises items of income and expense, which are not recognized in profit or loss as required or permitted by *PFRS*.

Retained earnings include net income attributable to the equity holders of the Parent, reduced by dividends declared on common stock. Dividends are recognized as a liability and deducted from retained earnings when they are declared. Dividend declarations approved after the financial reporting date are disclosed as events after the financial reporting date.

Non-controlling interests represent the equity interests in *MIESCOR* and its subsidiaries, *CEDC*, *Comstech* and *Fieldtech*, which are not held by *MERALCO*.

Employee Stock Purchase Plan

Up to 2009, *MERALCO* had an employee stock purchase plan, which covered active and retired employees. Under the plan, the qualified participant may purchase fixed number of shares of stock at a pre-agreed price. The plan features include vesting requirements and payment terms.

The cost of equity-settled transactions with employees is measured by reference to the difference between the fair value of the shares on the grant date and the price at which the share may be purchased under the award or offer. In valuing equity-settled transactions, no account is taken of any performance conditions other than market conditions.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the year in which the performance and/or service conditions are fulfilled, ending on the date at which the relevant employees become fully entitled to the award (‘the vesting date’). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and *MERALCO*’s best estimate of the number of equity instruments that will ultimately vest. The profit or loss charge or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of the reporting date.

No expense is recognized for awards that do not ultimately vest.

When the terms of the equity-settled awards are modified and the modification increases the fair value of the equity instruments granted, as measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognized for services received as consideration for the equity instrument granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognized for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognized over the remainder of the original vesting period. If the modification occurs after vesting date, the incremental fair value granted is recognized immediately or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits associated with the transaction will flow to the *MERALCO Group* and the revenue can be reliably measured. In addition, collectability is reasonably assured and the delivery of the goods or rendering of the service has occurred. The *MERALCO Group* assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The *MERALCO Group* concluded that it is acting as principal in all of its revenue arrangements. The following specific recognition criteria must also be met before revenue is recognized:

Sale of Electricity

Revenues are recognized upon supply of power to the customers and are stated at amounts invoiced to customers, inclusive of pass-through components, *VAT* and other taxes, where applicable, and net of discounts and/or rebates. The Uniform Filing Requirements ("*UFR*") on the rate unbundling released by the *ERC* on October 30, 2001 specified the following bill components: (a) generation charge, (b) transmission charge, (c) *SL* charge, (d) distribution charge, (e) supply charge, (f) metering charge, (g) Currency Exchange Rate Adjustment ("*CERA*") I and II, where applicable and (h) inter-class rate and lifeline subsidies. *VAT*, business taxes such as *LFT*, the Power Act Reduction (for residential customers) adjustment, universal charges, and Feed-in-Tariff-Allowance ("*FiT-All*") are also separately presented in the customer's billing statement. *VAT* and business taxes (billed and collected on behalf of the national and local governments, respectively) and universal charges and *FiT-All* [billed and collected on behalf of Power Sector Assets and Liabilities Management Corporation ("*PSALM*") and National Transmission Corporation ("*TransCo*"), respectively] do not form part of *MERALCO* and *CEDC*'s revenues. Revenues are adjusted for the estimated over and/or under-recoveries of pass-through charges.

Sale of Services

Revenues from construction contracts are recognized and measured using the percentage-of-completion method of accounting for the physical portion of the contract work, determined based on the actual costs incurred in relation to the total estimated costs of the contract. Revenue from contracts to manage, supervise or coordinate construction activity for others and contracts where

materials and services are supplied by project owners are recognized only to the extent of the contracted fees.

Contract costs principally include subcontracted costs related to contract performance. Expected losses on contracts are recognized immediately when it is probable that the total contract costs will exceed total contract revenues. The amount of such loss is determined irrespective of whether or not work has commenced on the contract; the stage of completion of contract activity; or the amount of profits expected to arise on other contracts, which are not treated as a single construction contract. Changes in contract performance, contract conditions and estimated profitability, including those arising after final contract settlements and after gross margins are recognized in the period in which the changes are determined.

Service and consulting fees are recognized when services are rendered.

Interest Income

Revenue is recognized as interest accrues, using the effective interest method. The effective interest rate is the rate that discounts estimated future cash receipts through the expected life of the financial instrument.

Dividends

Revenue is recognized when the *MERALCO Group*'s right to receive the payment is established.

Lease Income

Income arising from lease of investment properties and pole positions is accounted for on a straight-line basis over the lease term.

Lease income is included under "Revenues - Sale of other services" account in the consolidated statement of income.

Expense Recognition

Expenses are decreases in economic benefits during the financial reporting period in the form of outflows or decrease of assets or incurrence of liabilities that result in decrease in equity, other than those relating to distributions to equity participants. These are recognized when incurred.

Insurance Claim Cost Recognition

Liabilities for unpaid claim costs and claim adjustment expenses relating to insurance contracts are accrued when the insured events occur.

Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or the arrangement conveys a right to use the asset.

Company as Lessee

Operating lease payments are recognized as expense in the consolidated statement of income on a straight-line basis over the lease term.

Company as Lessor

Leases where the *MERALCO Group* does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

Foreign Currency-Denominated Transactions and Translations

The consolidated financial statements are presented in Philippine peso, which is also *MERALCO*'s functional and presentation currency. The Philippine peso is the currency of the primary economic environment in which the *MERALCO Group* operates, except for *LOIL* and *MPG Asia*. This is also the currency that mainly influences the revenue from and cost of rendering services. Each entity in the *MERALCO Group* determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

The functional currency of *LOIL* and *MPG Asia* is the United States ("U.S.") dollar.

Transactions in foreign currencies are initially recorded in the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated using functional currency closing rate of exchange prevailing at the end of the reporting date. All differences are recognized in the consolidated statement of income except for foreign exchange differences that relate to capitalizable borrowing costs on qualifying assets. Nonmonetary items that are measured in terms of historical cost in foreign currency are translated using the exchange rate as at the date of the initial transactions.

As at the reporting date, the monetary assets and liabilities of associates, *LOIL* and *MPG Asia* whose functional currency is other than Philippine peso, are translated into Philippine peso at the rate of exchange prevailing at the end of the reporting period, and income and expenses of an associate are translated monthly using the weighted average exchange rate for the month. The exchange differences arising on translation are recognized as a separate component of *OCI* as cumulative translation adjustments. On disposal of the associate, the amount of cumulative translation adjustments recognized in other comprehensive income is recognized in the consolidated statement of income.

Income Taxes

Current Income Tax

Current income tax assets and liabilities for the current and prior period are measured at the amount expected to be recovered from or paid to the taxation authority. The tax rate and tax laws used to compute the amount are those that are enacted or substantively enacted as at the reporting date.

Deferred Income Tax

Deferred income tax is provided on all temporary differences at the reporting date between the income tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized except:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax assets to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent these have become probable that future taxable profit will allow the deferred income tax assets to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates and tax laws that are enacted or substantively enacted as at the reporting date.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current income tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Deferred income tax items are recognized in correlation to the underlying transaction either in profit or loss or directly in equity.

Earnings per Share

Basic earnings per share is calculated by dividing the net income for the period attributable to equity holders of the parent by the weighted average number of common shares outstanding during the period.

Diluted earnings per share is calculated by dividing the net income for the period attributable to equity holders of the parent by the weighted average number of shares outstanding, adjusted for the effects of any dilutive potential common shares.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. These are disclosed in the notes to consolidated financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized unless the realization of the assets is virtually certain. These are disclosed in the notes to consolidated financial statements when an inflow of economic benefits is probable.

Events After the Reporting Date

Post reporting date events that provide additional information about the *MERALCO Group's* financial position at the reporting date (adjusting events) are reflected in the consolidated financial statements. Post reporting date events that are non-adjusting events are disclosed in the notes to consolidated financial statements, when material.

5. Management's Use of Significant Judgments, Accounting Estimates and Assumptions

The preparation of the *MERALCO Group's* consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent assets and liabilities, at the end of the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future years.

Judgments

In the process of applying the *MERALCO Group's* accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements.

Determination of Functional Currency

The functional currencies of the entities under the *MERALCO Group* are the currencies of the primary economic environment in which each entity operates. It is the currency that mainly influences the revenue and cost of rendering services.

Based on the economic substance of the underlying circumstances, the functional and presentation currency of *MERALCO* and its subsidiaries, except *LOIL* and *MPG Asia*, is the Philippine peso. The functional and presentation currency of *LOIL* and *MPG Asia* is the U.S. dollar.

Operating Lease Commitments

As Lessor

The *MERALCO Group* has several lease arrangements as a lessor. Based on the terms and conditions of the arrangements, it has evaluated that the significant risks and rewards of ownership of such properties are retained by the *MERALCO Group*. The lease agreements do not transfer ownership of the assets to the lessees at the end of the lease term and do not give the lessees a bargain purchase option over the assets. Consequently, the lease agreements are accounted for as operating leases.

As Lessee

As a lessee, the *MERALCO Group* has commercial lease arrangements covering certain office spaces, payment offices and substation sites and towers. The *MERALCO Group* has determined, based on the evaluation of the terms and conditions of the arrangements, that it has not acquired any significant risks and rewards of ownership of such properties because the lease arrangements do not transfer to the *MERALCO Group* the ownership over the assets at the end of the lease term and do not provide the *MERALCO Group* a bargain purchase option over the leased assets. Consequently, the lease agreements are accounted for as operating leases.

Arrangement that Contains a Lease

MERALCO's Purchased Power Agreements (“*PPAs*”) and Purchase Supply Agreements (“*PSAs*”) with certain power generating companies qualify as leases on the basis that *MERALCO* and these power generating companies have ‘take or pay’ (“*ToP*”) arrangements where payments for purchased power or for contracted capacity are made on the basis of the availability of the power plant and not based solely on actual consumption. In determining the lease classification, it is judged that substantially all the risks and rewards incident to the ownership of the power plants are with these power generating companies. Thus, the *PPAs* and *PSAs* are classified as operating leases. Accordingly, capacity fees, fixed operating and maintenance fees, and transmission line fees that form part of purchased power expense are accounted for similar to a lease.

Components of purchased power cost, which have been accounted for similar to a lease, amounted to ₱36,848 million and ₱32,925 million for the nine months ended September 30, 2016 and 2015, respectively. These are recognized as “Purchased Power” in the consolidated statements of income.

See Note 24 – *Purchased Power*.

Entity in which the MERALCO Group Holds More Than the Majority of the Voting Rights Accounted for as a Joint Venture

MERALCO, through *MGen*, has a 51% interest in San Buenaventura Power Ltd. Co. (“*SBPL*”). While *MERALCO* owns majority of the voting rights in *SBPL*, it does not have sole control over *SBPL*. *MERALCO's* investment in *SBPL* is accounted for as a joint venture since key operating and financial decisions of *SBPL* require the unanimous vote and consent of the parties sharing control.

Contingencies

The *MERALCO Group* has possible claims from or obligation to other parties from past events and whose existence may only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within its control. Management has determined that the present obligations with respect to contingent liabilities and claims with respect to contingent assets do not meet the recognition criteria, and therefore has not recorded any such amounts.

See Note 29 – *Contingencies and Legal Proceedings*.

Estimates and Assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty as at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed as follows:

Estimating Useful Lives of Utility Plant and Others, Intangible Assets with Finite Lives and Investment Properties

The *MERALCO Group* estimates the useful lives of utility plant and others, intangible assets with finite lives and, investment properties based on the periods over which such assets are expected to be available for use. The estimate of the useful lives of the utility plant and others, intangible assets with finite lives and investment properties is based on management's collective assessment of industry practice, internal technical evaluation and experience with similar assets. The estimated useful lives are reviewed at least at each financial reporting date and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limitations on the use of such assets. It is possible, however, that future results of operations could be materially affected by changes in estimates brought about by changes in the factors mentioned in the foregoing. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of utility plant and others, intangible assets with finite lives and investment properties would increase recorded operating expenses and decrease noncurrent assets.

The total depreciation and amortization expense of utility plant and others amounted to ₱4,859 million and ₱4,701 million for the nine months ended September 30, 2016 and 2015, respectively. Total carrying values of utility plant and others, net of accumulated depreciation and amortization, amounted to ₱126,826 million and ₱124,913 million as at September 30, 2016 and December 31, 2015, respectively.

Total depreciation of investment properties amounted ₱4 million and ₱5 million for the nine months ended September 30, 2016 and 2015, respectively. Total carrying values of investment properties, net of accumulated depreciation, amounted to ₱1,514 million and ₱1,538 million as at September 30, 2016 and December 31, 2015, respectively.

Total amortization of intangible assets with finite lives amounted to ₱343 million and ₱329 million for the nine months ended September 30, 2016 and 2015, respectively. Total carrying values of intangible assets with finite lives, net of accumulated amortization, amounted to ₱2,381 million and ₱2,585 million as at September 30, 2016 and December 31, 2015, respectively.

See *Note 7 – Utility Plant and Others*, *Note 9 – Investment Properties* and *Note 10 – Other Noncurrent Assets*.

Impairment of Nonfinancial Assets

PFRS requires that an impairment review be performed when certain impairment indicators are present. These conditions include obsolescence, physical damage, significant changes in the manner by which an asset is used, worse than expected economic performance, drop in revenues or other external indicators, among others. In the case of goodwill, at a minimum, such asset is subject to an annual impairment test and more frequently whenever there is an indication that such asset may be impaired. This requires an estimation of the value in use of the cash generating unit to which the goodwill is allocated. Estimating the value in use requires preparation of an estimate of the expected future cash flows from the cash generating unit and choosing an appropriate discount rate in order to calculate the present value of those cash flows.

Determining the recoverable amount of utility plant and others, investment properties, investments in associates and interests in joint ventures, goodwill and other noncurrent assets, requires (i) the determination of future cash flows expected to be generated from the continued use as well as ultimate disposition of such assets and (ii) making estimates and assumptions that can materially affect the consolidated financial statements. Future events may cause management to conclude

that utility plant and others, construction in progress, investment properties, investments in associates and interests in joint ventures, and other noncurrent assets are impaired. Any resulting impairment loss could have a material adverse impact on the *MERALCO Group's* consolidated financial position and results of operations.

The preparation of estimated future cash flows involves significant estimations and assumptions. While management believes that the assumptions are appropriate and reasonable, significant changes in the assumptions may materially affect the assessment of recoverable values and may lead to future impairment charges under *PFRS*.

Provision for impairment loss on unbilled receivables amounted to ₱2,134 million as at September 30, 2016 and December 31, 2015.

The carrying values of nonfinancial assets as at June 30, 2016 and December 31, 2015 subject to impairment review are as follows:

Account	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Utility plant and others	₱126,826	₱124,913
Investments in associates and joint ventures	12,290	13,603
Intangible assets	2,381	2,585
Investment properties	1,514	1,538
Receivable from the <i>BIR</i>	181	181
Goodwill	36	36

See *Note 7 – Utility Plant and Others*, *Note 8 – Investments in Associates and Interests in Joint Ventures*, *Note 9 – Investment Properties* and *Note 10 – Other Noncurrent Assets*.

Goodwill

The *MERALCO Group's* consolidated financial statements and the results of operations reflect acquired businesses after the completion of the respective acquisition. The *MERALCO Group* accounts for the acquisition of businesses using the acquisition method of accounting, which requires extensive use of accounting judgments and estimates to allocate the purchase price to the fair market values of the acquiree's identifiable assets and liabilities and contingent liabilities, if any, at the acquisition date. Any excess in the purchase price over the estimated fair market values of the net assets acquired is recorded as goodwill in the consolidated statement of financial position. Thus, the number of items, which involve judgments made in estimating the fair market value to be assigned to the acquiree's assets and liabilities, can materially affect the *MERALCO Group's* financial position.

Realizability of Deferred Tax Assets

The *MERALCO Group* reviews the carrying amounts of deferred tax assets at the end of each reporting date and reduces these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred income tax assets to be utilized.

Assessment on the recognition of deferred tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income for the subsequent reporting date. This forecast is based on past results and future expectations on revenues and expenses as well as future

tax planning strategies. Management believes that sufficient taxable profit will be generated to allow all or part of the recorded or recognized deferred tax assets to be utilized. The amounts of the deferred tax assets considered realizable could be adjusted in the future if estimates of taxable income are revised. Based on the foregoing assessment, following are the relevant consolidated information with respect to deferred tax assets:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions)</i>	
Recognized deferred tax assets	₱22,936	₱21,275
Unrecognized deferred tax assets	475	372

See Note 28 – *Income Taxes and Local Franchise Taxes*.

Determination of Fair Values of Financial Assets and Financial Liabilities

Where fair value of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but when this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair values of financial instruments.

See Note 27 – *Financial Assets and Financial Liabilities*.

Estimating Allowance for Doubtful Accounts

If there is objective evidence that an impairment loss has been incurred in the trade and other receivables balance of the *MERALCO Group*, an estimate of the allowance for doubtful accounts related to trade and other receivables that are specifically identified as doubtful of collection is made. The amount of allowance is evaluated by management on the basis of factors that affect the collectability of the accounts. In such case, use of judgment based on the best available facts and circumstances, including but not limited to, the length of the *MERALCO Group*'s relationship with the customer and the customer's credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due in order to reduce the *MERALCO Group*'s receivables to amounts that management expects to collect is applied. These specific reserves are re-evaluated and adjusted as additional information received affect the amounts estimated.

In addition to specific allowance against individually significant receivables, an assessment for collective impairment allowance against credit exposures of the customers, which were grouped based on common credit characteristics, although not specifically identified as requiring a specific allowance, have a greater risk of default than when the receivables were originally granted to customers is done. This collective allowance is based on historical loss experience using various factors, such as historical performance of the customers within the collective group, deterioration in the markets in which the customers operate, and identified structural weaknesses or deterioration in the cash flows of customers.

Total asset impairment provision for trade and other receivables and other current assets, net of recoveries, recognized in the consolidated statements of income amounted to ₱199 million, and

₱501 million for the nine months ended September 30, 2016 and 2015, respectively. Trade and other receivables, net of asset impairment, amounted to ₱25,549 million and ₱26,761 million as at September 30, 2016 and December 31, 2015, respectively.

See *Note 12 – Trade and Other Receivables* and *Note 14 – Other Current Assets*.

Estimating Net Realizable Value of Inventories

Inventories consist of materials and supplies used in the power distribution and services segments, and are valued at the lower of cost or net realizable value. The cost of inventories is written down whenever the net realizable value of inventories becomes lower than the cost due to damage, physical deterioration, obsolescence, and change in price levels or other causes. The lower of cost or net realizable value of inventories is reviewed on a periodic basis. Inventory items identified to be obsolete and unusable are written off and charged as expense in the consolidated statement of income.

The carrying values of inventories amounted to ₱2,838 million and ₱2,273 million as at September 30, 2016 and December 31, 2015, respectively.

See *Note 13 – Inventories*.

Estimation of Retirement Benefit Costs

The cost of defined benefit retirement plans and other post-employment benefits as well as the present value of the retirement obligation are determined using actuarial valuations. The actuarial valuation involves making various assumptions. These include the determination of the discount rates, future salary increases, mortality rates and future retirement benefits increases. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, defined benefit obligations are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date. The retirement and other post-employment benefits expense amounted to ₱1,093 million and ₱1,016 million for the nine months ended September 30, 2016 and 2015, respectively. The retirement and other post-employment benefit liabilities as at September 30, 2016 and December 31, 2015 amounted to ₱3,684 million and ₱3,620 million, respectively.

In determining the appropriate discount rate, management considers the interest rates of government bonds in the respective currencies, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation. The underlying bonds are further reviewed for quality, and those having excessive credit spreads are removed from the population of bonds on which the discount rate is based, on the basis that they do not represent high quality bonds.

The mortality rate is based on publicly available mortality tables for the specific country and is modified accordingly with estimates of mortality improvements. Future salary increases and retirement benefits increases are based on expected future inflation rates for the specific country.

See *Note 25 – Expenses and Income* and *Note 26 – Long-term Employee Benefits*.

Insurance Liabilities Arising from Insurance Contracts

RSIC estimates the expected ultimate costs of claims reported and claims incurred but not yet reported as at the reporting date. It takes a significant period of time to establish with certainty the ultimate cost of claims.

The primary technique adopted by *RSIC*'s management in estimating the cost of claims incurred but not yet reported is using the past claims settlement trend to predict the future claims settlement trend. At each reporting date, estimates of prior year claims are reassessed for adequacy and any changes are charged to provisions. Insurance contract liabilities are not discounted for the time value of money.

As at September 30, 2016 and December 31, 2015, gross carrying values of insurance liabilities arising from insurance contracts, included in "Other noncurrent liabilities" account, amounted to ₱301 million and ₱242 million, respectively.

Provision for Asset Retirement Obligations

Provision for asset retirement obligations is recognized in the year in which they are incurred if a reasonable estimate of fair value can be made. This requires an estimation of the cost to restore or dismantle, on a per area basis, depending on the location, and is based on the best estimate of the expenditure required to settle the obligation at the future restoration/dismantlement date, discounted using a pre-tax rate that reflects the current market assessment of the time value of money and, where appropriate, the risk specific to the liability.

No asset retirement obligation was recognized since the amount is immaterial.

Provisions

The *MERALCO Group* has various claims, assessments and cases as discussed in *Note 29 – Contingencies and Legal Proceedings*. The *MERALCO Group*'s estimate for probable costs for the resolution of these claims, assessments and cases has been developed in consultation with external (if any) and internal counsels handling the defense in these claims, assessments and cases and is based upon thorough analysis of potential outcome.

The *MERALCO Group*, in consultation with its external legal counsels, does not believe that these claims and legal proceedings will have a material adverse effect in the consolidated financial statements. It is possible, however, that future financial performance could be materially affected by changes in the estimates or the effectiveness of management's strategies and actions relating to these proceedings.

The *MERALCO Group* recognized provisions on various claims and assessments amounting to ₱6,894 million and ₱5,562 million for the nine months ended September 30, 2016 and 2015, respectively.

See *Note 19 – Provisions* and *Note 22 – Trade Payables and Other Current Liabilities*.

Revenue Recognition

The *MERALCO Group*'s revenue recognition policies require the use of estimates and assumptions that may affect the reported amounts of its revenues and receivables.

Revenues from sale of electricity by *MERALCO* and *CEDC* are billed based on customer-specific billing cycle cut-off date for each customer, while recording of related purchased power cost in the accounts is based on calendar month as provided in the terms of the *PPAs* and *PSAs*. The recognition of unbilled revenues for billing cycles with earlier than month-end cut-off dates requires the use of estimates. The difference between the amounts initially recognized based on provisional invoices and the settlement of the actual billings by the generators is taken up in the

subsequent period. Also, revenues from sale of electricity are adjusted for the estimated over and/or under –recoveries of pass-through charges, which are subject of various applications for recovery and approval by the *ERC*.

Management believes that such use of estimates will not result in material adjustments in future periods.

Revenues and costs from construction contracts of *MIESCOR* are recognized based on the percentage of completion method. This is measured principally on the basis of the estimated completion of a physical proportion of the contract work as determined from the reports of the contractors and project consultants.

6. Segment Information

Each operating segment of the *MERALCO Group* engages in business activities from which revenues are earned and expenses are incurred (including revenue and expenses relating to transactions with other business segments within the *MERALCO Group*). The operating results of each of the operating segments are regularly reviewed by *MERALCO*'s chief operating decision-maker ("*Management Committee*") to determine how resources are to be allocated to the operating segments and to assess their performances for which discrete financial information is available.

For management purposes, the *MERALCO Group*'s operating businesses are organized and managed separately according to the nature of services provided, with each segment representing a strategic business unit that offers different products and/or services, as follows:

- Power

The Power segment consists of (a) electricity distribution, (b) power generation and (c) *RES*.

Electricity distribution – This is principally electricity distribution and supply of power on a pass-through basis covering all captive customers in the *MERALCO* and the *CEDC* franchise areas in the Luzon Grid. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country. *CEDC*'s franchise area covers the Clark Freeport Zone and the sub-zone as determined pursuant to Presidential Decree No. 66 and the Joint Venture Agreement executed between *CDC* and *MIESCOR*.

Power generation – The *MERALCO Group*'s re-entry in the power generation business is through investments in operating companies or participation in the development of power generation projects. *MGen*, the power generation arm of the *MERALCO Group*, has a 14% equity interest in *GBPC* effective June 30, 2016. *GBPC* currently operates a total of 709 MegaWatt ("*MW*") - gross of coal and diesel-fired power plants, and has a 150 *MW*- gross coal-fired power plants under construction in the Visayas.

MGen owns an effective 28% equity in PacificLight Power Pte Ltd. ("*PacificLight Power*") in Jurong Island, Singapore. *PacificLight Power* began commercial operations in February 2014.

AIE is currently developing a 2 x 600 *MW* supercritical pulverized coal-fired power plant in Atimonan, Quezon. Completion of the first 600 *MW* is targeted by 2020 and the second 600 *MW* by early 2021.

A *PSA* have been executed between *AIE* and *MERALCO* for the full capacity. The *PSA* was submitted to the *ERC* for its approval.

MGen is currently (i) constructing a 455 *MW* net capacity supercritical coal-fired power plant in Mauban, Quezon through *SBPL*, (ii) developing a 2 x 600 *MW* coal-fired power plant in Atimonan, Quezon through Atimonan One Energy Inc., (iii) developing a 2 x 300 *MW* Circulating Fluidized Bed ("*CFB*"), coal-fired power plant in the Subic Freeport Zone through Redondo Peninsula Energy, Inc. ("*RP Energy*"), (iv) developing 2 x 350 *MW* coal plant in Calaca, Batangas through St. Raphael Power Generation Corporation ("*SRPGC*"), and (v) developing a 4x 150 *MW* coal-fired power plant in Mariveles Bataan through Mariveles Power Generation Corporation ("*MPGC*").

MERALCO has also subscribed 50% equity interest in Pure Meridian Hydropower Corporation which shall undertake the development of hydroelectric power projects.

See Note 8 – *Investments in Associates and Interests in Joint Ventures*.

RES – This covers the sourcing and supply of electricity to qualified contestable customers. *MERALCO* serves as a local *RES* within its franchise area under a separate business unit, *MPower*. Under Retail Competition and Open Access ("*RCOA*"), qualified contestable customers who opt to switch to contestability and become contestable customers may source their electricity supply from competing retail electricity suppliers ("*RESs*"), including *MPower*.

▪ Other Services

The other services segment is involved principally in electricity-related services, such as; electro-mechanical engineering, construction, consulting and related manpower services, e-transaction and bills collection, telecoms services, rail-related operations and maintenance services, insurance and re-insurance, e-business development, power distribution management, and energy systems management and harnessing renewable energy. These services are provided by *MIESCOR*, *MBI* and *MLI* (collectively known as "*MIESCOR Group*"), *CIS*, *Bayad Center*, *CFSI* and *Fieldtech* (collectively referred to as "*CIS Group*"), *MRail*, *RSIC*, *LOIL*, *Finserve*, *e-MVI*, *Comstech*, *MEI* and *MSpectrum*.

The Management Committee monitors the operating results of each business unit separately for the purpose of determining resource allocation and assessing performance. Performance is evaluated based on (i) net income for the period, (ii) consolidated core earnings before interest, taxes, and depreciation and amortization or consolidated core ("*EBITDA*"); and (iii) consolidated core net income ("*CCNI*"). Net income for the period is measured consistent with reported net income in the consolidated statement of income.

Core *EBITDA* is measured as *CCNI* excluding depreciation and amortization, interest and other financial charges, interest and other financial income, equity in net earnings or losses of associates and joint ventures and provision for income tax.

CCNI for the period is measured as consolidated net income attributable to equity holders of the parent adjusted for foreign exchange gain or loss, mark-to-market gain or loss, impairment or reversal of impairment of noncurrent assets and certain other non-recurring gain or loss, if any, net of tax effect of the foregoing adjustments.

Billings between operating segments are done on an arm's-length basis in a manner similar to transactions with third parties. Segment revenues, segment expenses and segment results include transfers among business segments. Those transfers are eliminated upon consolidation.

The *MERALCO Group* operates and generates substantially all of its revenues in the Philippines (i.e., one geographical location). Thus, geographical segment information is not presented. The *MERALCO Group* has no revenues from transactions with a single external customer accounting for 10% or more of its revenues from external customers.

	Note	Power		Other Services		Inter-segment Transactions		Total	
		For the Nine Months Ended September 30		For the Nine Months Ended September 30		For the Nine Months Ended September 30		For the Nine Months Ended September 30	
		2016	2015	2016	2015	2016	2015	2016	2015
Revenues		₱189,135	₱191,496	₱7,262	₱6,758	₱195,164	₱197,047		
		<i>(Amounts in Millions)</i>							
Segment results		₱25,017	₱26,417	₱1,769	₱1,551	₱—	₱—	₱26,786	₱27,968
Depreciation and amortization		(4,972)	(4,816)	(234)	(219)	—	—	(5,206)	(5,035)
Interest and other financial income	25	1,498	1,044	30	25	—	—	1,528	1,069
Equity in net losses of associates and joint ventures	8	(40)	(144)	(93)	—	—	—	(133)	(144)
Interest and other financial charges	25	(949)	(882)	(35)	(22)	—	—	(984)	(904)
Provision for income tax - net		(5,742)	(6,355)	(429)	(383)	—	—	(6,171)	(6,738)
Net income attributable to non-controlling interests		—	—	—	—	(144)	(67)	(144)	(67)
Net income attributable to equity holders of the Parent		₱14,812	₱15,264	₱1,008	₱952	₱144	₱67	₱15,676	₱16,149

	Note	Power		Other Services		Inter-segment Transactions		Total	
		For the Three Months Ended September 30		For the Three Months Ended September 30		For the Three Months Ended September 30		For the Three Months Ended September 30	
		2016	2015	2016	2015	2016	2015	2016	2015
Revenues		₱64,366	₱61,207	₱2,445	₱2,303	₱451	₱471	₱66,360	₱63,039
		<i>(Amounts in Millions)</i>							
Segment results		₱8,104	₱7,591	₱585	₱524	₱—	₱—	₱8,689	₱8,115
Depreciation and amortization		(1,661)	(1,713)	(79)	(79)	—	—	(1,740)	(1,792)
Interest and other financial income	25	548	288	10	9	—	—	558	297
Equity in net losses of associates and joint ventures	8	(65)	(94)	(93)	—	—	—	(158)	(94)
Interest and other financial charges	25	(357)	(293)	(12)	(9)	—	—	(369)	(302)
Provision for income tax - net		(1,870)	(1,667)	(165)	(131)	—	—	(2,035)	(1,798)
Net income attributable to non-controlling interests		—	—	—	—	(37)	(24)	(37)	(24)
Net income attributable to equity holders of the Parent		₱4,699	₱4,112	₱246	₱314	₱37	₱24	₱4,908	₱4,402

The inter-segment revenues mainly represent revenues of other services segment earned from the power segment.

The following table shows the reconciliation of the *EBITDA* to net income:

	Unaudited			
	For the Nine Months		For the Three Months	
	Ended September 30		Ended September 30	
	2016	2015	2016	2015
	<i>(Amounts in millions)</i>			
<i>EBITDA</i>	₱26,309	₱27,167	₱8,265	₱7,474
Add (deduct):				
Depreciation and amortization	(5,206)	(5,035)	(1,740)	(1,792)
Interest and other financial income	1,528	1,069	558	297
Interest and other financial charges	(984)	(904)	(369)	(302)
Equity in net losses of associates and joint ventures	(133)	(144)	(158)	(94)
Foreign exchange gains	477	801	424	641
Income before income tax	21,991	22,954	6,980	6,224
Provision for income tax	(6,171)	(6,738)	(2,035)	(1,798)
Net income	₱15,820	₱16,216	₱4,945	₱4,426

The following table shows the reconciliation of the *CCNI* to net income:

	Unaudited			
	For the Nine Months		For the Three Months	
	Ended September 30		Ended September 30	
	2016	2015	2016	2015
	<i>(Amounts in millions)</i>			
<i>CCNI</i>	₱14,966	₱15,795	₱4,578	₱4,155
Add (deduct) non-core items, net of tax:				
Foreign exchange gain	383	629	346	505
Non-core income (expenses)	327	(275)	(16)	(258)
Net income for the period attributable to equity holders of the Parent	15,676	16,149	4,908	4,402
Net income for the period attributable to non-controlling interests	144	67	37	24
Net income	₱15,820	₱16,216	₱4,945	₱4,426

7. Utility Plant and Others

The movements in utility plant and others are as follows:

September 30, 2016 (Unaudited)										
	Note	Subtransmission and Distribution	Land	Buildings and Improvements	Office Furniture, Fixtures and				Construction in Progress	Total
					Communication Equipment	Other Equipment	Transportation Equipment	Others		
Cost:										
Balance at January 1, 2016		₱155,590	₱15,280	₱6,213	₱2,482	₱3,057	₱3,306	₱3,713	₱7,808	₱197,449
Additions		656	48	18	98	72	96	322	5,708	7,018
Disposals/retirements		(1,338)	—	(2)	(2)	(13)	(33)	(21)	—	(1,409)
Transfers from construction in progress		4,829	—	37	54	14	—	42	(4,976)	—
Reclassifications	9 and 10	(33)	—	(8)	2	(1)	—	9	—	(31)
Balance at September 30, 2016		159,704	15,328	6,258	2,634	3,129	3,369	4,065	8,540	203,027
Less accumulated depreciation and amortization:										
Balance at January 1, 2016		62,982	—	2,428	1,094	2,035	1,983	2,014	—	72,536
Depreciation and amortization		3,995	—	128	129	212	198	197	—	4,859
Disposals/retirements		(1,155)	—	(2)	1	(13)	(8)	(13)	—	(1,190)
Reclassifications		(3)	—	—	(3)	(3)	—	5	—	(4)
Balance at September 30, 2016		65,819	—	2,554	1,221	2,231	2,173	2,203	—	76,201
Net book value		₱93,885	₱15,328	₱3,704	₱1,413	₱898	₱1,196	₱1,862	₱8,540	₱126,826
December 31, 2015 (Audited)										
	Note	Subtransmission and Distribution	Land	Buildings and Improvements	Office Furniture, Fixtures and				Construction in Progress	Total
					Communication Equipment	Other Equipment	Transportation Equipment	Others		
Cost:										
Balance at January 1, 2015		₱148,977	₱15,280	₱5,599	₱2,153	₱2,836	₱3,148	₱3,147	₱7,491	₱188,631
Additions		228	—	24	259	202	279	543	9,028	10,563
Disposals/retirements		(1,595)	—	(2)	(6)	(34)	(123)	(9)	—	(1,769)
Transfers from construction in progress		7,980	—	604	70	7	2	48	(8,711)	—
Reclassification and others	10	—	—	(12)	6	46	—	(16)	—	24
Balance at December 31, 2015		155,590	15,280	6,213	2,482	3,057	3,306	3,713	7,808	197,449
Less accumulated depreciation and amortization:										
Balance at January 1, 2015		59,217	—	2,266	917	1,759	1,770	1,872	—	67,801
Depreciation and amortization		5,309	—	163	182	303	311	207	—	6,475
Disposals/retirements		(1,595)	—	(1)	(6)	(31)	(98)	(9)	—	(1,740)
Reclassification and others	10	51	—	—	1	4	—	(56)	—	—
Balance at December 31, 2015		62,982	—	2,428	1,094	2,035	1,983	2,014	—	72,536
Net book value		₱92,608	₱15,280	₱3,785	₱1,388	₱1,022	₱1,323	₱1,699	₱7,808	₱124,913

As at September 30, 2016 and December 31, 2015, the net book values of customer-funded assets included in “Utility plant and others” account amounted to ₱2,430 million and ₱2,031 million, respectively. The corresponding liabilities to customers in the same amounts as at September 30, 2016 and December 31, 2015 are included in “Other noncurrent liabilities” account in the consolidated statements of financial position.

Construction in progress mainly pertains to on-going electric capital projects (“ECPs”) and non-electric capital projects. ECPs are capital projects involving construction of new electric distribution-related facilities and the upgrade and major rehabilitation of existing electrical facilities. Total interest capitalized amounted to ₱125 million and ₱131 million for the nine months ended September 30, 2016 and 2015, respectively.

The average annual interest rates used for capitalization for the nine months ended September 30, 2016 and 2015 ranged from 4.40% to 4.50% and 4.41% to 4.62%, respectively.

8. Investments in Associates and Interests in Joint Ventures

This account consists of the following as at September 30, 2016 and December 31, 2015:

	Place of Incorporation	Principal Activity	2016 Percentage of Ownership	2015
Associates				
RP Energy	Philippines	Power generation	47	47
FPM Power Holdings Limited (“FPM Power”)	British Virgin Islands	Power generation	40	40
Buang Private Power Corporation (“BPPC”)	Philippines	Power generation	38	38
General Electric Philippines Meter and Instrument Company, Inc. (“GEPMICI”)	Philippines	Sale of metering products and services	35	35
Indra Philippines, Inc. (“Indra Philippines”)	Philippines	Management and IT consultancy	24	24
GBPC	Philippines	Power generation	22	22
AF Payments, Inc. (“AFP”)	Philippines	Electronic payment clearing and settlement system operator	10	10
MRail-DESCO Joint Venture (“MDJI”)	Philippines	Procurement	51	51
St. Raphael Power Generation Corporation (“SRPGC”)	Philippines	Power generation	33	–
Joint Ventures				
SBPL	Philippines	Power generation	51	51
Rockwell Business Center	Philippines	Real estate	30	30
Pure Meridian Hydropower Corporation (“PMHC”)	Philippines	Renewable energy	49	–
Mariveles Power Generation Corporation (“MPGC”)	Philippines	Power generation	49	–

The movements in investments in associates and interests in joint ventures account are as follows:

	September 30, 2016 (Unaudited) (Nine months)	December 31, 2015 (Audited) (One year)
(Amounts in millions)		
Acquisition costs:		
Balance at beginning of period	₱15,214	₱14,883
Additions	1,405	334
Disposal	(2,992)	(3)
Balance at end of period	13,627	15,214

(Forward)

	September 30, 2016 (Unaudited) (Nine months)	December 31, 2015 (Audited) (One year)
<i>(Amounts in millions)</i>		
Accumulated equity in net losses:		
Balance at beginning of period	(P1,513)	(P680)
Equity in net losses	(133)	(27)
Dividends	(82)	(605)
Disposal	(67)	(201)
Balance at end of period	(1,795)	(1,513)
Share in remeasurement adjustments on retirement liabilities:		
Balance at beginning of period	(12)	(20)
Actuarial loss	–	(1)
Effect of disposal	–	9
Balance at end of period	(12)	(12)
Share in cumulative translation adjustments:		
Balance at beginning of period	(86)	349
Translation adjustments	556	(435)
Balance at end of period	470	(86)
	P12,290	P13,603

The carrying values of investments in associates and interests in joint ventures follow:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
<i>GBPC</i>	P5,422	P8,186
<i>FPM Power</i>	3,000	2,777
Rockwell Business Center	1,207	1,234
<i>MPGC</i>	964	–
<i>RP Energy</i>	931	632
<i>Indra Philippines</i>	224	210
<i>AFPI</i>	202	230
<i>SBPL</i>	194	258
<i>SRPGC</i>	58	–
<i>GEPMICI</i>	52	65
<i>PMHC</i>	25	–
<i>BPPC</i>	11	11
	P12,290	P13,603

RP Energy

On July 22, 2011, *MGen* signed a Shareholders' Agreement with Therma Power, Inc. ("*TPI*") and Taiwan Cogeneration International Corporation – Philippine Branch ("*TCIC*") for the construction and operation of a 2 x 300 *MW CFB*, coal-fired power plant to be located in the Subic Bay Freeport Zone. The development and operations shall be undertaken by *RP Energy*, the joint venture entity.

On February 3, 2015, *RP Energy* received the *SC*'s decision denying the Writ of Kalikasan case previously filed by certain opposing parties against its planned power plant due to insufficiency of evidence. The *SC* upheld the validity of the Environment Compliance Certificate ("*ECC*") and its first two amendments, as well as the Lease and Development Agreement ("*LDA*") of *RP Energy* with Subic Bay Metropolitan Authority ("*SBMA*"). On February 23, 2016, the *LDA* and transmission line right of way lease agreement with *SBMA* were signed.

RP Energy will develop its 2 x 300 *MW* project in two (2) 300 *MW* phases. On October 13, 2016, the Engineering, Procurement and Construction ("*EPC*") for the first 300 *MW* have been executed.

In April 2016, *RP Energy* separately signed power supply agreements with *MERALCO* and Aboitiz Energy Solutions, Inc. *RP Energy* is awaiting the approval of the said agreements by the *ERC*.

RP Energy's project has been issued a Certificate of Registration in June 2016 by the Board of Investments ("*BOP*") entitling the project to certain investment promotion incentives.

RP Energy is also in the process to mandate a lead arranger to arrange the entire debt financing requirement of the project. All project debt will be raised from local banks.

Construction of the first 300 *MW* unit is expected to start in the fourth quarter of 2016, with commercial operations in early 2020. Meanwhile, work on the permanent transmission line interconnection is proceeding in preparation for the development of the second 300 *MW* unit.

FPM Power

FPM Power is 40%-owned by *MERALCO* through *MPG Asia*, a subsidiary of *MGen*, and 60%-owned by First Pacific Company Limited ("*First Pacific*"). On March 28, 2013, *FPM Power* acquired a 70% interest in *PacificLight Power*, which owns and operates a 2 x 400 *MW* LNG-fired power plant in Jurong Island, Singapore. *PacificLight Power*'s wholly owned subsidiary, *PacificLight Energy Pte. Ltd.*, is engaged in energy trading.

BPPC

BPPC was incorporated and registered with the Philippine *SEC* on February 3, 1993 to engage in the power generation business.

In accordance with the Build-Operate-Transfer ("*BOT*") Agreement signed in 1993, First Private Power Corporation ("*FPPC*"), then parent company, constructed the 215 *MW* Bauang Power Plant ("*Bauang Plant*"), and operated the same under a 15-year Cooperation Period up to July 25, 2010.

The *Bauang Plant* has since been turned over to the National Power Corporation ("*NPC*") without any compensation and free of any liens. In 2010, the Philippine *SEC* approved the merger of *FPPC* and *BPPC*, with *BPPC* as the surviving entity. *BPPC* management continues to evaluate its investment options in power generation and allied industries.

GEPMICI

GEPMICI was established in 1979 together with General Electric Company of U.S.A., to serve the Philippine market for ANSI-type Watt-hour meters.

GBPC

On October 7, 2013, *MGen* executed a Share Sale and Purchase Agreement with First Metro Investment Corporation (“*FMIC*”) for the sale by *FMIC* of a 20% equity interest in *GBPC* to *MGen*, and signed a related Shareholders Agreement on October 22, 2013. In June 2014, *MGen* acquired an additional 2% equity interest in *GBPC*, bringing its equity interest to 22%. On June 30, 2016, *MGen* and *JG Summit* executed a deed of absolute assignment of shares whereby *MGen* sells and assigns 153,921,676 shares representing 8% of its equity interest in *GBPC* to *JG Summit* for ₱3.151 billion.

GBPC owns an aggregate of 709 *MW* (gross) of coal and diesel power plants in operation in the Visayas region. Commissioning and commercial operations of Panay Energy Development Corporation’s (“*PEDC*”) 150 *MW CFB* coal-fired facility in Iloilo City are expected by the end of 2016. A *PSA* for 70 *MW* of the capacity has been filed with the *ERC* and is awaiting review and approval by the *ERC*.

AFPI

MERALCO, through *Finserve*, has a 10% equity interest in *AFPI* since its incorporation in February 2014. *AFPI* was incorporated primarily to operate and maintain an electronic payment clearing and settlement system through a contactless automated fare collection system for public utility, including generic contactless micropayment solution. It shall also supply and issue fare media and store value cards or reloadable cards for use in transport and non-transport facilities and operated and maintain the related hardware and software. While *MERALCO* has 10% equity interest, management has assessed that *MERALCO* has significant influence over *AFPI* mainly through its representation in *AFPI*’s board.

SBPL

On August 29, 2013, *MGen* signed a Joint Development Agreement with New Growth B.V., a 100% subsidiary of Electricity Generating Public Company Limited of Thailand (“*EGCO*”) for the development of a new 455 *MW* (net) supercritical coal-fired power plant in Mauban, Quezon. *MGen*’s equity in the joint venture company, *SBPL*, is 51%, with the option to assign or transfer 2% thereof to a separate entity. On November 11, 2014, the *DENR* granted *SBPL* an *ECC* covering the 455 *MW* (net) coal-fired power plant.

SBPL’s *EPC* was executed with the Consortium of Daelim Industrial Co. Ltd. and Mitsubishi Corporation following a competitive selection process on October 8, 2014. The construction period is set at 42 months from the commencement date of December 8, 2015.

On May 29, 2014, *MERALCO* signed a long term *PSA* with *SBPL*. The *ERC*-approved *PSA* was accepted by *SBPL* on May 30, 2015.

On October 8, 2015, *SBPL* entered into an Omnibus Agreement and related agreements with certain financial institutions providing for a term loan facility in an amount of up to ₱42.15 billion for the financing of the project. *SBPL* made its initial borrowing on December 1, 2015. On December 11, 2015, *SBPL* entered into an Operation and Maintenance Agreement with Pearl Energy Philippines Operating, Inc. for the operations and maintenance of the power plant.

SBPL is expected to achieve commercial operations in 2019.

Indra Philippines

Indra Philippines is an IT service provider in the country and in the Asia Pacific region, with a wide range of services across various industries. *Indra Philippines* provides services which meet certain of *MERALCO*'s IT requirements in the area of system development, outsourcing of Information Systems ("IS") and IT operations and management consulting.

In October 2015, *MERALCO* completed the sale to *Metro Pacific* and *Indra Sistemas S.A.* of its 84,012 shares and 337 shares, respectively, in *Indra Philippines* for an aggregate purchase price of ₱330 million.

Rockwell Business Center

The Rockwell Business Center is a joint venture between Rockwell Land Corporation ("*Rockwell Land*") and *MERALCO* over a pre-agreed cooperation period, pursuant to which *Rockwell Land* has three (3) Business Process Outsourcing-enabled buildings on a non-regulatory asset base property of *MERALCO*. Investment in Rockwell Business Center represents *MERALCO*'s 30% interest in the joint venture, accounted for using the equity method. *Rockwell Land* owns 70% interest in Rockwell Business Center.

MDJV

On June 2, 2014, *MRail* and *DESCO* entered into a Joint Venture Agreement for the purposes of participating in the bidding/negotiated procurement and undertaking of the project for the General Overhaul and Rehabilitation of three of Diesel Electric Locomotives by the Philippine National Railways. The equity share is 51:49 in favor of *MRail*.

SRPGC

On April 27, 2016, *MGen* and Semirara Mining and Power Corp. entered a joint venture agreement to develop a 2 x 350 MW (net) sub-critical pulverized coal-fired power plant in Calaca, Batangas. The development and operations shall be undertaken by *SRPGC*, the joint venture entity. A *PSA* was signed by *SRPGC* and *MERALCO* in April 2016 for 400 MW output of the plant's capacity. Target operation date of the power plant is in 2021. The *PSA* was submitted to the *ERC* in April 2016 for its review and approval.

PMHC

On January 7, 2016, *MERALCO* and Repower Energy Development Corporation ("*REDC*") agreed to put up a joint venture corporation, Pure Meridian Hydropower Corporation, which shall undertake the development of various hydroelectric power projects.

MPGC

On June 16, 2016, *MERALCO* and *MPGC* entered a joint venture agreement to develop, construct, finance, own, operate and maintain a 4 x 132 MW (net) circulating fluidized bed coal-fired power plant and associated facilities in Mariveles, Bataan.

The construction of the power plant is expected to be completed by 2019.

The condensed statements of financial position of material associates follow:

	September 30, 2016 (Unaudited)		
	GBPC	FPM Power	RP Energy
	<i>(Amounts in millions)</i>		
Current assets	₱19,825	₱6,260	₱628
Noncurrent assets	69,448	52,697	1,256
Current liabilities	(11,607)	(19,324)	(8)
Noncurrent liabilities	(33,618)	(30,297)	(2)
Non-controlling interests	(13,128)	(1,836)	–
Net assets	₱30,920	₱7,500	₱1,874

	December 31, 2015 (Audited)		
	GBPC	FPM Power	RP Energy
	<i>(Amounts in millions)</i>		
Current assets	₱22,043	₱5,831	₱130
Noncurrent assets	54,218	48,678	1,118
Current liabilities	(12,596)	(17,858)	(7)
Noncurrent liabilities	(31,827)	(28,083)	(2)
Non-controlling interests	(4,444)	(1,626)	–
Net assets	₱27,394	₱6,942	₱1,239

The condensed statements of comprehensive income of material associates are as follows:

	Unaudited					
	For the Nine Months Ended September 30					
	2016			2015		
	GBPC	FPM Power	RP Energy	GBPC	FPM Power	RP Energy
	<i>(Amounts in millions)</i>					
Revenues	₱13,017	₱19,853	₱2	₱14,254	₱23,543	₱1
Costs and expenses	(9,923)	(21,468)	(46)	(11,704)	(25,598)	(21)
Net income (loss)	3,094	(1,615)	(44)	2,550	(2,055)	(20)
Non-controlling interests	(987)	785	–	(903)	640	–
Net income (loss) attributable to equity holders of the parent	2,107	(830)	(44)	1,647	(1,415)	(20)
Other comprehensive loss	–	1,388	–	–	571	–
Total comprehensive income (loss)	₱2,107	(₱558)	(₱44)	₱1,647	(₱844)	(₱20)
Dividends received	₱–	₱–	₱–	₱–	₱–	₱–

The reconciliation of the net assets of the foregoing material associates to the carrying amounts of the interest in these associates recognized in the consolidated statements of financial position is as follows:

	September 30, 2016 (Unaudited)		
	GBPC	FPM Power	RP Energy
	<i>(Amounts in millions, except % of ownership)</i>		
Net assets of associates	₱30,920	₱7,500	₱1,874
Proportionate ownership in associates (%)	14	40	47
	4,329	3,000	881
Goodwill	1,093	–	50
	₱5,422	₱3,000	₱931

	December 31, 2015 (Audited)		
	<i>GBPC</i>	<i>FPM Power</i>	<i>RP Energy</i>
	<i>(Amounts in millions, except % of ownership)</i>		
Net assets of associates	₱27,394	₱6,942	₱1,239
Proportionate ownership in associates (%)	22	40	47
	6,027	2,777	582
Goodwill	2,159	—	50
	₱8,186	₱2,777	₱632

The following is the aggregate information of associates that are not individually material associates:

	Unaudited	
	For the Nine Months Ended	
	September 30	
	2016	2015
	<i>(Amounts in millions)</i>	
Share in net income	(₱13)	(₱3)
Share in other comprehensive income	—	1
Share in total comprehensive income	(₱13)	(₱2)
Dividends received	₱—	₱—

Joint Ventures

The condensed statements of financial position of Rockwell Business Center, a material joint venture, follow:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions)</i>	
Current assets	₱1,107	₱946
Noncurrent assets	3,235	3,364
Current liabilities	(429)	(296)
Noncurrent liabilities	—	(10)
Net assets	₱3,913	₱4,004

Current assets include cash and cash equivalents of ₱859 million and ₱781 million as at September 30, 2016 and December 31, 2015, respectively. Noncurrent assets represent substantially the cost of the two (2) *BPO* towers for lease and the construction costs of the third building of Rockwell Business Center. Current liabilities represent trade payables.

The condensed statements of comprehensive income of Rockwell Business Center for the nine months ended September 30, 2016 and 2015 are as follows:

	Unaudited	
	For the Nine Months Ended	
	September 30	
	2016	2015
	<i>(Amounts in millions)</i>	
Revenues	₱507	₱370
Costs and expenses - net of other income	(174)	(105)
Provision for income tax - net	(89)	(35)
Net income	244	230
Other comprehensive income	—	—
Total comprehensive income	₱244	₱230
Dividends received	₱73	₱—

The foregoing condensed statements of comprehensive income include the following:

	Unaudited	
	For the Nine Months Ended	
	September 30	
	2016	2015
	<i>(Amounts in millions)</i>	
Depreciation	₱150	₱152
Interest income	(8)	(6)
Provision for income tax	89	35

The reconciliation of the net assets of Rockwell Business Center to the carrying amounts of the interest in Rockwell Business Center recognized in the consolidated financial statements is as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions, except % of ownership)</i>	
Net assets	₱3,913	₱4,004
Proportionate ownership (%)	30	30
	1,174	1,201
Effect of difference between <i>MERALCO</i> 's percentage share in net income and proportionate ownership	33	33
	₱1,207	₱1,234

The following is the condensed financial information of joint ventures which are not considered as material:

	Unaudited	
	For the Nine Months Ended	
	September 30	
	2016	2015
	<i>(Amounts in millions)</i>	
Share in net income	(P41)	P37
Share in other comprehensive loss	–	(2)
Share in total comprehensive income (loss)	(P41)	P35
Dividends received	P9	P–

9. Investment Properties

The movements in investment properties are as follows:

September 30, 2016 (Unaudited)			
	Land	Buildings and Improvements	Total
	<i>(Amounts in millions)</i>		
Cost:			
Balance at January 1, 2016	P1,427	P224	P1,651
Disposals/adjustments	–	(20)	(20)
Balance at September 30, 2016	1,427	204	1,631
Less accumulated depreciation:			
Balance at January 1, 2016	–	113	113
Depreciation	–	4	4
Balance at September 30, 2016	–	117	117
	P1,427	P87	P1,514
December 31, 2015 (Audited)			
	Land	Buildings and Improvements	Total
	<i>(Amounts in millions)</i>		
Cost:			
Balance at January 1, 2015	P1,446	P187	P1,633
Additions	–	33	33
Reclassifications	–	6	6
Disposals	(19)	(2)	(21)
Balance at December 31, 2015	1,427	224	1,651
Less accumulated depreciation:			
Balance at January 1, 2015	–	107	107
Depreciation	–	7	7
Disposals	–	(1)	(1)
Balance at December 31, 2015	–	113	113
	P1,427	P111	P1,538

Investment properties consist of real properties held for capital appreciation, former substation sites and other non-regulatory asset base real properties, some of which are being leased out.

The aggregate fair values of the investment properties are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions)</i>	
Land	₱1,863	₱1,863
Buildings and improvements	170	170

Land pertains primarily to properties where the *BPO* building and “Strip” mall are located and to other non-regulated asset base properties.

The fair values of investment properties were determined by independent, professionally qualified appraisers. The fair value represents the price that would be received to sell an investment property in an orderly transaction between market participants at the measurement date.

The fair value disclosures of the investment properties are categorized as Level 3 as there is no active market for identical or similar properties. The inputs include price per square meter ranging from ₱40 to ₱96,000. There have been no changes in the valuation techniques used.

In conducting the appraisal, the independent professional appraisers used any of the following approaches:

a. Market Data or Comparative Approach

Under this approach, the value of the property is based on sales and listings of comparable property registered within the vicinity. This approach requires the establishment of a comparable property by reducing comparative sales and listings to a common denominator with the subject. This is done by adjusting the differences between the subject property and those actual sales and listings regarded as comparables. The properties used are either situated within the immediate vicinity or at different floor levels of the same building, whichever is most appropriate to the property being valued. Comparison was premised on the factors of location, size and physical attributes, selling terms, facilities offered and time element.

b. Depreciated Replacement Cost Approach

This method of valuation considers the cost to reproduce or replace in new condition the assets appraised in accordance with current market prices for similar assets, with allowance for accrued depreciation based on physical wear and tear and obsolescence.

10. Other Noncurrent Assets

This account consists of:

	Note	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>			
HTM investments	14 and 27	₱23,861	₱17,167
AFS financial assets	27	25,164	10,961
Intangible assets	7	2,381	2,585
Deferred input VAT		1,494	1,664
Advance payments to a supplier	27 and 30	1,228	1,030
Receivable from the BIR	29	181	181
Deferred reinsurance premium		156	119
Goodwill		36	36
Others		548	1,851
		₱55,049	₱35,594

HTM Investments

The details of HTM investments are as follows:

	September 30, 2016 (Unaudited)			December 31, 2015 (Audited)		
	Current Portion (Note 14)	Noncurrent Portion	Total	Current Portion	Noncurrent Portion	Total
<i>(Amounts in millions)</i>						
Government securities	₱1,185	₱23,127	₱24,312	₱4,072	₱16,476	₱20,548
Private debt securities	–	734	734	–	691	691
	₱1,185	₱23,861	₱25,046	₱4,072	₱17,167	₱21,239

This account represents investments in government securities issued by the Republic of Philippines and private debt securities issued by Philippine listed corporations.

AFS Financial Assets

The details of AFS financial assets are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Investments in government securities	₱18,566	₱1,792
Investments in Unit Investment Trust Funds (“UITFs”)	5,912	9,027
Investments in ordinary shares and club shares of stock:		
Quoted	651	107
Unquoted	35	35
	₱25,164	₱10,961

The rollforward of unrealized gains (losses) on quoted *AFS* financial assets included in the consolidated statements of financial position follows:

	Unaudited	
	For the Nine Months	
	Ended September 30	
	2016	2015
	<i>(Amounts in millions)</i>	
Balance at beginning of period	₱102	₱112
Gains on change in fair value	681	82
Balance at end of period	₱783	₱194

Intangible Assets

The movements of intangible assets are as follows:

September 30, 2016 (Unaudited)				
			Land and	
			Leasehold	
	<i>Note</i>	Software	Franchise	Rights
				Total
				<i>(Amounts in millions)</i>
Cost:				
Balance at January 1, 2016		₱4,144	₱49	₱431
Additions		112	—	—
Reclassifications	<i>7</i>	31	—	—
Balance at September 30, 2016		4,287	49	431
Less accumulated amortization:				
Balance at January 1, 2016		1,799	—	240
Amortization		330	—	13
Reclassifications		4	—	—
Balance at September 30, 2016		2,133	—	253
		₱2,154	₱49	₱178

December 31, 2015 (Audited)				
			Land and	
			Leasehold	
	<i>Note</i>	Software	Franchise	Rights
				Total
				<i>(Amounts in millions)</i>
Cost:				
Balance at January 1, 2015		₱3,467	₱49	₱431
Additions		707	—	—
Reclassifications	<i>7</i>	(30)	—	—
Balance at December 31, 2015		4,144	49	431
Less accumulated amortization:				
Balance at January 1, 2015		1,389	—	222
Amortization		410	—	18
Balance at December 31, 2015		1,799	—	240
		₱2,345	₱49	₱191

Deferred Input VAT

The amount includes portion of input *VAT* incurred and paid in connection with purchase of capital assets in excess of ₱1 million per month. As provided for in *RA* No. 9337 ("*EVAT Law*"), said portion of input *VAT* shall be deferred and credited evenly over the estimated useful lives of the related capital assets or 60 months, whichever is shorter, against the output *VAT* due.

Unbilled Receivables

This account represents generation and other pass-through costs incurred by *MERALCO* and *CEDC* as *DUs*, which are still to be billed and which are covered by the approved recovery mechanism of the *ERC*. The balance also includes other unbilled generation and pass-through charges of current and prior years, which are the subject of various applications for recovery and approval by the *ERC*.

Provision for impairment loss on unbilled receivables amounted to ₱2,134 million as at September 30, 2016 and December 31, 2015.

11. Cash and Cash Equivalents

This account consists of:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions)</i>	
Cash on hand and in banks	₱5,090	₱5,098
Cash equivalents	31,491	45,742
	₱36,581	₱50,840

Cash in banks earn interest at prevailing bank deposit rates. Cash equivalents are temporary cash investments, which are made for varying periods up of to three (3) months depending on *MERALCO Group's* immediate cash requirements, and earn interest at the prevailing short-term investment rates.

12. Trade and Other Receivables

This account consists of:

	<i>Note</i>	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>			
Trade:			
Electricity:			
Billed	23 and 27	₱19,928	₱19,898
Unbilled	2 and 10	3,779	4,116
Service contracts		3,108	3,624
Cost and estimated earnings in excess of billings on uncompleted contracts		689	780
Insurance receivable		139	99
Nontrade	23 and 27	1,415	1,909
		29,058	30,426
Less allowance for doubtful accounts		3,509	3,665
		₱25,549	₱26,761

Billed receivables from sale of electricity of *MERALCO* and *CEDC* consist of the following:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Residential	₱9,269	₱8,969
Commercial	7,346	7,574
Industrial	3,033	3,044
Streetlights	280	311
	19,928	19,898
Less allowance for doubtful accounts	3,291	3,459
	₱16,637	₱16,439

Movements in allowance for doubtful accounts for trade and other receivables are as follows:

	September 30, 2016 (Unaudited)			
	Balance at January 1, 2016	Provisions (Reversals)	Write-offs	Balance at September 30, 2016
<i>(Amounts in millions)</i>				
Billed trade receivables:				
Residential	₱2,175	₱159	(₱362)	₱1,972
Commercial	909	63	(53)	919
Industrial	249	60	(18)	291
Streetlights	126	(17)	—	109
	3,459	265	(433)	3,291
Other trade receivables	203	11	—	214
Nontrade receivables	3	1	—	4
	₱3,665	₱277	(₱433)	₱3,509

September 30, 2016 (Unaudited)						
	Residential	Commercial	Industrial	Streetlights	Other Trade Receivables	Nontrade Receivables
	Total					
	(Amounts in millions)					
Individually impaired	₱882	₱287	₱121	₱31	₱214	₱4
Collectively impaired	1,090	632	170	78	–	–
	₱1,972	₱919	₱291	₱109	₱214	₱4
	₱3,509					

December 31, 2015 (Audited)				
	Balance at January 1, 2015	Provisions (Reversals)	Write-offs	Balance at December 31, 2015
	(Amounts in millions)			
Billed trade receivables:				
Residential	₱1,806	₱805	(₱436)	₱2,175
Commercial	963	23	(77)	909
Industrial	291	(11)	(31)	249
Streetlights	147	(20)	(1)	126
	3,207	797	(545)	3,459
Other trade receivables	218	(15)	–	203
Nontrade receivables	2	1	–	3
	₱3,427	₱783	(₱545)	₱3,665

December 31, 2015 (Audited)						
	Residential	Commercial	Industrial	Streetlights	Other Trade Receivables	Nontrade Receivables
	Total					
	(Amounts in millions)					
Individually impaired	₱1,404	₱362	₱114	₱44	₱203	₱3
Collectively impaired	771	547	135	82	–	–
	₱2,175	₱909	₱249	₱126	₱203	₱3
	₱3,665					

Trade Receivables – Electricity

Trade receivables of *MERALCO* and *CEDC* include charges for pass-through costs. Pass-through costs consist largely of generation, transmission and *SL* charges, which represent 51%, 12% and 4%, respectively, of the total billed amount in 2016 and 55%, 11% and 5%, respectively, of the total billed amount in 2015. Billed receivables are due 10 days after bill date. *MERALCO*'s and *CEDC*'s trade receivables are noninterest-bearing and are substantially secured by bill deposits.

Unbilled receivables represent electricity consumed after the meter reading cut-off dates, which will be billed to customers in the immediately following billing period. This also includes the current portion of pass-through costs under-recoveries, net of over-recoveries, which are billed to the customers over the period approved by the *ERC*.

See *Note 18 – Customers' Deposits* and *Note 27 – Financial Assets and Financial Liabilities*.

Trade Receivables – Service Contracts

Service contracts receivable arise from contracts entered into by *MIESCOR Group*, *e-MVI* and subsidiary, *CIS*, *Bayad Center*, *MRail*, and *MEI* for construction, engineering, related manpower, consulting, light rail maintenance, data transport, bills collection, tellering and e-business development and energy management services to third parties.

Receivables from service contracts and others are noninterest-bearing and are generally on 30- to 90-day terms.

13. Inventories

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Materials and supplies:		
At net realizable value ("NRV")	₱160	₱160
At cost	2,678	2,113
	₱2,838	₱2,273

The reversal of write-down of inventory cost to *NRV* amounted ₱2 million for the nine months ended September 30, 2015.

14. Other Current Assets

		September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>Note</i>	<i>(Amounts in millions)</i>	
Advances to an associate	23 and 27	₱5,506	₱5,342
Prepayments and advances to suppliers		2,411	2,469
Pass-through <i>VAT</i> - net		1,729	1,550
Prepaid tax		1,369	1,438
<i>HTM</i> investments	10 and 27	1,185	4,072
Input <i>VAT</i>		503	477
Others		72	73
		₱12,775	₱15,421

Pass-through *VAT* pertains to *VAT* on generation and transmission costs billed to the *DU*, which are in turn billed to the customers. Remittance of such pass-through *VAT* to the generation companies is based on collection of billed receivables from the customers.

15. Equity

Common Stock

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(In millions, except par value)</i>		
Authorized - ₱10 par value a share	1,250	1,250
Issued and outstanding - number of shares	1,127	1,127

There was no movement in the number of shares of *MERALCO*'s common stock.

The common shares of *MERALCO* were listed in the *PSE* on January 8, 1992. There are 44,197 and 44,193 shareholders of *MERALCO*'s common shares as at September 30, 2016 and December 31, 2015, respectively.

Unappropriated Retained Earnings

The unappropriated retained earnings include accumulated earnings of subsidiaries, associates and joint ventures, and the balance of *MERALCO*'s revaluation increment in utility plant and others and investment properties carried at deemed cost and deferred tax assets totaling to ₱42,345 million and ₱40,618 million as at September 30, 2016 and December 31, 2015, respectively. These amounts are restricted for dividend declaration purposes as of the close of the respective reporting period.

The following are the cash dividends declared on common shares as at September 30, 2016 and 2015:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount (In millions)
July 25, 2016	August 24, 2016	September 19, 2016	₱13.48	₱15,193
April 25, 2016	May 25, 2016	June 17, 2016	1.68	1,894
February 26, 2016	March 23, 2016	April 15, 2016	9.92	11,181
July 27, 2015	August 26, 2015	September 18, 2015	6.76	7,619
February 23, 2015	March 23, 2015	April 15, 2015	8.49	9,569

MERALCO pays regular cash dividends equivalent to 50% of *CCNI* for the year, which may be supplemented by a special dividend determined on a “look-back” basis. Declaration and payment of special dividend are dependent on the availability of unrestricted retained earnings and availability of free cash. The declaration, record and payment dates shall be consistent with the guidelines and regulations of the Philippine *SEC*.

Appropriated Retained Earnings

On February 22, 2010, retained earnings of ₱6,000 million were appropriated specifically for the *MERALCO Group*'s business expansion into power generation. The amount appropriated was increased by ₱5,000 million for the development of new projects and investments in power generation. The additional appropriation was approved on March 22, 2013 by the *BOD*. As at September 30, 2016, the development of the first project, a 2 x 300 *MW CFB* coal-fired plant through *RP Energy*, is proceeding with the decision of the *SC* denying the Writ of *Kalikasan* case previously filed by certain opposing parties against its planned power plant due to insufficiency of evidence. Construction of the first 300 *MW* unit is expected to start in the last quarter of 2016, with commercial operations by 2020. Meanwhile, work on the permanent transmission line interconnection is proceeding in preparation for the development of the second 300 *MW* unit.

Separately, *MERALCO* signed a Joint Development Agreement and Shareholders Agreement to co-develop a 455 *MW* (net) supercritical coal-fired power plant in Mauban, Quezon under *SBPL*, which has signed *PSA* and *EPC* contracts, has achieved financial close, and has a target completion in 2019.

On July 25, 2016, the *BOD* approved the reversal of the appropriated retained earnings of ₱11,000 million.

See Note 8 – *Investments in Associates and Interests in Joint Ventures*.

Treasury Shares

Treasury shares represent subscribed shares and the related rights of employees who have opted to withdraw from the *ESPP* in accordance with the provisions of the *ESPP* and which

MERALCO purchased. As at September 30, 2016 and December 31, 2015, a total of 172,412 shares were acquired from employees who have opted to cancel their participation in the *ESPP*.

16. Employee Stock Purchase Plan

MERALCO had an *ESPP*, which entitled participants to purchase *MERALCO*'s common shares subject to certain terms and conditions during a nominated offer period.

MERALCO allotted a total of 55 million common shares for *ESPP* awards. As at December 31, 2015, 12 million common shares are available for future offerings. There were no *ESPP* awards since October 2009.

The fair value of the offerings was estimated at the dates of the grant using the Black-Scholes Option Pricing Model.

17. Interest-bearing Long-term Financial Liabilities

This account consists of the following:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions)</i>	
Long-term portion of interest-bearing financial liabilities - Long-term debt	₱27,004	₱27,370
Current portion of interest-bearing financial liabilities:		
Long-term debt	372	373
Redeemable preferred stock	1,502	1,522
	1,874	1,895
	₱28,878	₱29,265

All of the redeemable preferred shares have been called for redemption as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. The accrued interests amounted to ₱250 million as at September 30, 2016 and December 31, 2015. Interest is no longer accrued when the preferred shares were called for redemption.

The details of interest-bearing long-term financial liabilities are as follows:

Description	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
<i>Fixed Rate Loans</i>		
₱11.5 Billion 7-year Bonds	₱11,500	₱11,500
₱7.0 Billion 12-year Bonds	7,000	7,000
₱7.2 Billion Note Facility Agreement	6,480	6,840
₱130 Million Term Loan Facility	118	130
<i>Floating Rate Loan</i>		
₱2.5 Billion Term Loan Facility	2,437	2,450
Total long-term debt	27,535	27,920
Less unamortized debt issuance costs	159	177
	27,376	27,743
<i>Redeemable Preferred Stock</i>	1,502	1,522
	28,878	29,265
Less current portion	1,874	1,895
Long-term portion of interest-bearing financial liabilities	₱27,004	₱27,370

All of *MERALCO*'s interest-bearing long-term financial liabilities as at September 30, 2016 and December 31, 2015 are denominated in Philippine peso. The scheduled maturities of *MERALCO*'s outstanding long-term debt at nominal values as at September 30, 2016 are as follows:

	Amount
	<i>(In millions)</i>
Less than one (1) year	₱396
One (1) year up to two (2) years	2,809
More than two (2) years up to three (3) years	383
More than three (3) years up to four (4) years	383
More than four (4) years up to five (5) years	11,884
More than five (5) years	11,680
	₱27,535

₱18.5 Billion Fixed Rate Puttable Bonds

On September 23, 2013, the *BOD* of *MERALCO* authorized the offer, sale and issuance by way of public offering in the Philippines, 7- and 12-year corporate bonds, puttable in five (5) and 10 years, respectively, with an aggregate principal amount of up to ₱15 billion with an overallotment option of up to ₱5.0 billion. The 12-year corporate bonds also include a call option, where *MERALCO* may redeem (in whole but not in part only) the outstanding bonds on the 7th year from issue date at the early redemption price of 101.0%. The put and call options are clearly and closely related to the host instruments, and thus, were not recognized separately.

On December 12, 2013, the ₱11.5 billion fixed rate puttable bonds due in 2020 and ₱7.0 billion fixed rate puttable bonds due in 2025, were listed on the Philippine Dealing and Exchange Corporation.

The net proceeds of the bonds were utilized for refinancing certain loans including principal payments, accrued interest, prepayment penalties and other financing costs.

₱7.2 Billion Note Facility Agreement

In February 2014, *MERALCO* entered into a Fixed Rate Note Facility Agreement for its ₱7,200 million, 10-year note due in February 2024. The principal is payable in nominal annual amortizations with a balloon payment upon final maturity.

₱130 Million Term Loan Facility

On June 27, 2014, *MIESCOR* obtained a ₱130 million, 7-year fixed rate term loan. The principal is payable over six (6) years with final maturity in June 2021.

₱2.5 Billion Term Loan Facility

The ₱2,500 million, 7-year Floating Rate Term Loan Facility, was drawn in January 2011 from a local bank. Interest rate is repriced every six (6) months based on 6-month *PDST-F* plus a spread. The principal is payable in nominal annual amortizations with a balloon payment on final maturity in January 2018.

The annual interest rates for the interest-bearing financial liabilities are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
Fixed Rate Loans	4.38% to 5.50%	4.38% to 5.50%
Floating Rate Loans	2.50% to 2.63%	2.52% to 2.63%

Debt Covenants

MERALCO's loan agreements require compliance with debt service coverage of 1.2 times calculated on specific measurement dates. The agreements also contain restrictions with respect to the creation of liens or encumbrances on assets, issuance of guarantees, mergers or consolidations, disposition of a significant portion of its assets and related party transactions.

As at September 30, 2016 and December 31, 2015, *MERALCO* is in compliance with all covenants of the loan agreements.

Unamortized Debt Issuance Costs

Unamortized debt issuance costs amounted to ₱159 million and ₱177 million as at September 30, 2016 and December 31, 2015, respectively.

The following presents the changes to the unamortized debt issuance costs:

		September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	Note		
(Amounts in millions)			
Balance at beginning of period		₱177	₱200
Amortization charged to interest and other financial charges	25	(18)	(23)
Balance at end of period		₱159	₱177

Redeemable Preferred Stock

The movements in the number of shares of the redeemable preferred stock, which have all been called, are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
Balance at beginning of period	152,231,414	154,901,389
Redemptions	(1,992,809)	(2,669,975)
Balance at end of period	150,238,605	152,231,414

The original “Terms and Conditions” of *MERALCO*’s Special Stock Subscription Agreement, which required an applicant to subscribe to preferred stock with 10% dividend to cover the cost of extension of, or new, distribution facilities, have been amended by the *Magna Carta* and the *DSOAR*, effective June 17, 2004 and January 18, 2006, respectively. The amendment sets forth the guidelines for the issuance of preferred stock, only if such instrument is available.

18. Customers’ Deposits

This account consists of:

	September 30, 2016 (Unaudited)			December 31, 2015 (Audited)		
	Current Portion (Note 22)	Noncurrent Portion	Total	Current Portion (Note 22)	Noncurrent Portion	Total
(Amounts in millions)						
Bill deposits	₱2,389	₱23,772	₱26,161	₱2,470	₱23,584	₱26,054
Meter deposits	488	—	488	497	—	497
	₱2,877	₱23,772	₱26,649	₱2,967	₱23,584	₱26,551

Bill Deposits

Bill deposits serve to guarantee payment of bills by a customer in accordance with existing regulations.

As provided for under the *Magna Carta* and *DSOAR*, all captive customers are required to pay a deposit to the *DU* an amount equivalent to the estimated monthly bill calculated based on applied load, which shall be recognized as bill deposit of the captive customer. Such deposit shall be adjusted after one year based on the historical 12-month average bill. A captive customer who has paid his electric bills on or before due date for three (3) consecutive years may apply for the

full refund of the bill deposit, together with the accrued interests, prior to the termination of his service; otherwise bill deposits and accrued interests shall be refunded within one (1) month from the termination of service, provided all bills have been paid.

On February 22, 2010, the amended *DSOAR*, which became effective on April 1, 2010, was promulgated by the *ERC*. Under the amended *DSOAR*, interest on bill deposits for both residential and non-residential customers shall be computed using the equivalent peso savings account interest rate of the Land Bank of the Philippines ("*Land Bank*") or other government banks, on the first working day of the year, subject to the confirmation of the *ERC*. Interest rate for bill deposits is 0.250% per annum starting January 1, 2014.

As provided for under *ERC* Resolution No. 1, *A Resolution Adopting the Revised Rules for the Issuance of Licenses to Retail Electricity Suppliers*, a local *RES* may require security deposits from its contestable customers, which shall earn interest equivalent to the actual interest earnings of the total amount of deposits received from the customers.

The following are the movements of the bill deposits account:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Balance at beginning of period	₱26,054	₱27,906
Additions	3,272	4,807
Refunds	(3,165)	(6,659)
Balance at end of period	26,161	26,054
Less portion maturing within one year	2,389	2,470
Noncurrent portion of bill deposits and related interests	₱23,772	₱23,584

Meter Deposits

Meter deposits were intended to guarantee the cost of meters installed.

The *Magna Carta* for residential customers (effective June 17, 2004) and *DSOAR* (effective January 18, 2006) for non-residential customers exempt all customer groups from payment of meter deposits beginning July 2004 for residential customers and April 2006 for non-residential customers.

The *ERC* released Resolution No. 8, Series of 2008, otherwise known as "Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers" ("*Rules*") which required the refund of meter deposits from the effectivity of the said *Rules* on July 5, 2008. Under the *Rules*, a customer has the option of receiving his refund in cash, credit to future monthly billings, or as an offset to other due and demandable claims of the *DU* against him.

The total amount of refund shall be equivalent to the meter deposit paid by the customer plus the total accrued interest earned from the time the customer paid the meter deposit until the day prior to the start of refund.

On August 8, 2008, in compliance with the *Rules*, *MERALCO* submitted to the *ERC* an accounting of the total meter deposit principal amount for refund. The actual refund of meter deposits commenced on November 3, 2008.

As at September 30, 2016 and December 31, 2015, total meter deposits refunded by *MERALCO* amounted to ₱2,604 million (inclusive of ₱1,351 million interest) and ₱2,599 million (inclusive of ₱1,349 million interest), respectively.

19. Provisions

Provisions consist of amounts recognized for probable costs, losses and expenses relating to claims against the *MERALCO Group*, among others. The movements follow:

	Note	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>			
Balance at beginning of period		₱37,402	₱30,393
Additions (reversals) for the period		(1,822)	7,026
Settlements		(368)	(17)
Balance at end of period		35,212	37,402
Less current portion	22	14,782	16,388
Noncurrent portion of provisions		₱20,430	₱21,014

The balance of provisions substantially represents the amounts of claims related to a commercial contract which remains unresolved and local taxes being contested as discussed in *Note 29 – Contingencies and Legal Proceedings*, consistent with the limited disclosure as allowed in *PFRS*.

20. Customers' Refund

This account represents the balance of the refund related to the *SC* decision promulgated on April 30, 2003, which has not yet been claimed by customers.

In June 2003, the *ERC*, in the implementation of the *SC* decision, ordered *MERALCO* to refund to its customers an equivalent ₱0.167 per *kWh* for billings made from February 1994 to April 2003.

On February 1, 2011, *MERALCO* filed a motion with the *ERC* to: (i) allow it to continue with the implementation of the refund to eligible accounts or customers under Phases I to IV, for another five (5) years from the end of Phase IV-B, or from the end of December 2010 to the end of December 2015; and (ii) adopt its proposed procedures for the implementation of the *SC* refund during the extended period. The *ERC* approved *MERALCO*'s motion in its Order dated February 7, 2011.

On December 18, 2015, *MERALCO* filed a Motion seeking the *ERC*'s approval for the continuation of the implementation of the refund to eligible accounts or customers under Phases I to IV, three (3) years from January 1, 2016 or until December 31, 2018.

21. Notes Payable

Notes payable represent unsecured interest-bearing working capital loans obtained from various local banks. Annual interest rates range from 2.5% to 4.25% and 2.9% to 4.25% as at September 30, 2016 and December 31, 2015, respectively, on peso-denominated loans.

Interest expense on notes payable amounted to ₱14 million and ₱12 million for each of the nine months ended September 30, 2016 and 2015, respectively.

See Note 25 – *Expenses and Income*.

22. Trade Payables and Other Current Liabilities

This account consists of the following:

	Note	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>			
Trade accounts payable	23 and 24	₱29,580	₱29,458
Provisions	19 and 29	14,727	16,388
Output VAT - net		6,914	6,437
Accrued expenses:			
Employee benefits		2,013	1,734
Taxes		1,320	1,635
Interest	17	99	115
Others		1,027	2,007
Current portions of:			
Bill deposits and related interests	18	2,389	2,470
Meter deposits and related interests	18	488	497
Deferred income		1,150	1,037
Refundable service extension costs		2,502	2,502
Dividends payable on:			
Common stock	15	609	450
Redeemable preferred stock	17	250	250
Payable to customers		7,996	8,009
Universal charges payable		2,412	2,256
Feed-in-tariff allowance		645	217
Regulatory fees payable		138	275
Reinsurance liability		66	86
Other current liabilities		3,454	3,734
		₱77,779	₱79,557

Trade Accounts Payable

Trade accounts payable mainly represent obligations to power generating companies, NPC/ PSALM, National Grid Corporation of the Philippines (“NGCP”), and Philippine Electricity Market Corporation (“PEMC”), for cost of power purchased and for cost of transmission. In addition, this account includes liabilities due to local and foreign suppliers for purchases of goods and services, which consist of transformers, poles, materials and supplies, and contracted services.

Trade payables are non-interest-bearing and are generally settled within the 15- to 60-day trade term. Other payables are non-interest-bearing and are due within one (1) year from incurrence.

See Note 23 – *Related Party Transactions* and Note 30 – *Significant Contracts and Commitments*.

Refundable Service Extension Costs

Article 14 of the *Magna Carta*, specifically, “Right to Extension of Lines and Facilities”, requires a customer requesting for an extension of lines and facilities beyond 30-meter service distance from the nearest voltage facilities of the *DU* to advance the cost of the project. The amended *DSOAR*, which became effective on April 1, 2010, requires such advances from customers to be refunded at the rate of 75% of the distribution revenue generated from the extension lines and facilities until such amounts are fully refunded. The related asset forms part of the rate base only at the time a refund has been paid out. Customer advances are non-interest-bearing.

As at September 30, 2016 and December 31, 2015, the noncurrent portion of refundable service extension costs of ₱4,784 million and ₱4,234 million, respectively, is presented as “Refundable service extension costs - net of current portion” account in the consolidated statements of financial position.

Universal Charges Payable

Universal charges payable are charges passed on and collected from customers on a monthly basis by *DUs*. These are charges imposed to recover the stranded debts, stranded contract costs of *NPC* and stranded contract costs of eligible contracts of distribution. *DUs* remit collections monthly to *PSALM* who administers the fund generated from universal charges and disburses the said funds in accordance with the intended purposes.

23. Related Party Transactions

The following summarizes the total amount of transactions, which have been provided and/or contracted by the *MERALCO Group* to/with related parties for the relevant financial period. The outstanding balances are unsecured, non-interest-bearing and settled in cash.

Pole Attachment Contract with Philippine Long Distance Telephone Company (“PLDT”)

MERALCO has a Pole Attachment Contract with *PLDT* similar to third party pole attachment contracts of *MERALCO* with other telecommunication companies. Under the Pole Attachment Contract, *PLDT* shall use the contracted cable position exclusively for its telecommunication cable network facilities.

Sale of Electricity under Various Service Contracts

MERALCO sells electricity to related party shareholder groups within the franchise area such as *PLDT*, *Metro Pacific* and *JG Summit* and their respective subsidiaries, and affiliates for their facilities within *MERALCO*’s franchise area. The rates charged to related parties are the same *ERC*-mandated rates applicable to customers within the franchise area.

Purchase of Telecommunication Services from PLDT and Subsidiaries

The *MERALCO Group*’s telecommunications carriers include *PLDT* for its wireline and *SMART Communications, Inc.* and *Digitel Mobile Philippines, Inc.*, for its wireless services. Such services are covered by standard service contracts between the telecommunications carriers and each legal entity within the *MERALCO Group*.

Purchase of Goods and Services

In the ordinary course of business, the *MERALCO Group* purchases goods and services from its affiliates and sells power to such affiliates.

Following is the summary of related party transactions for the nine months ended September 30, 2016 and 2015 and the outstanding balances as at September 30, 2016 and December 31, 2015:

Category	Amount of Transactions For the Nine Months Ended September 30		Outstanding Receivable (Liability)		Terms	Conditions
	2016	2015	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)		
	(Amounts in millions)					
Sale of electricity:						
<i>JG Summit Group</i>	₱2,182	₱2,630	₱219	₱242	10-day; noninterest-bearing	Unsecured, no impairment
<i>PLDT Group</i>	930	1,126	46	64	10-day; noninterest-bearing	Unsecured, no impairment
<i>Metro Pacific Group</i>	106	123	4	6	10-day; noninterest-bearing	Unsecured, no impairment
Purchases of IT services - <i>Indra Philippines</i>	533	506	(8)	(50)	30-day; noninterest-bearing	Unsecured
Purchases of meters and devices - <i>GEPMICI</i>	185	322	(35)	(19)	30-day; noninterest-bearing	Unsecured
Revenue from pole attachment - <i>PLDT</i>	302	267	38	16	Advance payment	Unsecured, no impairment
Purchases of wireline and wireless services - <i>PLDT Group</i>	59	53	(15)	(11)	30-day; noninterest-bearing	Unsecured

Advances to FPM Power

On March 22, 2013, *FPM Power* availed of a non-interest-bearing loan from *MPG Asia* amounting to US\$110 million, which is payable on demand. The loan is outstanding as at September 30, 2016 and December 31, 2015.

See *Note 14 – Other Current Assets*.

Transaction with MERALCO Retirement Benefits Fund (“Fund”)

The *MERALCO Group’s Fund* holds 6,000 common shares of *RP Energy* at par value of ₱100 per share, with total carrying amount of ₱600,000 or an equivalent 3% equity interest in *RP Energy*. The fair value of *RP Energy’s* common shares cannot be reliably measured as these are not traded in the financial market. As at September 30, 2016 and December 31, 2015, the fair value of the total assets being managed by the Fund amounted to ₱37.6 billion and ₱36.2 billion, respectively.

See *Note 26 – Long-Term Employee Benefits*.

Compensation of Key Management Personnel

The compensation of key management personnel of the *MERALCO Group* by benefit type is as follows:

	Unaudited			
	For the Nine Months Ended September 30		For the Three Months Ended September 30	
	2016	2015	2016	2015
	<i>(Amounts in millions)</i>			
Short-term employee benefits	₱488	₱472	₱113	₱91
Long-term employee incentives and retirement benefits	457	225	197	75
Total compensation to key management personnel	₱945	₱697	₱310	₱166

Each of the directors is entitled to a per diem of ₱120,000 for every *BOD* meeting attended. Each member of the Audit and Risk Management, Remuneration and Leadership Development, Finance, Governance and Nomination Committees is entitled to a fee of ₱20,000 for every committee meeting attended.

On March 22, 2013, the *BOD* approved the amendment of *MERALCO's* By-Laws which entitles all directors to a reasonable per diem for their attendance in meetings of the *BOD* and Board Committees plus an additional compensation, provided that the total value of such additional compensation, in whatever form so given, shall not exceed one (1) percent of the income before income tax of *MERALCO* during the preceding year.

Consistent with the foregoing, the *BOD* approved the increase in the compensation of all members of the *BOD* up to a maximum of the pre-agreed amount per annum. The increase in compensation shall be through a stock grant based on a pre-approved number of shares for each director. The implementation of such plan was approved by the stockholders in the annual general meeting of stockholders on May 28, 2013.

As at September 30, 2016, there are no agreements between the *MERALCO Group* and any of its key management personnel providing for benefits upon termination of employment or retirement, except with respect to benefits provided under (i) a defined benefit retirement plan, (ii) a program which aims to address capability refresh and organizational optimization requirements, and (iii) a contributory provident plan. Post-retirement benefits under the defined benefit retirement plan cover employees hired up to December 31, 2003 only. The provident plan, which is implemented on a voluntary basis, covers employees hired beginning January 1, 2004.

24. Purchased Power

The details of purchased power are as follow:

	Unaudited			
	For the Nine Months Ended		For the Three Months	
	September 30		Ended September 30	
	2016	2015	2016	2015
<i>(Amounts in millions)</i>				
Generation costs	₱116,263	₱121,612	₱39,841	₱38,837
Transmission costs	28,160	25,925	9,144	8,135
	₱144,423	₱147,537	₱48,985	₱46,972

Purchased power costs for the captive customers are pass-through costs and are revenue-neutral to *MERALCO* and *CEDC*, as *DUs*.

Generation costs include line rentals, market fees and must-run unit charges billed by *PEMC*.

Purchased power includes, among others, capacity fees, fixed operating and maintenance fees, and transmission line fees that are accounted for similar to a lease under Philippine Interpretation *IFRIC 4*, “Determining whether an arrangement contains a lease”. The total amounts billed by the suppliers presented as part of “Purchased power” account in the consolidated statements of income amounted to ₱36,848 million and ₱32,925 million for the nine months ended September 30, 2016 and 2015, respectively. These also include the actual *SL* incurred which is within the *SL* cap of 8.5%. *MERALCO*’s actual 12 months moving average *SL* rates are 6.40% and 6.56% for the nine months ended September 30, 2016 and 2015, respectively.

The details of purchased power follow:

	Unaudited			
	For the Nine Months		For the Three Months	
	Ended September 30		Ended September 30	
	2016	2015	2016	2015
<i>(Amounts in millions)</i>				
First Gas Power Corporation (“ <i>FGPC</i> ”) and FGP Corp. (“ <i>FGP</i> ”)	₱29,942	₱37,511	₱9,074	₱11,169
<i>NGCP</i>	27,955	25,760	9,084	8,092
South Premiere Power Corporation (“ <i>SPPC</i> ”)	21,578	21,942	6,335	7,098
San Miguel Energy Corporation (“ <i>SMEC</i> ”)	11,949	10,099	4,086	2,768
<i>PEMC/WESM</i>	12,351	10,788	5,518	4,392
<i>QPPL</i>	10,244	10,068	3,415	3,583
Masinloc Power Partners Co. Ltd. (“ <i>MPPCL</i> ”)	9,225	8,708	3,208	2,845
Therma Luzon, Inc. (“ <i>TLI</i> ”)	7,687	6,922	2,835	2,658
Sem-Calaca Power Corporation (“ <i>Sem-Calaca</i> ”)	6,882	8,000	2,840	2,588
Therma Mobile, Inc. (“ <i>TMO</i> ”)	2,350	2,520	816	780
Trans-Asia Oil and Energy Development Corporation (“ <i>Trans-Asia</i> ”)	1,618	1,621	577	540
Southwest Luzon Power Generation Corporation	1,513	—	613	—
1590 Energy Corporation	679	1,325	326	204
Others	450	2,273	258	255
	₱144,423	₱147,537	₱48,985	₱46,972

Generation and transmission costs over- or under-recoveries result from the lag in the billing and recovery of generation and transmission costs from consumers. As at September 30, 2016 and December 31, 2015, the total transmission costs and *SL* charge over-recoveries included in “Other noncurrent liabilities” account in the consolidated statements of financial position amounted to ₱6,088 million and ₱5,829 million, respectively.

25. Expenses and Income

Salaries, Wages and Employee Benefits

	<i>Note</i>	Unaudited			
		For the Nine Months Ended September 30		For the Three Months Ended September 30	
		2016	2015	2016	2015
<i>(Amounts in millions)</i>					
Salaries, wages and related employee benefits		₱8,300	₱8,327	₱2,734	₱2,814
Retirement benefits	26	1,012	923	340	316
Other long-term post-employment benefits	26	81	93	27	31
		₱9,393	₱9,343	₱3,101	₱3,161

Other Expenses

	<i>Note</i>	Unaudited			
		For the Nine Months Ended September 30		For the Three Months Ended September 30	
		2016	2015	2016	2015
<i>(Amounts in millions)</i>					
Materials used	13	₱1,767	₱1,172	₱623	₱501
Rent and utilities		547	615	175	177
Transportation and travel		278	347	82	122
Insurance		263	221	88	12
Advertising		197	170	77	36
Communication	23	96	102	34	30
Others		878	838	259	323
		₱4,026	₱3,465	₱1,338	₱1,201

Interest and Other Financial Charges

	<i>Note</i>	Unaudited			
		For the Nine Months Ended September 30		For the Three Months Ended September 30	
		2016	2015	2016	2015
		<i>(Amounts in millions)</i>			
Interest expense on interest-bearing long-term financial liabilities, net of interest capitalized	<i>7 and 17</i>	₱876	₱788	₱336	₱265
Interest expense on bill deposits	<i>18</i>	49	67	16	28
Interest expense on notes payable	<i>21</i>	14	12	4	—
Amortization of debt issuance costs	<i>17</i>	18	17	6	7
Others		27	20	7	2
		₱984	₱904	₱369	₱302

Interest and Other Financial Income

	Note	Unaudited			
		For the Nine Months Ended September 30		For the Three Months Ended September 30	
		2016	2015	2016	2015
(Amounts in millions)					
Interest income on cash in banks and cash equivalents	11	₱871	₱675	₱341	₱189
Income from <i>HTM</i> investments		612	155	202	95
Carrying costs on <i>ERC</i> - approved under-recoveries		—	198	—	—
Others		45	41	15	13
		₱1,528	₱1,069	₱558	₱297

26. Long-term Employee Benefits

Liabilities for long-term employee benefits consist of the following:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Retirement benefits liability	₱2,004	₱2,021
Long-term incentives	933	3,287
Other long-term post-employment benefits	1,680	1,599
	4,617	6,907
Less current portion	—	3,287
	₱4,617	₱3,620

Defined Benefit Retirement Plans

The features of the *MERALCO Group's* defined benefit plans are discussed in *Note 4 – Significant Accounting Policies, Changes and Improvements*.

Actuarial valuations are prepared annually by the respective independent actuaries engaged by *MERALCO* and its subsidiaries.

Expense recognized for defined benefit plans (included in “Salaries, wages and employee benefits” account in the consolidated statements of income)

	Unaudited			
	For the Nine Months Ended September 30		For the Three Months Ended September 30	
	2016	2015	2016	2015
	<i>(Amounts in millions)</i>			
Current service costs	₱919	₱896	₱311	₱308
Net interest costs	78	20	24	7
Net retirement benefits expense	₱997	₱916	₱335	₱315

Retirement Benefits Liability

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions)</i>	
Defined benefit obligation	₱39,559	₱38,220
Fair value of plan assets	(37,555)	(36,199)
Retirement benefits liability	₱2,004	₱2,021

Changes in the net retirement benefits liability are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	<i>(Amounts in millions)</i>	
Retirement benefits liability at beginning of period	₱2,021	₱685
Net retirement benefits expense	997	1,230
Contributions by employer	(1,014)	(775)
Amounts recognized in <i>OCI</i>	–	881
Retirement benefits liability at end of period	₱2,004	₱2,021

Changes in the present value of the defined benefit obligation are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Defined benefit obligation at beginning of period	₱38,220	₱37,129
Interest costs	1,388	1,620
Current service costs	919	1,216
Benefits paid	(968)	(1,720)
Actuarial losses (gains) due to:		
Changes in financial assumptions	—	(1,550)
Experience adjustments	—	1,525
Defined benefit obligation at end of period	₱39,559	₱38,220

Changes in the fair value of plan assets are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Fair value of plan assets at beginning of period	₱36,199	₱36,444
Benefits paid	(968)	(1,720)
Interest income	1,341	1,606
Return on plan assets, excluding amount included in net interest on the net defined benefit obligation and interest income	(31)	(906)
Contributions by employer	1,014	775
Fair value of plan assets at end of period	₱37,555	₱36,199

The Board of Trustees (“BoT”) which manages the *Fund*, is chaired by the chairman of *MERALCO*, who is neither an executive nor a beneficiary. The other members of the *BoT* are (i) an independent member of the *BOD*; (ii) a member of the *BOD* who represents the largest shareholder group; (iii) an executive member of the *BOD*; and (iv) three (3) senior executives.

The *Fund* follows a generally conservative investment approach where investments are diversified to minimize risks but ensures an increase in value of the *Fund* assets. The assets of the *Fund* are managed by four (4) local trustee banks and one (1) foreign bank whose common objective is to maximize the long-term expected return of plan assets. As approved by the *BoT*, the plan assets are invested in a guided proportion of fixed income instruments, cash investments and equities.

The net carrying amount and fair value of the assets of the *Fund* as at September 30, 2016 and December 31, 2015 amounted to ₱37,555 million and ₱36,199 million, respectively. The major categories of plan assets are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amount in millions)</i>		
Cash and cash equivalents	₱2,613	₱3,007
Investments quoted in active markets:		
Quoted equity investments		
Holding firms	3,324	2,973
Electricity, energy, power and water	1,159	1,576
Telecommunication	795	915
Property	764	743
Food, beverages and tobacco	714	722
Banks	650	671
Retail	176	14
Mining	114	78
Construction, infrastructure and allied services	90	53
Transportation services	67	90
Others	886	25
Quoted debt investments		
“AAA” rated securities	14,484	12,670
Government securities	9,270	9,813
Unquoted investments		
Receivables	1,495	1,895
Property	954	954
Fair value of plan assets	₱37,555	₱36,199

Marketable equity securities, government securities, bonds and commercial notes are investments held by the trustee banks. The *Fund* does not have any direct equity interests in *MERALCO*.

Other Long-term Post-employment Benefits (included as part of “Salaries, wages and employee benefits” account in the consolidated statements of income)

	Unaudited			
	For the Nine Months Ended September 30		For the Three Months Ended September 30	
	2016	2015	2016	2015
<i>(Amounts in millions)</i>				
Interest costs	₱60	₱64	₱20	₱21
Current service costs	21	29	7	10
	₱81	₱93	₱27	₱31

Other Long-term Post-employment Benefits Liability

Changes in the present value of other long-term post-employment benefits liability are as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
	(Amounts in millions)	
Balance at beginning of period	₱1,599	₱1,899
Interest costs	60	84
Current service costs	21	39
Benefits paid	—	(70)
Actuarial gains due to change in assumptions	—	(353)
Balance at end of period	₱1,680	₱1,599

Actuarial Assumptions

The principal assumptions used as at September 30, 2016 and December 31, 2015 in determining retirement benefits and other long-term post-employment benefits obligations are shown below:

	2016	2015
Annual discount rate	5.0%	5.0%
Future range of annual salary increases	6.0% - 8.0%	6.0% - 8.0%

Sensitivity Analysis

The calculation of the defined benefit obligation is sensitive to the assumptions set above. The following table summarizes how the impact on the defined benefit obligation at the end of the reporting period would have increased (decreased) as a result of a change in the respective assumptions by:

		Effect on Present Value of Defined Benefit Obligation	
	% Change	2016	2015
		(Amounts in millions)	
Annual discount rate	+1.0%	(₱4,393)	(₱4,393)
	-1.0%	5,407	5,407
Future range of annual salary increases	+1.0%	1,752	1,752
	-1.0%	(1,588)	(1,588)

Funding

MERLCO contributes to the *Fund* from time to time such amounts of money required under accepted actuarial principles to maintain the Fund in a sound condition, subject to the provisions of the Plan.

The amount of the annual contributions to the *Fund* is determined through an annual valuation report performed by the actuary.

The following is the maturity profile of the undiscounted benefit obligation as at September 30, 2016:

	Amounts in millions
Less than one (1) year	₱1,518
One (1) year up to five (5) years	9,152
More than five (5) years up to 10 years	14,068
More than 10 years up to 15 years	19,670
More than 15 years up to 20 years	19,907
More than 20 years	60,267

Risk

The *Fund* is exposed to the following risks:

Credit Risk

The *Fund*'s exposure to credit risk arises from its financial assets which comprise cash and cash equivalents, investments and rental receivable. The credit risk results from the possible default of the issuer of the financial instrument, with a maximum exposure equivalent to the carrying amounts of the instruments.

The credit risk is minimized by ensuring that the exposure to the various chosen financial investment structures is limited primarily to government securities and bonds or notes duly recommended by the Trust Committees of the appointed fund managers of the *Fund*.

Share Price Risk

The *Fund*'s exposure to share price risk arises from the shares of stock it holds and being traded at the *PSE*. The price share risk emanates from the volatility of the stock market.

The policy is to limit investment in shares of stock to blue chip issues or issues with good fair values or those trading at a discount to its net asset value so that in the event of a market downturn, the *Fund* may still consider to hold on to such investments until the market recovers.

By having a balanced composition of holdings in the equities portfolio, exposure to industry or sector-related risks is reduced. The mix of various equities in the portfolio reduces volatility and contributes to a more stable return over time. Equity investments are made within the parameters of the investment guidelines approved by the *BoT*. The *BoT* also meets periodically to review the investment portfolio based on financial market conditions. Share prices are also monitored regularly.

Liquidity Risk

Liquidity risk is the risk that the *Fund* is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. Liquidity risk is being managed to ensure that adequate fixed income and cash deposits are available to service the financial obligations of the *Fund*. The schedule of the maturities of fixed income investment assets are staggered by tenure or term. Policies are established to ensure that all financial obligations are met, wherein the timing of the maturities of fixed income investments are planned and matched to the due date of various obligations. Thus, for this investment class, maturities are classified into short-, medium- and long-term. A certain percentage of the portfolio is kept as cash to manage liquidity and settle all currently maturing financial obligations.

Defined Contribution Provident Plan

MERALCO has a defined contributory Provident Plan effective January 1, 2009, intended to be a Supplemental Retirement Benefit for employees hired beginning 2004, the participation of which is on a voluntary basis. Each qualified employee-member who chooses to participate in the plan shall have the option to contribute up to a maximum of 25% of his base salary. MERALCO shall match the member's contribution up to 100% of employee's contribution or 10% of the member's monthly base salary, subject to a certain threshold. Upon resignation, the member shall be entitled to the total amount credited to his personal retirement account immediately preceding his actual retirement date, subject to provisions of the Provident Plan. MERALCO's contribution to the Provident Plan amounted to ₱15 million and ₱7 million for the nine months ended September 30, 2016 and 2015, respectively.

Consolidated Retirement Benefits Cost (included in "Salaries, wages and employee benefits" account in the consolidated statements of income)

	Unaudited			
	For the Nine Months Ended September 30		For the Three Months Ended September 30	
	2016	2015	2016	2015
<i>(Amounts in millions)</i>				
Expense recognized for defined benefit plans	₱997	₱916	₱335	₱315
Expense recognized for defined contribution plan	15	7	5	1
Retirement benefits expense	₱1,012	₱923	₱340	₱316

Long-term Incentive Plan ("LTIP")

MERALCO's LTIP covers qualified executives and is based on the MERALCO Group's achievement of specified level of CCNI approved by the BOD and determined on an aggregate basis for a three-year period as well as executives' attainment of a minimum level of performance rating. Executives invited to LTIP must serve a minimum uninterrupted period to be entitled to an award. Further, the employee should be on active employment at the time of pay-out.

27. Financial Assets and Financial Liabilities

Financial assets consist of cash and cash equivalents and trade and nontrade receivables, which are generated directly from operations, and AFS investments and HTM investments. The principal financial liabilities consist of bank loans, redeemable preferred shares, trade and nontrade payables, which are incurred to finance operations in the normal course of business. Accounting policies related to financial assets and financial liabilities are set out in Note 4 – Significant Accounting Policies, Changes and Improvements.

The following table sets forth the financial assets and financial liabilities as at September 30, 2016 and December 31, 2015:

	Loans and Receivables	HTM Investments	Fair Value through Profit or Loss	Held-for- trading	AFS Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities
<i>(Amounts in millions)</i>							
Assets as at September 30, 2016							
<i>Noncurrent</i>							
Other noncurrent assets	₱1,228	₱23,861	₱—	₱—	₱25,164	₱—	₱50,253
<i>Current</i>							
Cash and cash equivalents	36,581	—	—	—	—	—	36,581
Trade and other receivables	21,770	—	—	—	—	—	21,770
Advances to an associate	5,506	—	—	—	—	—	5,506
Other current assets	—	1,185	—	—	—	—	1,185
Total assets	₱65,085	₱25,046	₱—	₱—	₱25,164	₱—	₱115,295
Liabilities as at September 30, 2016							
<i>Noncurrent</i>							
Interest-bearing long-term financial liabilities - net of current portion	₱—	₱—	₱—	₱—	₱—	₱27,004	₱27,004
Customers' deposits - net of current portion	—	—	—	—	—	23,772	23,772
Refundable service extension costs - net of current portion	—	—	—	—	—	4,784	4,784
<i>Current</i>							
Notes payable	—	—	—	—	—	11,236	11,236
Trade payables and other current liabilities	—	—	—	—	—	46,787	46,787
Customers' refund	—	—	—	—	—	5,078	5,078
Current portion of interest-bearing long-term financial liabilities	—	—	—	—	—	1,874	1,874
Total liabilities	₱—	₱—	₱—	₱—	₱—	₱120,535	₱120,535
<i>(Amounts in millions)</i>							
	Loans and Receivables	HTM Investments	Fair Value through Profit or Loss	Held-for- trading	AFS Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities
Assets as at December 31, 2015							
<i>Noncurrent</i>							
Other noncurrent assets	₱1,030	₱17,167	₱—	₱—	₱10,961	₱—	₱29,158
<i>Current</i>							
Cash and cash equivalents	50,840	—	—	—	—	—	50,840
Trade and other receivables	22,645	—	—	—	—	—	22,645
Advances to an associate	5,342	—	—	—	—	—	5,342
Other current assets	—	4,072	—	—	—	—	4,072
Total assets	₱79,857	₱21,239	₱—	₱—	₱10,961	₱—	₱112,057
Liabilities as at December 31, 2015							
<i>Noncurrent</i>							
Interest-bearing long-term financial liabilities - net of current portion	₱—	₱—	₱—	₱—	₱—	₱27,370	₱27,370
Customers' deposits - net of current portion	—	—	—	—	—	23,584	23,584
Refundable service extension costs - net of current portion	—	—	—	—	—	4,234	4,234
<i>Current</i>							
Notes payable	—	—	—	—	—	1,043	1,043
Trade payables and other current liabilities	—	—	—	—	—	46,677	46,677
Customers' refund	—	—	—	—	—	5,550	5,550
Current portion of interest-bearing long-term financial liabilities	—	—	—	—	—	1,895	1,895
Total liabilities	₱—	₱—	₱—	₱—	₱—	₱110,353	₱110,353

Fair Values

The fair values of the financial assets and financial liabilities are prices that would be received to sell the financial assets or paid to transfer the financial liabilities in orderly transactions between market participants at the measurement date. Set out below is a comparison of carrying amounts and fair values of the *MERALCO Group's* financial instruments as at September 30, 2016 and December 31, 2015.

	2016		2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(Amounts in millions)			
Financial assets				
Loans and receivables -				
Advance payments to a supplier	₱1,228	₱1,113	₱1,030	₱963
AFS financial assets	25,164	25,164	10,961	10,961
HTM investments	25,046	25,580	21,239	21,230
	₱51,438	₱51,857	₱33,230	₱33,154
Financial liabilities				
Financial liabilities carried at amortized cost -				
Interest-bearing-long-term financial liabilities	₱28,878	₱30,138	₱29,265	₱30,531

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and Cash Equivalents, Trade and Other Receivables, Advances to an Associate, Trade Payables and Other Current Liabilities and Notes Payable

Due to the short-term nature of transactions, the fair values of these instruments approximate their carrying amounts as at reporting date.

Advance Payments to a Supplier

The fair values of advance payments to a supplier were computed by discounting the instruments' expected future cash flows using the rates of 3.63% as at September 30, 2016 and 3.93% as at December 31, 2015.

AFS Financial Assets

The fair values were determined by reference to market bid quotes as at reporting date. The unquoted equity securities were carried at cost.

HTM Investments

The fair values were determined by discounting the expected future cash flows using the interest rate as at cut-off date.

Meter Deposits and Customers' Refund

Meter deposits and customers' refund are due and demandable. Thus, the fair values of these instruments approximate their carrying amounts.

Bill Deposits

The carrying amount of bill deposits approximates their fair values as bill deposits are interest-bearing.

Interest-bearing Long-term Financial Liabilities

The fair values of interest-bearing long-term debt (except for redeemable preferred stock) were computed by discounting the instruments' expected future cash flows using the rates ranging from 0.47% to 4.17% as at September 30, 2016 and 0.48% to 4.22% as at December 31, 2015.

Redeemable Preferred Stock

The carrying amount of the preferred stock represents the fair value. Such preferred shares have been called and are payable anytime upon presentation by the shareholder of their certification. This is included under "Interest-bearing long-term financial liabilities" account.

Refundable Service Extension Costs

The fair values of refundable service extension costs cannot be reliably measured since the timing of related cash flows cannot be reasonably estimated and are accordingly measured at cost.

Fair Value Hierarchy

Below is the list of financial assets and financial liabilities that are classified using the fair value hierarchy:

	September 30, 2016 (Unaudited)				December 31, 2015 (Audited)			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	<i>(Amounts in millions)</i>							
Financial assets								
Advance payments to a supplier	P-	P-	P1,113	P1,113	P-	P-	P963	P963
AFS investments	25,129	-	35	25,164	10,926	-	35	10,961
HTM investments	25,438	-	142	25,580	21,110	-	120	21,230
	P50,567	P-	P1,290	P51,857	P32,036	P-	P1,118	P33,154
Financial liabilities								
Interest-bearing long-term financial liabilities	P-	P-	P30,138	P30,138	P-	P-	P30,531	P30,531

For the nine months ended September 30, 2016 and 2015, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Financial Risk Management Objectives and Policies

The main risks arising from the financial instruments are interest rate risk, foreign currency risk, commodity price risk, credit risk and liquidity risk. The importance of managing these risks has significantly increased in light of the considerable change and volatility in the Philippine and international financial markets. The *BOD* reviews and approves policies for managing each of these risks. Management monitors the market price risk arising from all financial instruments. The policies for managing these risks are as follows:

Interest Rate Risk

The *MERALCO Group*'s exposure to the changes in market interest rates relate primarily to the long-term interest-bearing financial liabilities.

The *MERALCO Group*'s policy is to manage its interest rate risk exposure using a mix of fixed and variable rate debts. The strategy, which yields a reasonably lower effective cost based on market conditions, is adopted. Refinancing of fixed rate loans may also be undertaken to manage interest cost. Approximately 91% of the borrowings bear fixed rate of interest as at September 30, 2016 and December 31, 2015, respectively.

The following table sets out the maturity profile of the financial instruments that are exposed to interest rate risk (exclusive of debt issuance costs):

	Within 1 Year	Over 1–2 Years	Over 2–3 Years	Over 3–4 Years	Over 4–5 Years	More than 5 Years	Total
<i>(Amounts in millions)</i>							
September 30, 2016 (Unaudited)	₱12	₱2,425	₱–	₱–	₱–	₱–	₱2,437
December 31, 2015 (Audited)	13	12	2,425	–	–	–	2,450

Floating interest rate of bank loans is repriced at intervals of less than one year. The other financial liabilities of the *MERALCO Group* that are not included in the foregoing have fixed interest rate and are therefore not subject to interest rate risk.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the *MERALCO Group*'s income before income tax for the nine months ended September 30, 2016 and 2015 through the impact on floating rate borrowings. There is no other impact on the *MERALCO Group*'s equity other than those already affecting the consolidated statement of income.

	2016		2015	
	Increase (Decrease) in Basis Points	Effect on Income before Income Tax	Increase (Decrease) in Basis Points	Effect on Income before Income Tax
<i>(Amounts in millions)</i>				
Floating rate loans from various banks	+100 (100)	(₱18) 18	+100 (100)	(₱18) 18

Interest expense of floating rate loans for the period is computed by taking into account actual principal movements, based on management's best estimate of a +/-100 basis points change in interest rates. There has been no change in the methods and assumptions used by management in the above analysis.

Foreign Currency Risk

The revaluation of any of foreign currency-denominated financial assets and financial liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the end of each reporting period. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency-denominated financial instruments. While an insignificant percentage of the *MERALCO Group*'s revenues and liabilities is denominated in U.S. dollars, a substantial portion of the *MERALCO Group*'s capital expenditures for electricity capital projects and a portion of the operating expenses are denominated in foreign currencies, mostly in U.S. dollars. As such, a strengthening or weakening of the Philippine peso against the U.S. dollar will decrease or increase in Philippine peso terms, the principal amount of the *MERALCO Group*'s foreign currency-denominated

liabilities and the related interest expense, foreign currency-denominated capital expenditures and operating expenses as well as *U.S.* dollar-denominated revenues.

The following table shows the consolidated foreign currency-denominated financial assets and financial liabilities as at September 30, 2016 and December 31, 2015, translated to Philippine peso at ₱48.50 and ₱47.06 to US\$1, respectively.

	September 30, 2016 (Unaudited)		December 31, 2015 (Audited)	
	U.S. Dollar	Peso Equivalent	U.S. Dollar	Peso Equivalent
<i>(Amounts in millions)</i>				
Financial assets:				
Cash and cash equivalents	\$188	₱9,137	\$240	₱11,295
Trade and other receivables	4	211	2	101
Advances to an associate	110	5,335	110	5,177
Advance payments to a supplier	21	1,028	18	826
	323	15,711	370	17,399
Financial liabilities -				
Trade payables and other liabilities	(5)	(220)	(3)	(137)
	\$318	₱15,491	\$367	₱17,262

All of the *MERALCO Group's* long-term financial liabilities are denominated in Philippine peso. However, an insignificant portion of its trade payables are denominated in *U.S.* dollar. Thus, the impact of ₱1 movement of the Philippine peso against the *U.S.* dollar will not have a significant impact on the *MERALCO Group's* obligations. Further, *PBR* assumes a forecast level of foreign currency movements in its calculation of the regulatory asset base and expenditures. *PBR* also allows for adjustment of the rates the *MERALCO Group* charges should there be significant deviations in the foreign exchange forecast from what is actually realized.

The following table demonstrates the sensitivity to a reasonably possible change in the *U.S.* dollar exchange rate vis-a-vis the Philippine peso, with all other variables held constant, of the *MERALCO Group's* income before income tax for the nine months ended September 30, 2016 and 2015 (due to changes in the fair value of financial assets and financial liabilities). There is no other impact on the *MERALCO Group's* equity other than those already affecting the consolidated statement of income.

	2016		2015	
	Appreciation (Depreciation) of U.S. Dollar <i>(In %)</i>	Effect on Income before Income Tax <i>(In millions)</i>	Appreciation (Depreciation) of U.S. Dollar <i>(In %)</i>	Effect on Income before Income Tax <i>(In millions)</i>
<i>U.S.</i> dollar-denominated financial assets	+5	₱771	+5	₱863
and financial liabilities	-5	(771)	-5	(863)

Foreign exchange gain or loss for the period is computed based on management's best estimate of a +/-5 percent change in the closing Philippine peso to *U.S.* dollar conversion rate using the year-end balances of *U.S.* dollar-denominated cash and cash equivalents, receivables and liabilities. There has been no change in the methods and assumptions used by management in the above analysis.

Commodity Price Risk

Commodity price risk is the risk that the fair value or cash flows of a financial instrument will fluctuate because of changes in commodity prices. The exposure of *MERALCO* and *CEDC* to price risk is minimal. The cost of fuel is part of *MERALCO*'s and *CEDC*'s generation costs that are recoverable through the generation charge in the billings to customers.

Credit Risk

Credit risk is the risk that the *MERALCO Group* is exposed to as a result of its customers, clients or counterparties failing to discharge their contracted obligations. The *MERALCO Group* manages and controls credit risk by setting limits on the amount of risk that it is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

MERALCO as a franchise holder serving public interest cannot refuse customer connection. To mitigate risk, the *DSOAR* allows *MERALCO* to collect bill deposit equivalent to one month's consumption to secure credit. Also, as a policy, disconnection notices are sent three days after the bill due date and disconnections are carried out beginning on the third day after receipt of disconnection notice.

The *MERALCO* subsidiaries trade only with recognized, creditworthy third parties. It is the *MERALCO Group*'s policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivables are monitored on an ongoing basis to reduce exposure to bad debt.

With respect to placements of cash with financial institutions, these institutions are subject to the *MERALCO Group*'s accreditation evaluation based on liquidity and solvency ratios and on the bank's credit rating. The *MERALCO Group* transacts derivatives only with similarly accredited financial institutions. In addition, the *MERALCO Group*'s deposit accounts in banks are insured by the Philippine Deposit Insurance Corporation up to ₱500,000 per bank account.

Credit risk on other financial assets, which include cash and cash equivalents and trade and other receivables, arises from the potential default of the counterparty.

Finally, credit quality review procedures are in place to provide regular identification of changes in the creditworthiness of counterparties. Counterparty limits are established and reviewed periodically based on latest available financial information of counterparties, credit ratings and liquidity. The *MERALCO Group*'s credit quality review process allows it to assess any potential loss as a result of the risks to which it may be exposed and to take corrective actions.

There are no significant concentrations of credit risk within the *MERALCO Group*.

The table below shows the maximum exposure to credit risk for the components of the consolidated statements of financial position as at September 30, 2016 and December 31, 2015. The maximum exposure is equivalent to the nominal amount of the accounts.

	Gross Maximum Exposure	
	2016	2015
	<i>(Amounts in millions)</i>	
Cash and cash equivalents:		
Cash in banks	₱4,971	₱4,976
Cash equivalents	31,491	45,742
Trade and other receivables:		
Billed electricity	16,637	16,439
Service contracts	2,899	3,427
Insurance receivable	139	99
Cost and estimated earnings in excess of billings on uncompleted contracts	684	774
Nontrade receivables	1,411	1,906
Other current assets:		
Advances to an associate	5,506	5,342
HTM investments	1,185	4,072
Other noncurrent assets:		
HTM investments	23,861	17,167
AFS investments	25,164	10,961
Advance payments to a supplier	1,228	1,030
	₱115,176	₱111,935

The credit quality of financial assets is managed by *MERALCO* using “High Grade”, “Standard Grade” and “Sub-standard Grade” for accounts, which are neither impaired nor past due as internal credit ratings. The following tables show the credit quality by asset class:

September 30, 2016 (Unaudited)						
	Neither Past Due nor Impaired					
	High Grade	Standard Grade	Sub-standard Grade	Past Due but not Impaired	Impaired Financial Assets	Total
	(Amounts in millions)					
Cash in banks and cash equivalents	₱36,462	₱—	₱—	₱—	₱—	₱36,462
Trade and other receivables:						
Billed electricity	3,555	2,017	9,171	1,894	3,291	19,928
Service contracts	788	—	244	1,867	209	3,108
Insurance receivable	14	—	111	14	—	139
Cost and estimated earnings in excess of billings on uncompleted contracts	—	—	409	275	5	689
Nontrade receivables	567	18	267	559	4	1,415
Other current assets:						
Advances to an associate	—	5,506	—	—	—	5,506
HTM investments	1,185	—	—	—	—	1,185
Other noncurrent assets						
HTM investments	23,861	—	—	—	—	23,861
Advance payments to a supplier	—	—	1,228	—	—	1,228
	₱66,432	₱7,541	₱11,430	₱4,609	₱3,509	₱93,521

December 31, 2015 (Audited)						
	Neither Past Due nor Impaired			Past Due but not Impaired	Impaired Financial Assets	Total
	High Grade	Standard Grade	Sub-standard Grade			
<i>(Amounts in millions)</i>						
Cash in banks and cash equivalents	₱50,718	₱—	₱—	₱—	₱—	₱50,718
Trade and other receivables:						
Billed electricity	3,457	2,054	9,107	1,821	3,459	19,898
Service contracts	867	—	397	2,163	197	3,624
Insurance receivable	17	—	57	25	—	99
Cost and estimated earnings in excess of billings on uncompleted contracts	—	—	463	311	6	780
Nontrade receivables	1,022	11	232	641	3	1,909
Other current assets:						
Advances to an associate	—	5,342	—	—	—	5,342
HTM investments	4,072	—	—	—	—	4,072
Other noncurrent assets	17,167	—	1,030	—	—	18,197
	₱77,320	₱7,407	₱11,286	₱4,961	₱3,665	₱104,639

Credit ratings are determined as follows:

- High Grade

High grade financial assets include cash in banks and cash equivalents to counterparties with good credit rating or bank standing. Consequently, credit risk is minimal. These counterparties include large prime financial institutions, large industrial companies and commercial establishments, and government agencies. For trade receivables, these consist of current month's billings (less than 30 days) that are expected to be collected within 10 days from the time bills are delivered.

- Standard Grade

Standard grade financial assets include trade receivables that consist of current month's billings (less than 30 days) that are expected to be collected before due date (10 to 14 days after bill date).

- Sub-standard Grade

Sub-standard grade financial assets include trade receivables that consist of current month's billings, which are not expected to be collected within 60 days.

The following table shows the aging analysis of financial assets as at September 30, 2016 and December 31, 2015:

September 30, 2016 (Unaudited)						
	Neither Past Due nor Impaired	Past Due But Not Impaired			Impaired Financial Assets	Total
		31-60 Days	61-90 Days	Over 90 Days		
(Amounts in millions)						
Cash and cash equivalents:						
Cash equivalents	₱31,491	₱-	₱-	₱-	₱-	₱31,491
Cash in banks	4,971	-	-	-	-	4,971
Trade and other receivables:						
Trade:						
Billed electricity	14,743	729	241	924	3,291	19,928
Service contracts	1,032	74	35	1,758	209	3,108
Insurance receivable	125	1	2	11	-	139
Cost and estimated earnings in excess of billings on uncompleted contracts	409	42	26	207	5	689
Nontrade receivables	852	150	34	375	4	1,415
Other current assets:						
Advances to an associate	5,506	-	-	-	-	5,506
HTM investments	1,185	-	-	-	-	1,185
Other noncurrent assets:						
Advance payments to a supplier	1,228	-	-	-	-	1,228
HTM investments	23,861	-	-	-	-	23,861
	₱85,403	₱996	₱338	₱3,275	₱3,509	₱93,521
December 31, 2015 (Audited)						
	Neither Past Due nor Impaired	Past Due But Not Impaired			Impaired Financial Assets	Total
		31-60 Days	61-90 Days	Over 90 Days		
(Amounts in millions)						
Cash and cash equivalents:						
Cash equivalents	₱4,976	₱-	₱-	₱-	₱-	₱4,976
Cash in banks	45,742	-	-	-	-	45,742
Trade and other receivables:						
Trade:						
Billed electricity	14,618	924	302	595	3,459	19,898
Service contracts	1,264	121	57	1,985	197	3,624
Insurance receivable	74	1	2	22	-	99
Cost and estimated earnings in excess of billings on uncompleted contracts	463	48	29	234	6	780
Nontrade receivables	1,265	143	44	454	3	1,909
Other current assets:						
Advances to an associate	5,342	-	-	-	-	5,342
HTM investments	4,072	-	-	-	-	4,072
Other noncurrent assets:						
Advance payments to a supplier	1,030	-	-	-	-	1,030
HTM investments	17,167	-	-	-	-	17,167
	₱96,013	₱1,237	₱434	₱3,290	₱3,665	₱104,639

Liquidity Risk

Liquidity risk is the risk that the *MERALCO Group* will be unable to meet its payment obligations when these fall due. The *MERALCO Group* manages this risk through monitoring of cash flows in consideration of future payment of obligations and the collection of its trade receivables. The *MERALCO Group* also ensures that there are sufficient, available and approved working capital lines that it can draw from at any time.

The *MERALCO Group* maintains an adequate amount of cash and cash equivalents, which may be readily converted to cash in any unforeseen interruption of its cash collections. The *MERALCO Group* also maintains accounts with several relationship banks to avoid significant concentration of funds with one institution.

The following table sets out the maturity profile of the financial liabilities based on contractual undiscounted payments plus future interest:

September 30, 2016 (Unaudited)					
	Less than 3 Months	Over 3–12 Months	Over 1–5 Years	More than 5 Years	Total
<i>(Amounts in millions)</i>					
Notes payable	₱11,236	₱–	₱–	₱–	₱11,236
Trade payables and other current liabilities	41,408	–	–	–	41,408
Customers' refund	5,078	–	–	–	5,078
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	–	66	2,452	–	2,518
Fixed rate borrowings	283	1,208	16,938	13,545	31,974
Redeemable preferred stock	1,502	–	–	–	1,502
Customers' deposits	349	2,528	5,035	18,737	26,649
Refundable service extension costs	190	2,312	4,760	24	7,286
Total undiscounted financial liabilities	₱60,046	₱6,114	₱29,185	₱32,306	₱127,651

2015					
	Less than 3 Months	Over 3–12 Months	Over 1–5 Years	More than 5 Years	Total
<i>(Amounts in millions)</i>					
Notes payable	₱1,043	₱–	₱–	₱–	₱1,043
Trade payables and other current liabilities	41,208	–	–	–	41,208
Customers' refund	5,550	–	–	–	5,550
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	27	39	2,518	–	2,584
Fixed rate borrowings	290	1,216	5,941	25,741	33,188
Redeemable preferred stock	1,522	–	–	–	1,522
Customers' deposits	242	2,725	4,811	18,773	26,551
Refundable service extension costs	44	2,458	1,766	2,468	6,736
Total undiscounted financial liabilities	₱49,926	₱6,438	₱15,036	₱46,982	₱118,382

The maturity profile of bill deposits is not determinable since the timing of each refund is linked to the cessation of service, which is not reasonably predictable. However, *MERALCO* estimates that the amount of bill deposits (including related interest) of ₱2,389 million and ₱2,470 million will be refunded within a year. This is shown as part of "Trade payables and other current liabilities" account in the consolidated statement of financial position as at September 30, 2016 and December 31, 2015, respectively.

Capital Management

The primary objective of the *MERALCO Group's* capital management is to enhance shareholder value. The capital structure is reviewed with the end view of achieving a competitive cost of capital and at the same time ensuring that returns on, and of, capital are consistent with the levels approved by its regulators for its core distribution business.

The capital structure optimization plan is complemented by efforts to improve capital efficiency to increase yields on invested capital. This entails efforts to improve the efficiency of capital assets, working capital and non-core assets.

The *MERALCO Group* monitors capital using, among other measures, debt to equity ratio, which is gross debt divided by equity attributable to the holders of the parent. The *MERALCO Group* considers long-term debt, redeemable preferred stock and notes payable as debt.

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions, except debt to equity ratio)</i>		
Long-term debt	₱27,376	₱27,743
Redeemable preferred stock	1,502	1,522
Notes payable	11,236	1,043
Debt (a)	40,114	30,308
Equity attributable to the holders of the parent (b)	68,907	80,276
Debt to equity ratio(a)/(b)	0.58	0.38

28. Income Taxes and Local Franchise Taxes

Income Taxes

The components of net deferred tax assets (liabilities) as at September 30, 2016 and December 31, 2015 are as follows:

	Note	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>			
Deferred tax assets:			
Provisions for various claims	19 and 22	₱20,036	₱17,621
Allowance for doubtful accounts	12	988	1,039
Unfunded retirement benefits cost and unamortized past service cost	26	962	1,008
Accrued employee benefits	26	784	1,466
Allowance for excess of cost over net realizable value of inventories	13	57	57
Others		109	84
		22,936	21,275
Deferred tax liabilities:			
Revaluation increment in utility plant and others	15	7,187	7,285
Capitalized interest		761	760
Depreciation method differential		707	777
Capitalized duties and taxes deducted in advance		593	608
Actuarial gains	26	426	426
Net book value of capitalized/realized foreign exchange losses		1	3
Others		130	137
		9,805	9,996
		₱13,131	₱11,279

The deferred tax assets and liabilities are presented in the consolidated statements of financial position as follows:

	September 30, 2016 (Unaudited)	December 31, 2015 (Audited)
<i>(Amounts in millions)</i>		
Deferred tax assets - net	₱13,150	₱11,296
Deferred tax liabilities - net	(19)	(17)
	₱13,131	₱11,279

Provision for (benefit from) income tax consists of:

	Unaudited			
	For the Nine Months Ended September 30		For the Three Months Ended September 30	
	2016	2015	2016	2015
<i>(Amounts in millions)</i>				
Current	₱8,008	₱8,859	₱2,972	₱2,903
Deferred	(1,837)	(2,121)	(937)	(1,105)
	₱6,171	₱6,738	₱2,035	₱1,798

A reconciliation between the provision for income tax computed at statutory income tax rate of 30% for the nine months ended September 30, 2016 and 2015, and provision for income tax as shown in the consolidated statements of income is as follows:

	Unaudited			
	For the Nine Months Ended September 30		For the Three Months Ended September 30	
	2016	2015	2016	2015
<i>(Amounts in millions)</i>				
Income tax computed at statutory tax rate	₱6,598	₱6,886	₱2,095	₱1,867
Income tax effects of:				
Interest income subjected to lower final tax rate	(445)	(249)	(163)	(121)
Nondeductible interest expense	184	103	68	50
Equity in net losses of associates and joint ventures	40	43	48	28
Nontaxable income	(64)	(8)	(2)	24
Others	(142)	(37)	(11)	(50)
	₱6,171	₱6,738	₱2,035	₱1,798

On December 18, 2009, the BIR issued Revenue Regulations (“RR”) No. 16-2008, which implemented the provisions of RA No. 9504 on Optional Standard Deductions (“OSD”). Such regulation allows both individual and corporate taxpayers to use OSD in computing their taxable income. For corporations, they may elect to adopt standard deduction in an amount not exceeding 40% of gross income in lieu of the allowed itemized deductions. In 2016 and 2015, MERALCO

elected to adopt the *OSD* in lieu of itemized deductions beginning with its first quarter income tax return.

The temporary difference for which deferred tax assets have not been recognized pertains to the tax effect of net operating loss carryover ("*NOLCO*") amounting ₱1,582 million and ₱1,240 million as at September 30, 2016 and December 31, 2015, respectively.

NOLCO totaling to ₱1,582 million may be claimed as deduction against taxable income as follows:

Date Incurred	Expiry Date	Amount (In millions)
December 31, 2013	December 31, 2016	₱402
December 31, 2014	December 31, 2017	500
December 31, 2015	December 31, 2018	338
September 30, 2016	September 30, 2019	342
		₱1,582

LFT

Consistent with the decisions of the *ERC*, *LFT* is a recoverable charge of the *DU* in the particular province or city imposing and collecting the *LFT*. It is presented as a separate line item in the customer's bill and computed as a percentage of the sum of generation, transmission, distribution services and related *SL* charges.

The *IRR* issued by the *ERC* provide that *LFT* shall be paid only on its distribution wheeling and captive market supply revenues. Pending the promulgation of guidelines from the relevant government agencies, *MERALCO* is paying *LFT* based on the sum of the foregoing charges in the customers' bill.

29. Contingencies and Legal Proceedings

Overpayment of Income Tax related to SC Refund

With the decision of the *SC* for *MERALCO* to refund ₱0.167 per *kWh* to customers during the billing period February 1994 to May 2003, *MERALCO* overpaid income tax in the amount of ₱7,107 million for taxable years 1994 to 1998 and 2000 to 2001. Accordingly, *MERALCO* filed a claim on November 27, 2003 for the recovery of such excess income taxes paid. After examination of the books of *MERALCO* for the covered periods, the *BIR* determined that *MERALCO* had in fact overpaid income taxes in the amount of ₱6,690 million. However, the *BIR* also maintained that *MERALCO* is entitled to a refund amount of only ₱894 million, which pertains to taxable year 2001, claiming that the period for filing a claim had prescribed in respect to the difference between *MERALCO*'s overpayment and the refund amount *MERALCO* is entitled to.

The *BIR* then approved the refund of ₱894 million for issuance of tax credit certificates ("*TCCs*"), proportionate to the actual refund of claims to utility customers. The *BIR* initially issued *TCCs* amounting to ₱317 million corresponding to actual refund to customers as at August 31, 2005. In May 2014, the *BIR* issued additional *TCCs* amounting to ₱396 million corresponding to actual refund to customers as at December 31, 2012.

As at September 30, 2016 and December 31, 2015, the amount of unissued *TCCs* amounting to ₱181 million, is presented as part of “Other noncurrent assets” account in the consolidated statements of financial position.

See *Note 10 – Other Noncurrent Assets*.

MERALCO filed a Petition with the Court of Tax Appeals (“*CTA*”) assailing the denial by the *BIR* of its income tax refund claim of ₱5,796 million for the years 1994 - 1998 and 2000, arising from the *SC* decision (net of ₱894 million as approved by the *BIR* for taxable year 2001). In a decision dated December 6, 2010, the *CTA*’s Second Division granted *MERALCO*’s claim and ordered the *BIR* to refund or to issue *TCC* in favor of *MERALCO* in the amount of ₱5,796 million in proportion to the tax withheld on the total amount that has been actually given or credited to its customers.

On appeal by the *BIR* to the *CTA* En Banc, *MERALCO*’s petition was dismissed on the ground of prescription in the Decision of the *CTA* En Banc dated May 8, 2012. On an *MR* by *MERALCO* of the said dismissal, the *CTA* En Banc partly granted *MERALCO*’s motion and issued an Amended Decision dated November 13, 2012, ruling that *MERALCO*’s claim was not yet barred by prescription and remanding the case back to the *CTA* Second Division for further reception of evidence.

The *BIR* filed an *MR* of the above Amended Decision, while *MERALCO* filed its Motion for Partial Reconsideration or Clarification of Amended Decision. Both parties filed their respective Comments to the said motions, and these were submitted for resolution at the *CTA* En Banc.

In a Resolution promulgated on May 22, 2013, the *CTA* denied the said motions of the *BIR* and *MERALCO*, and the *CTA* Second Division was ordered to receive evidence and rebuttal evidence relating to *MERALCO*’s level of refund to customers, pertaining to the excess charges it made in taxable years 1994-1998 and 2000, but corresponding to the amount of ₱5,796 million, as already determined by the said court.

On July 12, 2013, the *BIR* appealed the *CTA* En Banc’s Amended Decision dated November 13, 2012 and Resolution dated May 22, 2013 via Petition for Review with the *SC*. As at September 30, 2016, the case is pending resolution by the *SC*.

LFT Assessments of Municipalities

Certain municipalities have served assessment notices on *MERALCO* for *LFT*. As provided in the Local Government Code (“*LGC*”), only cities and provincial governments may impose taxes on establishments doing business in their localities. On the basis of the foregoing, *MERALCO* and its legal counsel believe that *MERALCO* is not subject or liable for such assessments.

Real Property Tax (“RPT”) Assessments

Several Local Government Units (“*LGUs*”) assessed *MERALCO* for deficiency *RPTs* on certain assets of *MERALCO*. The assets include electric transformers, distribution wires, insulators, and poles, collectively referred to as *TWIP*. Of these *LGUs*, one has secured a favorable decision from the *CA*. Such decision was appealed by *MERALCO* to the *SC* for the benefit of *MERALCO* customers. On October 22, 2015, *MERALCO* received a copy of the *SC* Decision promulgated on August 5, 2015 declaring, among others, that the transformers, electric posts, transmission lines, insulators, and electric meters of *MERALCO* are not exempted from *RPT* under the *LGU*.

MERALCO did not appeal said *SC* Decision. The cases of the other *LGUs* are pending with their respective administrative bodies or government offices.

MERALCO also filed a case against the City of Manila before Regional Trial Court-Pasig branch ("*RTC-Pasig*") to enjoin the collection of *RPT* on *MERALCO*'s *TWIP* and nullify *RPT* assessments made thereon based on the argument that these are not within the ambit of the definition of real property under the *LGC*. The case was set for mediation after the City of Manila files its comments on *MERALCO*'s petition. *MERALCO* has started presenting its evidence without prejudice to possible out-of-court settlement in light of the *SC* Decision in the case of Lucena City. Subsequently, the court has granted the motion jointly filed by *MERALCO* and the City of Manila for the withdrawal of the case subject to the terms and conditions set forth in the motion.

In the event that the assessment is sustained by the *SC* and payment is warranted or appropriate, *MERALCO* will file for the recovery of any resulting *RPT* payments from customers in the relevant *LGUs* through a separate application with the *ERC*. In 2016, *MERALCO* is in the process of settlement with various local governments.

Mediation with NPC

The *NPC* embarked on a Power Development Program ("*PDP*"), which consisted of contracting generating capacities and the construction of its own, as well as private sector, generating plants, following a crippling power supply crisis. To address the concerns of the creditors of *NPC*, namely, Asian Development Bank and the World Bank, the Department of Energy ("*DOE*") required that *MERALCO* enter into a long-term supply contract with the *NPC*.

Accordingly, on November 21, 1994, *MERALCO* entered into a 10-year Contract for Sale of Electricity ("*CSE*") with *NPC* to commence on January 1, 1995. The *CSE* and the rates and amounts charged to *MERALCO* therein, were approved by the *BOD* of *NPC* and the then Energy Regulatory Board, respectively.

Separately, the *DOE* further asked *MERALCO* to provide a market for half of the output of the Camago-Malampaya gas field to enable its development and production of natural gas, which was to generate significant revenues for the Philippine Government and equally significant foreign exchange savings for the country to the extent of the fuel imports, which the domestic volume of natural gas will displace.

MERALCO's actual purchases from *NPC* exceeded the contract level in the first seven (7) years of the *CSE*. However, the 1997 Asian crisis resulted in a significant curtailment of energy demand.

While the events were beyond the control of *MERALCO*, *NPC* did not honor *MERALCO*'s good faith notification of its off-take volumes. A dispute ensued and both parties agreed to enter into mediation.

The mediation resulted in the signing of a Settlement Agreement ("*SA*") between the parties on July 15, 2003. The *SA* was approved by the respective *BODs* of *NPC* and *MERALCO*. The net settlement amount of ₱14,320 million was agreed upon by *NPC* and *MERALCO* and manifested before the *ERC* through a Joint Compliance dated January 19, 2006. The implementation of the *SA* is subject to the approval of *ERC*.

Subsequently, the *OSG* filed a "Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between *NPC* and *MERALCO*". As a result, *MERALCO* sought judicial clarification with the *RTC-Pasig*. Pre-trials were set,

which *MERALCO* complied with and attended. However, the *OSG* refused to participate in the pre-trial and opted to seek a Temporary Restraining Order (“*TRO*”) from the *CA*.

In a Resolution dated December 1, 2010, the *CA* issued a *TRO* against the *RTC-Pasig*, *MERALCO* and *NPC* restraining the respondents from further proceeding with the case. Subsequently, in a Resolution dated February 3, 2011, the *CA* issued a writ of preliminary injunction enjoining the *RTC-Pasig* from conducting further proceedings pending resolution of the Petition. In a Decision dated October 14, 2011, the *CA* resolved to deny the Petition filed by the *OSG* and lifted the injunction previously issued. The said Decision likewise held that the *RTC-Pasig* committed no error in finding the *OSG* in default due to its failure to participate in the proceedings. The *RTC-Pasig* was thus ordered to proceed to hear the case *ex-parte*, as against the *OSG*, and with dispatch. The *OSG* filed an *MR* which was denied by the *CA* in its Resolution dated April 25, 2012. The *OSG* filed a Petition for Review on Certiorari with the *SC*. *MERALCO*'s Comment was filed on October 29, 2012. Subsequently, a Decision dated December 11, 2013 was rendered by the First Division of the *SC* denying the Petition for Review on Certiorari by the *OSG* and affirming the decision promulgated by the *CA* on October 14, 2011.

With the dismissal of the petition filed by the *OSG* with the *CA*, *MERALCO* filed a motion for the reception of its evidence *ex-parte* with the *RTC-Pasig* pursuant to the ruling of the *CA*. In a Decision dated May 29, 2012, the *RTC-Pasig* declared the *SA* valid and binding, independent of the pass-through for the settlement amount which is reserved for the *ERC*. The *OSG* has filed a Notice of Appeal with the *RTC-Pasig* on June 19, 2012. After both parties filed their respective appeal briefs, the *CA* rendered a Decision dated April 15, 2014 denying the appeal and affirming the *RTC* Decision, which declared the *SA* as valid and binding. The *OSG* filed a Petition for Review with the *SC*. On November 10, 2014, *MERALCO* filed its comment to the Petition. *PSALM* likewise filed its comment to the Petition. In a Resolution dated July 8, 2015, the *SC* resolved to serve anew its Resolutions requiring *NPC* to comment on the Petition. In compliance, *NPC* submitted its Comment dated September 8, 2015. *MERALCO* submitted its Motion for Leave to File and to Admit Attached Reply on October 12, 2015. Pursuant to the *SC* Resolution dated November 11, 2015, the *OSG* filed a Consolidated Reply to the comments filed by *NPC*, *MERALCO* and *PSALM*. *MERALCO* then filed a Motion for Leave to File and to Admit the Attached Rejoinder. As of September 30, 2016, *MERALCO* is awaiting further action of the *SC* on the matter.

Sucat-Araneta-Balintawak Transmission Line

The Sucat-Araneta-Balintawak transmission line is a two-part transmission line, which completed the 230 *kV* line loop within Metro Manila. The two main parts are the Araneta to Balintawak leg and the Sucat to Araneta leg, which cuts through Dasmariñas Village, Makati City.

On March 10, 2000, certain residents along Tamarind Road, Dasmariñas Village, Makati City or plaintiffs, filed a case against *NPC* with the *RTC-Makati*, enjoining *NPC* from further installing high voltage cables near the plaintiffs' homes and from energizing and transmitting high voltage electric current through said cables because of the alleged health risks and danger posed by the same through the electromagnetic field emitted by said lines. Following its initial status quo Order issued on March 13, 2000, *RTC-Makati* granted on April 3, 2000 the preliminary injunction sought by the plaintiffs. The decision was affirmed by the *SC* on March 23, 2006, which effectively reversed the decision of the *CA* to the contrary. The *RTC-Makati* subsequently issued a writ of execution based on the Order of the *SC*. *MERALCO*, in its capacity as an intervenor, was constrained to file an Omnibus Motion to maintain status quo because of the

significant effect of a de-energization of the Sucat-Araneta line to the public and economy. Shutdown of the 230 kV line will result in widespread and rotating brownouts within *MERALCO*'s franchise area with certain power plants unable to run at their full capacities.

On September 8, 2009, the *RTC-Makati* granted the motions for intervention filed by intervenors *MERALCO* and *NGCP* and dissolved the Writ of Preliminary Injunction issued, upon the posting of the respective counter bonds by defendant *NPC*, intervenors *MERALCO* and *NGCP*, subject to the condition that *NPC* and intervenors will pay for all damages, which the plaintiffs may incur as a result of the Writ of Preliminary Injunction.

In its Order dated February 5, 2013, the *RTC-Makati* granted plaintiffs' motion and directed the re-raffle of the case to another branch after the judicial dispute resolution failed.

This case remains pending and is still at the pre-trial stage. During the pre-trial stage, plaintiffs filed a Manifestation stating that they are pursuing the deposition, a supposed expert in electromagnetic field, through oral examination without leave of court in late January or early February 2016 or on such date as all the parties may agree amongst themselves at the Consulate Office of the Philippines in Vancouver, Canada. *NPC* and intervenors filed their Opposition and Counter-Manifestation. Intervenor *NGCP* filed a Motion to Prohibit the Taking of the Deposition of Dr. Blank. Intervenor *MERALCO* intends to file its Comment/Opposition in due course.

Petition for Dispute Resolution against PEMC, TransCo, NPC and PSALM

On September 9, 2008, *MERALCO* filed a Petition for Dispute Resolution, against *PEMC*, *TransCo*, *NPC* and *PSALM* with the *ERC* as a result of the congestion in the transmission system of *TransCo* arising from the outages of the San Jose-Tayabas 500 kV Line 2 on June 22, 2008, and the 500 kV 600 Mega Volt-Ampere Transformer Bank No. 2 of *TransCo*'s San Jose, Bulacan substation on July 11, 2008. The Petition seeks to, among others, direct *PEMC* to adopt the *NPC*- Time-of-Use ("*TOU*") rate or the new price determined through the price substitution methodology of *PEMC* as approved by the *ERC*, as basis for its billing during the period of the congestion and direct *NPC* and *PSALM* to refund the transmission line loss components of the line rentals associated with *NPC/PSALM* bilateral transactions from the start of *WESM* operation on June 26, 2006.

In a Decision dated March 10, 2010, the *ERC* granted *MERALCO*'s petition and ruled that there is double charging of the Transmission Line Costs billed to *MERALCO* by *NPC* for the Transition Supply Contract ("*TSC*") quantities to the extent of 2.98% loss factor, since the start of the *TSC* in November 2006. Thus, *NPC* was directed to refund line rental adjustment to *MERALCO*. In the meantime, the *ERC* issued an Order on May 4, 2011 allowing *PEMC* to submit an alternative methodology for the segregation of line rental into congestion cost and line losses from the start of the *WESM*. *PEMC* has filed its compliance submitting its alternative methodology.

On September 8, 2011, *MERALCO* received a copy of *PEMC*'s compliance to *ERC*'s directive and on November 11, 2011, *MERALCO* filed a counter-proposal which effectively simplifies *PEMC*'s proposal.

In an Order of the *ERC* dated June 21, 2012, *MERALCO* was directed to submit its computation of the amount of the double charging of line loss on a per month basis from June 26, 2006 up to June 2012. On July 4, 2012, *MERALCO* filed its Compliance to the said Order. Thereafter, the *ERC* issued an Order directing the parties to comment on *MERALCO*'s submissions.

Hearings were conducted on October 2, 2012 and October 16, 2012 to discuss the parties' proposal and comments.

In an Order dated March 4, 2013, the *ERC* approved the methodology proposed by *MERALCO* and *PEMC* in computing the double charged amount on line losses by deducting 2.98% from the *NPC-TOU* amount. Accordingly, the *ERC* determined that the computed double charge amount to be collected from *NPC* is ₱5.2 billion, covering the period November 2006 to August 2012 until actual cessation of the collection of the 2.98% line loss charge in the *NPC-TOU* rates imposed on *MERALCO*. In this regard, *NPC* was directed by the *ERC* to refund said amount by remitting to *MERALCO* the equivalent amount of ₱73.9 million per month until the over-recoveries are fully refunded. In said Order, the *ERC* likewise determined that the amount to be collected from the successor generating companies ("*SGCs*") is ₱4.7 billion. Additionally, *MERALCO* was directed to file a petition against the following *SGCs*: *MPPCL*, Aboitiz Power Renewables, Inc. ("*APRI*"), *TLI*, *SMEC* and *Sem-Calaca*, within 30 days from receipt thereof, to recover the line loss collected by them. On April 19, 2013, *MERALCO* filed a Motion for Clarification with the *ERC* regarding the directives contained in the March 4, 2013 Order. On April 30, 2013 and May 8, 2013, *PSALM* and *NPC*, respectively, filed motions seeking reconsideration of the March 4, 2013 Order. *MERALCO* filed a motion seeking for an additional 15 days from its receipt of the *ERC*'s Order resolving its Motion for Clarification, within which to file its Petition against the *SGCs*.

In an Order dated July 1, 2013, the *ERC* issued the following clarifications/resolutions: 1) *SPPC* should be included as one of the *SGCs* against whom a petition for dispute resolution should be filed by *MERALCO*; 2) Amount to be refunded by *NPC* is not only ₱5.2 billion but also the subsequent payments it received from *MERALCO* beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates; 3) Petition to be filed by *MERALCO* against the *SGCs* should not only be for the recovery of the amount of ₱4.7 billion but also the subsequent payments beyond August 2012 until the actual cessation of the collection of the 2.98% line loss charge in its *TOU* rates; 4) "*SCPC Ilijan*" pertains to *SPPC* instead. Thus, the refundable amount of ₱706 million pertaining to "*SCPC Ilijan*" should be added to *SPPC*'s refundable amount of ₱1.1 billion; 5) Grant the Motion for Extension filed by *MERALCO* within which to file a petition against the following *SGCs*: *MPPCL*, *APRI*, *TLI*, *SMEC*, *Sem-Calaca* and *SPPC*; and 6) deny the respective Motions for Reconsideration filed by *NPC* and *PSALM*.

On September 12, 2013, *MERALCO* filed a Manifestation with Motion with the *ERC* seeking approval of its proposal to offset the amount of ₱73.9 million per month against some of its monthly remittances to *PSALM*. *PSALM* and *NPC* filed their comments *Ad Cautelam* and Comment and Opposition *Ad Cautelam*, respectively, on *MERALCO*'s Manifestation and Motion. On November 4, 2013, *MERALCO* filed its reply. As at September 30, 2016, *MERALCO*'s Manifestation and Motion is pending resolution by the *ERC*.

On October 24, 2013, *MERALCO* received *PSALM*'s Petition for Review on Certiorari with the *CA* (With Urgent *TRO* and/or Writ of Preliminary Mandatory Injunction Applications) questioning the March 4, 2013 and July 1, 2013 Orders of the *ERC*.

On February 3, 2014, *MERALCO* filed a Comment with Opposition to the Application for Temporary Restraining Order or Writ of Preliminary Injunction dated January 30, 2014. *PEMC* filed a Comment and Opposition Re: Petition for Certiorari with Urgent Temporary Restraining Order and/or Writ of Preliminary Mandatory Injunction dated January 6, 2014. On June 4, 2014, the *CA* issued a Resolution declaring that *PSALM* is deemed to have waived the filing of a Reply to the comment and opposition of *MERALCO* and *PEMC* and directing the parties to submit their simultaneous memoranda within 15 days from notice. On December 1, 2014, the *CA* issued a

decision dismissing the Petition for Certiorari filed by *PSALM* against the *ERC*, *MERALCO* and *PEMC* and affirming *ERC*'s ruling on the refund of the ₱5.2 billion of transmission line losses double charged by *PSALM* and *NPC*. On January 30, 2015, *PSALM* filed its *MR* on the December 1, 2014 Decision of the *CA*. *MERALCO* has filed its Opposition to the *MR*. In a Resolution dated August 11, 2015, the *CA* denied *PSALM*'s *MR*. On October 27, 2015, *MERALCO* received *PSALM*'s Petition for Review with the *SC*. *MERALCO* is awaiting further action of the *SC* on the Petition.

Petition for Dispute Resolution against SPPC, MPPCL, APRI, TLI, SMEC and Sem-Calaca

On August 29, 2013, *MERALCO* filed a Petition for Dispute Resolution against *SPPC*, *MPPCL*, *APRI*, *TLI*, *SMEC* and *Sem-Calaca*. Said Petition seeks the following: 1) refund of the 2.98% transmission line losses in the amount of ₱5.4 billion, inclusive of the ₱758 million line loss for the period September 2012 to June 25, 2013, from said *SGCs*; and 2) approval of *MERALCO*'s proposal to correspondingly refund to its customers the aforementioned line loss amounts, as and when the same are received from the *SGCs*, until such time that the said over-recoveries are fully refunded, by way of automatic deduction of the amount of refund from the computed monthly generation rate. On September 20, 2013, *MERALCO* received the *SGCs*' Joint Motion to Dismiss. On October 7, 2013, *MERALCO* filed its Comment on the said Joint Motion.

On October 8, 2013, *MERALCO* received the *SGCs* Manifestation and Motion, which sought, among other things, the cancellation of the scheduled initial hearing of the case, including the submission of the parties respective Pre-trial Briefs, until the final resolution of the *SGC*'s Joint Motion to Dismiss. On October 11, 2013, *MERALCO* filed its Pre-trial Brief. On October 14, 2013, *MERALCO* filed its Opposition to the *SGC*'s Manifestation and Motion. On October 24, 2013, *MERALCO* received the *SGC*'s Reply to its Comment on the Joint Motion to Dismiss. On October 29, 2013, *MERALCO* filed its Rejoinder. Thereafter, the *SGC*'s filed their Sur-Rejoinder dated November 4, 2013. As at September 30, 2016, the Joint Motion to Dismiss is pending resolution by the *ERC*.

PSALM versus PEMC and MERALCO

Due to the significant increases in *WESM* prices during the 3rd and 4th months of the *WESM* operations, *MERALCO* raised concerns with the *PEMC* to investigate whether *WESM* rules were breached or if anti-competitive behavior had occurred.

While resolutions were initially issued by the *PEMC* directing adjustments of *WESM* settlement amounts, a series of exchanges and appeals with the *ERC* ensued. *ERC* released an order directing that the *WESM* settlement price for the 3rd and 4th billing months be set at *NPC-TOU* rates, prompting *PSALM* to file a Motion for Partial Reconsideration, which was denied by the *ERC* in an Order dated October 20, 2008. *PSALM* filed a Petition for Review before the *CA*, which was dismissed on August 28, 2009, prompting *PSALM* to file an *MR*, which was likewise denied by the *CA* on November 6, 2009. In December 2009, *PSALM* filed a Petition for Review on Certiorari with the *SC*. *MERALCO* has filed its comments on the Petition and its Memorandum.

As at September 30, 2016, *PSALM*'s Petition for Review is pending resolution by the *SC*.

Petition for Dispute Resolution with NPC on Premium Charges

On June 2, 2009, *MERALCO* filed a Petition for Dispute Resolution against *NPC* and *PSALM* with respect to *NPC*'s imposition of premium charges for the alleged excess energy it supplied to

MERALCO covering the billing periods May 2005 to June 2006. The premium charges amounting to ₱315 million during the May-June 2005 billing periods have been paid but are the subject of a protest by *MERALCO*, and premium charges of ₱318 million during the November 2005, February 2006 and April to June 2006 billing periods are being disputed and withheld by *MERALCO*. *MERALCO* believes that there is no basis for the imposition of the premium charges. The hearings on this case have been completed. As at September 30, 2016, the petition is pending resolution by the *ERC*.

SC TRO on MERALCO's December 2013 Billing Rate Increase

On December 9, 2013, the *ERC* gave clearance to the request of *MERALCO* to implement a staggered collection over three (3) months covering the December 2013 billing month for the increase in generation charge and other bill components such as *VAT*, *LFT*, transmission charge, and *SL* charge. The generation costs for the November 2013 supply month increased significantly because of the aberrant spike in the *WESM* charges on account of the non-compliance with *WESM* Rules by certain plants resulting in significant power generation capacities not being offered and dispatched, and the scheduled and extended shutdowns, and the forced outages, of several base load power plants, and the use of the more expensive liquid fuel or bio-diesel by the natural gas-fired power plants that were affected by the Malampaya Gas Field, shutdown from November 11 to December 10, 2013.

On December 19, 2013, several party-list representatives of the House of Representatives filed a Petition against *MERALCO*, *ERC* and the *DOE* before the *SC*, questioning the *ERC* clearance granted to *MERALCO* to charge the resulting price increase, alleging the lack of hearing and due process. It also sought for the declaration of the unconstitutionality of the *EPIRA*, which essentially declared the generation and supply sectors competitive and open, and not considered public utilities. A similar petition was filed by a consumer group and several private homeowners associations challenging also the legality of the *AGRA* that the *ERC* had promulgated. Both petitions prayed for the issuance of *TRO*, and a Writ of Preliminary Injunction.

On December 23, 2013, the *SC* consolidated the two (2) Petitions and granted the application for *TRO* effective immediately and for a period of 60 days, which effectively enjoined the *ERC* and *MERALCO* from implementing the price increase. The *SC* also ordered *MERALCO*, *ERC* and *DOE* to file their respective comments to the Petitions. Oral Arguments were conducted on January 21, 2014, February 4, 2014 and February 11, 2014. Thereafter, the *SC* ordered all the Parties to the consolidated Petitions to file their respective Memorandum on or before February 26, 2014 after which the Petitions will be deemed submitted for resolution of the *SC*. *MERALCO* complied with said directive and filed its Memorandum on said date.

On February 18, 2014, acting on the motion filed by the Petitioners, the *SC* extended for another 60 days or until April 22, 2014, the *TRO* that it originally issued against *MERALCO* and *ERC* last December 23, 2013. The *TRO* was also similarly applied to the generating companies, specifically *MPPCL*, *SMEC*, *SPPC*, *FGPC*, and the *NGCP*, and the *PEMC* (the administrator of *WESM* and market operator) who were all enjoined from collecting from *MERALCO* the deferred amounts representing the ₱4.15 per *kWh* price increase for the November 2013 supply month. In the meantime, on January 30, 2014, *MERALCO* filed an Omnibus Motion with Manifestation with the *ERC* for the latter to direct *PEMC* to conduct a re-run or re-calculation of the *WESM* prices for the supply months of November to December 2013. Subsequently, on February 17, 2014, *MERALCO* filed with the *ERC* an Application for the recovery of deferred generation costs for the December 2013 supply month praying that it be allowed to recover the same over a six (6)-month period.

On March 3, 2014, the *ERC* issued an Order voiding the Luzon *WESM* prices during the November and December 2013 supply months on the basis of the preliminary findings of its Investigating Unit that these are not reasonable, rational and competitive, and imposing the use of regulated rates for the said period. *PEMC* was given seven (7) days upon receipt of the Order to calculate these regulated prices and implement the same in the revised *WESM* bills of the concerned *DUs* in Luzon. *PEMC*'s recalculated power bills for the supply month of December 2013 resulted in a net reduction of the December 2013 supply month bill of the *WESM* by ₱9.3 billion. Due to the pendency of the *TRO*, no adjustment was made to the *WESM* bill of *MERALCO* for the November 2013 supply month. The timing of amounts to be credited to *MERALCO* is dependent on the reimbursement of *PEMC* from associated generator companies. However, several generating companies, including *MPPCL*, *SN Aboitiz Power, Inc.*, *Team Energy*, *PanAsia Energy, Inc.* ("*PanAsia*"), and *SMEC*, have filed motions for reconsideration questioning the Order dated March 3, 2014. *MERALCO* has filed a consolidated comment to these motions for reconsideration. In an Order dated October 15, 2014, the *ERC* denied the motions for reconsideration. The generating companies have appealed the Orders with the *CA* where the petitions are pending. *MERALCO* has filed a motion to intervene and a comment in intervention in the petition filed by *SMEC* and shall file similar pleadings in the cases filed by the other generators.

In view of the pendency of the various submissions before the *ERC* and mindful of the complexities in the implementation of *ERC*'s Order dated March 3, 2014, the *ERC* directed *PEMC* to provide the market participants an additional period of 45 days to comply with the settlement of their respective adjusted *WESM* bills. In an Order dated May 9, 2014, the parties were then given an additional non-extendible period of 30 days from receipt of the Order within which to settle their *WESM* bills. However, in an Order dated June 6, 2014 and acting on an intervention filed by *Angeles Electric Corporation*, the *ERC* deemed it appropriate to hold in abeyance the settlement of *PEMC*'s adjusted *WESM* bills by the market participants.

On April 22, 2014, the *SC* extended indefinitely the *TRO* issued on December 23, 2013 and February 18, 2014 and directed generating companies, *NGCP* and *PEMC* not to collect from *MERALCO*. As at September 30, 2016, the *SC* has yet to resolve the various petitions filed against *MERALCO*, *ERC*, and *DOE*.

ERC Investigation Unit ("IU") Complaint

On December 26, 2013, the *ERC* constituted the *IU* under its Competition Rules to investigate possible anti-competitive behavior by the industry players and possible collusion that transpired in the *WESM* during the supply months of November 2013 and December 2013. *MERALCO* participated in the proceedings and submitted a Memorandum.

An investigating officer of the *IU* filed a Complaint dated May 9, 2015 against *MERALCO* and *TMO* for alleged anti-competitive behavior constituting economic withholding in violation of Section 45 of the *EPIRA* and Rule 11, Section 1 and 8(e) of the *EPIRA IRR*. In an Order dated June 15, 2015 the *ERC* directed *MERALCO* to file its comment on the Complaint. *MERALCO* and *TMO* have filed their respective answers to the Complaint.

In an Order dated September 1, 2015, the *ERC* directed the investigating officer to file his reply to *MERALCO*. In a Manifestation and Motion to Set the Case for Hearing dated November 9, 2015, the investigating officer manifested that he would no longer file a reply and that the case be set for hearing.

On May 24, 2016, the *ERC* promulgated Resolution No. 14, Series of 2016, which resolved to divide the Commission into two core groups for the conduct of hearings and to designate the commissioners to act as presiding officers in anti-competition cases. The raffle pursuant to said Resolution was conducted on June 15, 2016.

In a Notice of Pre-Trial Conference dated June 16, 2016, the *ERC* set the pre-trial conference on August 18, 2016 and required *MERALCO* and *TMO* to submit their respective pre-trial briefs. However, on July 27, 2016, the complainant filed two (2) omnibus motions for the consolidation and deferment of the pre-trial conferences. Hence, in an Order dated August 1, 2016, the respondents were given 10 days to submit their comments on the motion for consolidation with the complainant given five (5) days to file his reply. As such, the pre-trial conferences as scheduled were deferred until further notice and all parties were granted a period of 20 days to submit their respective pre-trial briefs.

In the meantime, *MERALCO* likewise filed an Urgent Motion to Dismiss with Motion to Suspend Proceedings which was adopted by *TMO* in its Manifestation and Motion filed on July 28, 2016.

On August 23, 2016, *MERALCO* filed an Urgent Motion Ad Cautelam for suspension of proceeding including period to file pre-trial brief and judicial affidavit.

In a Motion dated August 25, 2016, complainant filed a Motion to defer the submission of the Complainant's pre-trial brief and judicial affidavit.

SPPC vs. PSALM

SPPC and *PSALM* are parties to an Independent Power Producer Administration ("*IPPA*") Agreement covering the Ilijan Power Plant. On the other hand, *MERALCO* and *SPPC* have a *PSA* covering the sale of electricity from the Ilijan Power Plant to *MERALCO*. In a letter dated September 8, 2015, *SPPC* informed *MERALCO* that due to an ongoing dispute with *PSALM* arising from difference in interpretation of the provisions of the *IPPA* Agreement, the latter terminated said Agreement. *SPPC* filed a complaint at *RTC* Mandaluyong to nullify the termination notice for lack of factual and legal basis. On said date, the Executive Judge of *RTC* Mandaluyong issued a 72-hour *TRO*. In an Order dated September 11, 2015, the *RTC* Mandaluyong Branch 208 extended the *TRO* by an additional 17 days. In an Order dated September 28, 2015, the *RTC* granted the prayer for preliminary injunction. *PSALM* has filed motions for reconsideration to question the Orders.

MERALCO filed a Motion for Leave to Intervene with Motion to Admit Attached Complaint-in-Intervention. In an Order dated October 19, 2015, the *RTC* Mandaluyong allowed *MERALCO*'s intervention in the proceedings and admitted its Complaint-in-Intervention. *PSALM* filed an *MR* dated November 6, 2015 of the Order admitting *MERALCO*'s intervention. The preliminary conference of the case is set on December 15, 2016.

Others

Liabilities for certain local taxes amounting to ₱5,790 million and ₱6,103 million as at September 30, 2016 and December 31, 2015, respectively, are included in the "Other noncurrent liabilities" account in the consolidated statements of financial position.

Management and its internal and external counsels believe that the probable resolution of these issues will not materially affect the *MERALCO Group*'s financial position and results of operations.

30. Significant Contracts and Commitments

Contracts for the CSE and PSAs with Privatized Plants and IPPAs

MERALCO entered into separate *PSAs* with *SPPC*, *Sem-Calaca* and *MPPCL* on December 12, 20 and 21, 2011, respectively. Also, separate *PSAs* with *TLI* and *SMEC* were executed on February 29 and June 26, 2012, respectively. These *PSAs* are for a period of seven (7) years, extendable for three (3) years upon agreement of the parties. Thereafter, applications for approval of the *PSAs* were filed with the *ERC*.

MPower likewise signed separate *PSAs* with *SPPC*, *MPPCL*, *Sem-Calaca*, and *TLI* on December 12, 2011, March 16, 2012, June 25, 2012, October 10, 2012 and October 19, 2012, respectively.

In separate Decisions dated December 17, 2012, the *ERC* approved with modifications the *PSAs* of *MERALCO* with *SPPC*, *Sem-Calaca*, *MPPCL*, *TLI* and *SMEC*.

MRs were filed regarding the *ERC* decisions on the *PSAs* with *SPPC*, *Sem-Calaca* and *SMEC*. *MERALCO* is awaiting the decision of the *ERC* on the *SPPC* and *Sem-Calaca MRs*. In an Order dated December 16, 2013, the *ERC* denied the Motion for Partial Reconsideration on the *PSA* with *SMEC*. Both *MERALCO* and *SMEC* have filed separation motions with respect to such order and now await *ERC* resolution thereof.

MERALCO entered into separate Supplemental Agreements with *MPPCL* and *TLI* on April 8 and 27, 2016, respectively, for the extension of the term of these *PSAs* for an additional period of three years up to December 25, 2022. Thereafter, relevant Manifestations with Motion for Approval of the Supplemental Agreements were filed with the *ERC*.

Under the *PSAs*, fixed capacity fees and fixed operating maintenance fees are recognized monthly based on their contracted capacities. The annual projection of these payments is shown in the table below:

Year	Contracted Capacity (In Megawatt)	Fixed Payment Amount (In millions)
2017	3,080	₱39,760
2018	2,880	39,481
2019	2,460	34,268
2020	455	8,159
2021	455	8,203
2022-2039	455	157,150

FGPC and FGP

In compliance with the *DOE*'s program to create a market for Camago-Malampaya gas field and enable its development, *MERALCO* was committed to contract 1,500 *MW* of the 2,700 *MW* output of the Malampaya gas field.

Accordingly, *MERALCO* entered into separate 25-year *PPAs* with *FGPC* (March 14, 1995) and *FGP* (July 22, 1999) for a minimum number of *kWh* of the net electrical output of the Sta. Rita and San Lorenzo power plants, respectively, from the start of their commercial operations. The *PPA* with *FGPC* terminates on August 17, 2025, while that of *FGP* ends on October 1, 2027.

On January 7, 2004, *MERALCO*, *FGP* and *FGPC* signed an Amendment to their respective *PPAs*. The negotiations resulted in certain new conditions including the assumption of *FGP* and *FGPC* of community taxes at current tax rate, and subject to certain conditions increasing the discounts on excess generation, payment of higher penalties for non-performance up to a capped amount, recovery of accumulated deemed delivered energy until 2011 resulting in the non-charging of *MERALCO* of excess generation charge for such energy delivered beyond the contracted amount but within a 90% capacity quota. The amended terms under the respective *PPAs* of *FGP* and *FGPC* were approved by the *ERC* on May 31, 2006.

Under the respective *PPAs* of *FGP* and *FGPC*, the fixed capacity fees and fixed operating and maintenance fees are recognized monthly based on the actual Net Dependable Capacity tested and proven, which is usually conducted on a semi-annual basis.

QPPL

MERALCO entered into a *PPA* with *QPPL* on August 12, 1994, which was subsequently amended on December 1, 1996. Under the terms of the amended *PPA*, *MERALCO* is committed to purchase a specified volume of electric power and energy from *QPPL*, subject to certain terms and conditions. The *PPA* is for a period of 25 years from the start of commercial operations up to July 12, 2025.

In a Letter Agreement signed on February 21, 2008, the amount billable by *QPPL* included a transmission line charge reduction in lieu of a previous rebate program. The Letter Agreement also provides that *MERALCO* make advances to *QPPL* of US\$2.85 million per annum for 10 years beginning 2008 to assist *QPPL* in consideration of the difference between the transmission line charge specified in the Transmission Line Agreement (“*TLA*”) and the *ERC*-approved transmission line charge in March 2003. *QPPL* shall repay *MERALCO* the same amount at the end of the 10-year period in equal annual payments without adjustment. However, if *MERALCO* is able to dispatch *QPPL* at a plant capacity factor of no less than 86% in any particular year, *MERALCO* shall not be required to pay US\$2.85 million on that year. This arrangement did not have any impact on the rates to be charged to consumers and hence, did not require any amendment in the *PPA*, as approved by *ERC*.

See Note 10 – Other Noncurrent Assets.

Committed Energy Volume to be Purchased

The following are forecasted purchases/payments to *FGPC*, *FGP* and *QPPL* corresponding to the Minimum Energy Quantity (“*MEQ*”) provisions of the contracts. The forecasted fixed payments include capacity charge and fixed operation and maintenance cost escalated using the U.S. and Philippine Consumer Price Index.

Year	MEQ	Equivalent Amount
	<i>(In million kwh)</i>	<i>(In Millions)</i>
2017	14,758	₱20,416
2018	14,758	20,560
2019	14,758	20,681
2020	14,758	20,804
2021 to 2027	81,631	115,510

Philippine Power and Development Company ("PPDC")

On May 15, 2014, *MERALCO* and *PPDC* executed a *PSA*. *PPDC* operates three (3) run-of-river hydro power plants, namely: (1) Palakpakin, a 448 *kW* hydro power plant located at Barangay Prinza, Calauan, Laguna; (2) Calibato, a 75 *kW* Calibato hydro power plant located at Barangay Sto. Angel, San Pablo City, Laguna; and (3) Balugbog, a 528 *kW* hydro power plant located at Barangay Palina, Nagcarlan, Laguna. The *PSA* has a term of five (5) years from the delivery period commencement date.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for the approval of its *PSA* with *PPDC*. This *PSA* provides that *MERALCO* shall accept all the energy deliveries of *PPDC* as measured by the latter's billing meter. Hearings on this case have been completed. As at September 30, 2016, the case is submitted for decision by the *ERC*.

Bacavalley Energy Inc. ("BEI")

MERALCO signed a *CSE* with *BEI* on November 12, 2010. *BEI* owns and operates a four (4) *MW* renewable energy generation facility powered by landfill gas in San Pedro, Laguna. The *CSE* has a term of two (2) years from the delivery period commencement date.

The terms of the *CSE* with *BEI* are similar to that signed with Montalban Methane Power Corp. ("*MMPC*"). Purchases from *BEI*, an embedded renewable energy generator, are *VAT* zero-rated and exempt from power delivery service charge. *MERALCO* filed an application for the approval of the *CSE* with the *ERC*, for the provisional implementation of the contract on December 15, 2010. In an order dated January 31, 2011, the *ERC* provisionally approved the said application.

After a series of negotiations, *MERALCO* and *BEI* signed the Letter Agreements dated March 1, 2013 and March 5, 2013, extending the *CSE* between said parties for another two (2) years from March 16, 2013, or until March 16, 2015. In its Order December 9, 2013, the *ERC* allowed the *CSE* to be extended until March 15, 2015. On March 12, 2015, *MERALCO* and *BEI* executed a Letter of Agreement extending the *CSE* until March 16, 2016. On March 16, 2015, *MERALCO* filed a Manifestation with motion to the *ERC* for approval of the extended term. On March 1, 2016, *BEI* requested for another extension of the *CSE* for another two (2) years. In its letter dated April 7, 2016, *MERALCO* denied *BEI*'s request to extend the *CSE*.

Pangea Green Energy Philippines, Inc. ("PGEP")

On May 31, 2012, *MERALCO* signed a *CSE* with *PGEP*, a biomass power plant located in Payatas, Quezon City using methane gas extracted from the Payatas Landfill as its fuel. Its plant has a total nominal generating capacity of 1,236 *kW*. The *CSE* has a term of two (2) years from the delivery period commencement date.

On June 15, 2012, *MERALCO* filed an application for approval of the *CSE*. On August 28, 2012, the *ERC* issued an Order provisionally approving the application. On August 29, 2013, the *ERC* extended the provisional authority in its Order dated August 12, 2013. On March 2, 2015, *MERALCO* and *PGEP* executed a Letter of Agreement extending the *CSE* until February 29, 2016. On March 4, 2015, *MERALCO* filed a Manifestation with motion to the *ERC* for approval of the extended term. On September 16, 2015, *MERALCO* received a letter from *PGEP* seeking the termination of the *CSE* effective October 15, 2015. The termination of the *CSE* was thereafter formalized in the Letter Agreement dated October 29, 2015 where the parties agreed to terminate the *CSE* effective October 9, 2015, which was *PGEP*'s Facility Registration

Date with the *WESM*. On January 8, 2016, *MERALCO* filed a *Manifestation with Motion* with the *ERC* seeking approval of the extended term of March 4, 2015 until October 9, 2015. As at September 30, 2016, the case is pending decision by the *ERC*.

TMO

On March 4, 2013, *MERALCO* signed an Interconnection Agreement with *TMO* for their 243 *MW* generating facility at the Navotas Fish Port Complex, Navotas City, which is an interconnection at *MERALCO*'s Grace Park-Malabon 115 *kV* line. *TMO* is an embedded generator. *TMO* shall construct at its own cost, operate and maintain the 115 *kV* line connecting its generating facility to *MERALCO*'s system. *TMO* and *MERALCO* subsequently signed a Supplement to the Interconnection Agreement dated July 3, 2014 covering the construction of a second line from the connection point at the Grace Park-Malabon 115 *kV* line to the *TMO* switchyard.

On September 27, 2013, *MERALCO* signed a *PSA* with *TMO* for the output of the barge-mounted, bunker oil-fired diesel engines moored at the Fish port Complex in Navotas, Manila. On September 30, 2013, *MERALCO* filed an application with the *ERC* for the approval of the *PSA*. In an Order dated November 4, 2013, the *ERC* granted the prayer for Provisional Authority. After hearing and submission of the required documents, including the *FOE*, the case is now submitted for decision.

On December 17, 2014, *MERALCO* and *TMO* entered into an Amendment to the *PSA* based on the power situation outlook for 2015 and 2016 issued by the *NGCP* that the reserve capacity will be below the Contingency Reserves due to the maintenance shutdowns and forced outages of major power plants in Luzon. The amendment to the *PSA* was filed for approval with the *ERC* on January 21, 2015. In an Order dated April 6, 2015, the *ERC* approved the Amendment in the *PSA* between *MERALCO* and *TMO* with modification. In an Order dated July 1, 2015, the *ERC* clarified that the provisional approval, while not specifically modifying nor stating any condition with respect to the implementation of the outage provisions of the amendment, covers the increase in outage allowance and the minor change in operating procedures.

On June 16, 2015, *MERALCO* received the Omnibus Motion for Partial Reconsideration and Deferment of Implementation of the Order dated April 6, 2015; Urgent Resolution of the Application; and Confidential Treatment filed by *TMO*

In an Order dated April 5, 2016, the *ERC* ruled that the provisional authority granted to *MERALCO* and *TMO* is extended unless revoked or made permanent. On June 10, 2016 and July 5, 2016, respectively, *MERALCO* and *TMO* filed a Motion for Clarification of the *ERC* Order dated April 5, 2016. As at September 30, 2016, the case is pending decision by the *ERC*.

SBPL

On May 30, 2014, *MERALCO* signed a long-term *PSA* for a 455 *MW* net capacity and electrical output with *SBPL*. *SBPL* will be constructing a supercritical coal-fired power plant in Mauban, Quezon.

On June 2, 2014, *MERALCO* filed an application with the *ERC* for approval of its *PSA* with *SBPL*. On May 19, 2015, *MERALCO* received the *ERC* Decision approving with modification the *PSA* between *MERALCO* and *SBPL*.

Bacman Geothermal, Inc. ("BGI")

On November 25, 2014, *MERALCO* signed a *PSA* with *BGI* for the purchase of up to 50 *MW* capacity and energy from the latter's power plant. The *PSA* shall expire on December 25, 2019, extendible by an additional two (2) years upon mutual agreement of the parties. On March 4, 2015, the Joint Application for approval of said *PSA* was filed with the *ERC*. Hearings have been completed and as at September 30, 2016, the case is submitted for decision.

Redondo Peninsula Energy, Inc. ("RP Energy")

On April 20, 2016, *MERALCO* signed a 20 year term *PSA* with *RP Energy* for the purchase of 225 *MW* capacity and energy from the 300 *MW* coal-fired power plant that *RP Energy* intends to construct, own, operate, manage and maintain in the Municipality of Subic in the Province of Zambales, within the Subic Bay Freeport Zone. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

Atimonan One Energy, Inc. ("AIE")

On April 26, 2016, *MERALCO* signed a 20 year term *PSA* with *AIE* for the purchase of 1,200 *MW* of electrical output from the 2 x 600 *MW* supercritical coal-fired power generating facility that *AIE* intends to construct, own, operate, manage and maintain in the Municipality of Atimonan, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

St. Raphael Power Generation Corporation ("SRPGC")

On April 26, 2016, *MERALCO* signed 20 year term *PSA* with *SRPGC* for the purchase of up to 400 *MW* of electrical output from the 2 x 350 *MW* coal-fired power generating facility that *SRPGC* intends to construct, own, operate, manage and maintain in Calaca, Batangas. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

Central Luzon Premiere Power Corp. ("CLPPC")

On April 26, 2016, *MERALCO* signed a 20 year term *PSA* with *CLPPC* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *CLPPC* intends to construct, own and operate in Pagbilao, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

Mariveles Power Generation Corporation ("MPGC")

On April 26, 2016, *MERALCO* signed a 20 year term *PSA* with *MPGC* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *MPGC* intends to construct, own and operate in Mariveles, Bataan. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

Panay Energy Development Corporation ("PEDC")

On April 26, 2016, *MERALCO* signed a 20 year term *PSA* with *PEDC* for the purchase of up to 70 *MW* of electrical output from the 1 x 150 *MW* coal-fired power generating facility that *PEDC* owns and operates in Brgy. Ingore, La Paz, Iloilo. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

Global Luzon Energy Development Corporation (“GLEDC”)

On April 27, 2016, *MERALCO* signed a 20 year term *PSA* with *GLEDC* for the purchase of 600 *MW* of electrical output from the 2 x 335 *MW* coal-fired power generating facility that *GLEDC* intends to construct, own, operate, manage and maintain in Brgy. Luna, La Union. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*.

Powersource First Bulacan Solar, Inc. (“PFBSI”)

On September 16, 2016, *MERALCO* signed a 20 year term *PSA* with *PFBSI* for the purchase of 50 *MW* of electrical output from its solar plant in San Miguel, Bulacan.

Solar Philippines Tanauan Corporation (“SPTC”)

On September 16, 2016, *MERALCO* signed a 20 year term *PSA* with *SPTC* for the purchase of 50 *MW* of electrical output from its solar plant in Tanauan, Batangas.

The *PSAs* shall become effective upon approval of the *ERC*.

Interim Power Supply Agreements (“IPSAs”)

On April 1, 2014, *MERALCO* signed two separate *IPSAs* with the wholly-owned subsidiaries of *GBPC*, namely: (1) *PPC* for a 27 *MW* firm output from its 72-*MW* diesel-fired power plant in La Paz, Iloilo City; and (2) *TPC* for a 28 *MW* firm and 9 *MW* non-firm output from its 40-*MW* diesel-fired power plant in Carmen, Toledo City. Both *IPSAs*, had an initial terms of up to June 30, 2014, and were subsequently extended to October 31, 2014, and further up to July 25, 2015. In its various Decisions dated June 2, 2014, July 10, 2014 and March 15, 2015, the *ERC* approved the applications and extensions with modification.

On June 20, 2014, *MERALCO* filed an Urgent Motion for Extension of the term of the *IPSAs*. On July 10, 2014, the *ERC* approved the extension of the *IPSA* with *PPC* and *TPC* until October 31, 2014, subject to the same condition provided in its June 2, 2014 Decision.

Considering that *MERALCO* still needs additional capacity for the period of January 26, 2015 to July 25, 2015, it executed again separate *IPSAs* with *PPC* for 27 *MW* and with *TPC* for 28 *MW* on firm basis and nine (9) *MW* on non-firm basis. The *IPSAs* with *PPC* and *TPC*, both dated November 14, 2014, were filed with the *ERC* for approval on January 8, 2015. Hearings on this case have been completed. On March 16, 2015, the *ERC* approved the *IPSA* with *PPC* and *TPC*. On April 3, 2014, *MERALCO* signed an *IPSA* with 1590 Energy Corporation for the 140 *MW* output from the Bauang power plant – a 225-*MW* diesel-fired power plant in Bauang, La Union for a term of up to June 30, 2014. This *IPSA* became effective upon the final approval of the *ERC* in its Decision dated May 12, 2014.

On June 30, 2014, the *ERC* approved the extension of the *IPSA* with 1590 Energy Corporation until October 31, 2014. A Memorandum of Agreement (“*MOA*”) dated October 30, 2014 was executed with 1590 Energy Corporation extending the *IPSA* until July 25, 2015. Said *MOA* was filed with the *ERC* for approval on October 30, 2014. The *ERC* issued an Order dated December 15, 2014 approving the extension of the *IPSA* under the same terms as approved by the *ERC* in its Decision dated May 12, 2014.

On January 19, 2016, after the conduct of a price challenge in compliance to *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed an *IPSA* with 1590 Energy Corporation. The *IPSA* is

for the 170 *MW* (firm from February 26 to July 25, 2016; non-firm from July 26, 2016 to February 25, 2017) output from the Bauang power plant – a 215 *MW* bunker oil-fired diesel engine power plant in Bauang, La Union. The term of the *IPSA* is until February 25, 2017, and shall be automatically extended for an additional period of one year up to two times, unless terminated by either party prior to the expiration of its term. The *IPSA* was filed for approval by the *ERC* on February 10, 2016 and shall become effective upon the approval by the *ERC*. In an Order dated April 5, 2016, the *ERC* provisionally approved the *IPSA*.

On January 21, 2016, after the conduct of a price challenge in compliance to *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed two separate *IPSAs* with (1) *TPC* for the 28 *MW* (firm) output from its 40 *MW* diesel-fired power plant in Carmen, Toledo City; and (2) *PPC* for the 45 *MW* (firm) output from its 72 *MW* diesel-fired power plant in La Paz, Iloilo City. The term of the *IPSAs* is until February 25, 2017, and shall be automatically extended for an additional period of one year up to four times, unless terminated by either party prior to the expiration of its term. Both *IPSAs* were filed for approval of the *ERC* on February 10, 2016 and shall become effective upon the approval of the *ERC*. In an Order dated April 5, 2016, the *ERC* provisionally approved these *IPSAs*.

*Interconnection Agreement with Alternergy Wind One Philippine Holdings Corporation
("Alternergy")*

On March 1, 2012, *MERALCO* signed an Interconnection Agreement with *Alternergy* for the latter's 90 *MW* wind farm renewable energy plant in Pililla, Rizal, which shall interconnect at *MERALCO*'s Malaya-Teresa 115 *kV* line. *Alternergy* is an embedded generator. *Alternergy* shall construct at its own cost, operate and maintain the 115 *kV* line connecting its generating facility to *MERALCO*'s system. On September 3, 2014, *MERALCO* signed a supplement to the Interconnection Agreement with *Alternergy* to temporarily connect the latter's facilities to *MERALCO*'s Malaya-Caliraya 115 *kV* line until December 31, 2015 and thereafter, proceed to the ultimate connection at the Malaya-Teresa 115 *kV* line. In its letter to *MERALCO* dated October 30, 2015, *Alternergy* expressed its intention to extend its use of the 115 *kV* line until the completion of the construction of the Phase 2 Line or until December 31, 2016. In the letter agreement dated December 2, 2015, *MERALCO* and *Alternergy* formalized their agreement as regards the extended use of said line.

Interconnection Agreement with Maibarara Geothermal, Inc. ("MGI")

On December 6, 2012, *MERALCO* signed an Interconnection Agreement with *MGI* for the latter's 20*MW* (with maximum capacity of 40 *MW*) Geothermal Facility plant in Sto. Tomas, Batangas, which shall interconnect at *MERALCO*'s FPIP - Los Baños 115 *kV* line. *MGI* is an embedded generator. *MGI* shall construct at its own cost, operate and maintain the 115*kV* line connecting its generating facility to *MERALCO*'s system. In its Decision dated September 30, 2013, the *ERC* approved *MGI*'s application for authority to develop, own and operate dedicated point-to-point facilities to connect to the distribution system of *MERALCO*.

Interconnection Agreement with ATN Philippines Solar Energy Group, Inc. ("ATN")

On December 8, 2014, *MERALCO* signed an Interconnection Agreement with *ATN* for the latter's 25.2 MW solar generating facility in Rodriguez, Rizal, to be connected to *MERALCO*'s Novaliches 44 YJ, Diliman 435 VU and Parang 412 YL circuits. *ATN* is an embedded generator. *ATN* shall construct at its own cost, operate dedicated point-to-point lines and facilities that will connect its generating facility to *MERALCO*'s system.

Technical Services Agreement ("TSA") with Integrated Energy Distribution and Marketing ("IEDM"), Ibadan Electric Distribution Company ("IBEDC") and Yola Electric Distribution Company ("YEDC")

MERALCO provides technical and management services for the operations of *IBEDC* and *YEDC* in Nigeria. In consideration, *MERALCO* receives fixed monthly fees, subject to adjustment annually in accordance with the provisions of the Technical Services Agreement.

In 2015, the *TSA* was amended to limit the scope to the provision of technical services only for *IBEDC* and revised the fixed monthly fees accordingly.

Investment and Management Agreement with PELCO II

On February 12, 2014, *Comstech* entered into an *IMC* with *PELCO II* for a period of 20 years. *PELCO II* is an electric cooperative with franchise to distribute electric power in certain municipalities of Pampanga.

Pursuant to the *IMC*, *Comstech* shall render technical and management services for the operation, maintenance and management and improvement of *PELCO II*'s electric distribution. As consideration for its technical, consultancy and management services, *Comstech* is entitled to a performance-based remuneration and management fee based on a certain percentage of the operating revenues of *PELCO II*.

Agreement and Registration with PEZA

On May 26, 2014, *MERALCO* and *PEZA* entered into a concession agreement with a term of 25 years, whereby *MERALCO* has been contracted to operate the distribution system of *CEZ* beginning May 26, 2014.

On January 24, 2013, *MERALCO* entered into a tripartite agreement with *PEZA* and *Trans-Asia* for the sale of power to *CEZ* and its locators beginning January 26, 2013.

On November 7, 2014, *MERALCO* filed an application to *PEZA* as an Economic Zone Utilities Enterprise, pursuant to the Concession Agreement between *MERALCO* and *PEZA* dated May 26, 2014, whereby *MERALCO* has been contracted to manage and operate the *PEZA* electrical distribution system in *CEZ*.

On November 12, 2014, the *PEZA* Board approved *MERALCO*'s application, subject to *MERALCO*'s signing of a Supplemental Agreement with *PEZA* under standard registration terms and conditions, through Resolution No. 14-620.

On December 19, 2014, upon compliance with the pre-registration condition under said Board Resolution, as well as the payment of application and registration fees, *MERALCO* has submitted its duly signed and notarized Supplemental Agreement with *PEZA*.

On December 29, 2014, *MERALCO* has secured its Certificate of Registration No.10-01-U from *PEZA*, which confirms *MERALCO* as an Ecozone Utilities Enterprise at the Cavite Economic Zone.

31. Earnings Per Share Attributable to Equity Holders of the Parent

Basic and diluted earnings per share are calculated as follows:

	Unaudited			
	For the Nine Months Ended September 30		For the Three Months Ended September 30	
	2016	2015	2016	2015
<i>(In millions, except per share data)</i>				
Net income attributable to equity holders of the Parent (a)	₱15,676	₱16,149	₱4,908	₱4,402
Weighted average common shares outstanding (b)	1,127	1,127	1,127	1,127
Per Share Amounts:				
Basic and diluted earnings per share (a/b)	₱13.91	₱14.33	₱4.35	₱3.91

Basic and diluted earnings per share amounts are calculated by dividing net income for the period attributable to common shareholders of the parent by the weighted average number of common shares outstanding during the period. There are no potential dilutive common shares in 2016 and 2015.

There are no other transactions involving common shares or potential common shares between the reporting date and the date of completion of these consolidated financial statements.

32. Other Matters

Revised SL Caps

On December 8, 2008, the *ERC* promulgated resolution No.17, Series of 2008 adopting a lower maximum rate of *SL* (technical and non-technical) that a utility can pass on to its customers. The revised *SL* cap is 8.5% for private utilities, starting their January 2010 billing. Said cap is one percentage point lower than the *SL* cap of 9.5% provided under *RA* No. 7832. The actual volume of electricity used by *MERALCO* (administrative loss) is treated as part of the operation and maintenance expense beginning July 2011. The manner by which the utility is rewarded for its efforts in *SL* reduction is addressed by the *ERC* in the Performance Incentive Scheme ("*PIS*") under the *PBR*.

On December 8, 2009, *MERALCO* filed a Petition to amend said Resolution with an urgent prayer for the immediate suspension of the implementation of the new *SL* cap of 8.5% starting January 2010. The proposed amendment is aimed at making the Resolution consistent with the provisions of *RA* No. 9136 and *RA* No. 7832, by increasing the *SL* cap to not less than 9%. The

hearings on this case have been completed. As at September 30, 2016, this Petition is pending decision by the *ERC*.

Benefit-Sharing Scheme to Lower System Loss

On January 26, 2011, *MERALCO*, together with Private Electric Power Operators Association, Inc. ("*PEPOA*") and Philippine Rural Electric Cooperative Association ("*PHILRECA*"), filed a joint petition to the *ERC* to initiate rule-making to adopt the *Proposed Guidelines for the Implementation of an Incentive Scheme to Lower the System Losses of Private Distribution Utilities and Electric Cooperatives to Level Below the System Loss Cap, for the Benefit of End-Users*. This was aimed to encourage the *DUs* to reduce *SL* levels below the cap set by the *ERC* and benefit the end-users through lower system loss charges. Public hearings were conducted and completed on June 15, 2011.

On December 11, 2012, the *ERC* posted on its website the second draft of the *Rules to Govern the Implementation of a Benefit Sharing to Lower the System Losses of Electric Distribution Utilities*. As at September 30, 2016, the Joint Petition is pending further action or decision by the *ERC*.

RCOA

The transition period for *RCOA* commenced on December 26, 2012 in accordance with the joint statement released by the *ERC* and the *DOE* on September 27, 2012 and the Transitory Rules for the Implementation of *RCOA* (*ERC* Resolution No. 16, Series of 2012). The commercial operation of *RCOA* started on June 26, 2013.

On March 31, 2014, the *ERC* issued a resolution on the Withdrawal of the Rules on Customer Switching and the Retention of the Code of Conduct for Competitive Retail Market Participants. On the same date, *ERC* also issued a resolution adopting the Rules on the Establishment of Customer Information by the Central Registration Body ("*CRB*") and Reportorial Requirements. The resolution mandates all *DUs* to submit to the *ERC* and *CRB* information on end-users with (1) monthly average peak demand of at least 1 *MW* for the preceding 12 months; and (2) monthly average peak demand of 750 *kW* but not greater than 999 *kW*. The *ERC* will use these information in issuing the certificates of contestability.

On October 22, 2014, the *ERC* issued a resolution suspending the issuance of *RES* licenses. Under the resolution, the *ERC* resolves to hold in abeyance the evaluation of *RES* license applications and suspend the issuance of such licenses until such time that the amendments to the Rules for the issuance of *RES* licenses have been made by the *ERC*.

On July 1, 2015, the *DOE* published Department Circular No. DC2015-06-0010, "Providing Policies to Facilitate the Full Implementation of *RCOA* in the Philippine Electric Power Industry". The salient points of the circular are as follows:

- a. All contestable customers with average demand of 1 *MW* and above are mandated to secure their respective Retail Supply Contracts ("*RSC*") no later than June 25, 2016.
- b. All contestable customers with an average demand ranging from 750 *kW* to 999 *kW* for the proceeding 12-month period are mandated to secure their *RSCs* no later than June 25, 2016.
- c. Aggregators with aggregated demand not lower by 750 *kW* shall be allowed to compete with *RES*, generation companies and prospective generation companies effective June 26, 2016.

- d. Any electric end user with an average demand ranging from 501 *kW* to below 750 *kW* for the preceding 12 months may be allowed to choose their respective *RES* effective June 26, 2018 subject to the determination of the *ERC* on the basis of its evaluation on the performance of the retail market.
- e. Any *DU* which may incur displaced contract capacity/energy (“*DCC/E*”) shall inform the *ERC* of its impending *DCC/E*.

On March 8, 2016, the *ERC* promulgated Resolution No. 05 Series of 2016 entitled “*A Resolution Adopting the 2016 Rules Governing the Issuance of Licenses to Retail Electricity Suppliers (RES) and Prescribing the Requirements and Conditions Therefor*”. The Resolution removed the term Local *RES* as one of the entities that may engage in the business of supplying electricity to the Contestable Market without need of obtaining a license therefor from the *ERC*. Moreover, while an affiliate of a *DU* is allowed to become a *RES*, the allowance is “subject to restrictions imposed by the *ERC* on market share limits and the conduct of business activities”.

On May 12, 2016, the *ERC* issued Resolutions No. 10 and 11, Series of 2016, which:

1. Provided for Mandatory contestability. Failure of a Contestable Customer to switch to *RES* upon date of mandatory contestability (December 26, 2016 for those with average demand of at least one (1) *MW* and June 26, 2017 for at least 750 *MW*) shall result in the physical disconnection from the *DU* system unless it is served by the *SOLR*, or, if applicable, procures power from the *WESM*.
2. Prohibits *DUs* from engaging in the Supply of electricity to the Contestable Market except in its capacity as a *SOLR*;
3. Mandates Local *RESs* to wind down their supply businesses within a period of three (3) years;
4. Imposes upon all *RESs*, including *DU*-affiliate *RESs*, a market-share cap of 30% of the total average monthly peak demand of all contestable customers in the competitive retail electricity market; and
5. Prohibits *RESs* from transacting more than 50% of the total energy transactions of its Supply business, with its affiliate Contestable Customers

On May 27, 2016, *MERALCO* filed a Petition before Pasig *RTC*, praying that: (a) a *TRO* and subsequently a Writ of Preliminary Injunction (“*WPI*”) enjoining the *DOE* and *ERC* from implementing the Assailed Rules be issued; and the Assailed Rules be declared null and void for being contrary to the *EPIRA* and its *IRR*. In an Order dated June 13, 2016, *RTC*-Pasig Branch 157 granted a 20-day *TRO*, which became effective on June 16, 2016. In an Order dated July 13, 2016, *RTC*-Pasig granted a *WPI*, which became effective on July 14, 2016, and shall be effective for the duration of the pendency of the Petition. It enjoined *DOE* and *ERC* from implementing the Assailed Rules insofar as:

- it prohibits *DUs* from engaging in the Supply Business and correspondingly requires Local *RESs* to wind down their operations within the required three (3) year period;
- it imposes market caps/limitations;
- it imposes restrictions and requirements on *DUs*, such as but not limited to the two (2) year term limit for *RSCs* and the reportorial requirements to be submitted by *DUs* in respect of end users with at least a monthly average peak demand of 500 *KW*; and

- it requires Mandatory Contestability and imposes penalties for Contestable Customers that fail to enter into *RSCs* within the set sixty (60) day period.

Meanwhile, *ERC* filed a Petition for Certiorari and Prohibition with prayer for *TRO* and/or *WPI* before the *SC* ("*SC* Petition"), which asserted that *RTC-Pasig* has no jurisdiction to take cognizance of *MERALCO's* Petition, citing Sec. 78 of the *EPIRA*.

On October 10, 2016, the *SC*, in relation to the Petition filed by *DOE*, issued a *TRO* that restrained, *MERALCO*, the *RTC Pasig*, their representatives, agents or other persons acting on their behalf from continuing the proceedings before the *RTC Pasig*, and from enforcing all orders, resolutions and decisions rendered in Special Civil Action No. 4149 until the petition before the *SC* is finally resolved.

Interim Pre-Emptive Mitigating Measure in the WESM

On May 5, 2014, the *ERC* issued Resolution No 8, Series of 2014, setting an interim pre-emptive mitigating measure in the *WESM*, which established a price threshold in the *WESM* applied over a 72-hour period, which is determined through a rolling average Generated Weighted Average Price ("*GWAP*") of ₱8,186 per *MWh*. Also, a secondary cap amounting to ₱6,245 per *MWh* is imposed upon a breach of the threshold, or Secondary Cap mechanism. Such interim measure aims to mitigate sustained high prices in the *WESM* during the May and June 2014 supply months. On June 16, 2014, the *ERC* issued another resolution extending the effectivity of the pre-emptive mitigating measure for 45 days from expiration or until August 9, 2014. Public consultation and a subsequent focus group discussion were held on July 23 and 25, 2014, respectively. On August 5, 2014, the *ERC* resolved to (1) adopt a permanent pre-emptive mitigating measure that will be applied in the *WESM*; (2) direct all interested stakeholders to submit their proposed measures within 20 days from effectivity of such Resolution; and (3) extend the effectivity of the Secondary Cap mechanism for a period of 120 days from August 10, 2014 or until the establishment by the *ERC* of a permanent pre-emptive mitigating measure in the *WESM*, whichever comes earlier.

On September 29, 2014, the *ERC* conducted a public consultation on the proposed permanent pre-emptive mitigating measures in the *WESM*. Parties were then given an additional period until October 7, 2014 to file their additional comments, if any.

On October 24, 2014, the *WESM* Tripartite Committee issued a Joint Resolution to further extend the interim offer price cap in the *WESM* for 120 days starting October 24, 2014 to harmonize with the finalization of the permanent pre-emptive mitigating measure to apply in the *WESM*. On February 20, 2015, the *WESM* Tripartite Committee issued a joint resolution which extended further the imposition of the interim *WESM* offer price cap at its current level until September 30, 2015.

In December 2014, in its Resolution No. 20, Series of 2014, the *ERC* adopted and established a permanent pre-emptive mitigation measure in the *WESM*. The *ERC* set a Cumulative Price Threshold ("*CPT*") amounting to an average spot price of ₱9,000 per *MWh* over a rolling day 7-day period or 168-hour trading interval. Once this *CPT* for said period is breached, it triggers the imposition of a price cap amounting to ₱6,245 per *MWh*. The price cap shall be imposed until after a determination that succeeding *GWAP* rolling average is already below the *CPT*. The pre-emptive measure has taken effect beginning January 9, 2015.

The imposition of the mitigating measure was questioned by the Philippine Independent Power Producers Association ("*PIPPA*") in the *RTC* of Pasig through a Petition for Declaratory Relief

with Application for *TRO* and/or Writ of Preliminary Injunction. The Petition prayed for, among others, that the *ERC* Resolutions pertaining to the Secondary Cap mechanism be declared void *ab initio*. The original petition was subsequently amended to reflect the promulgation of the subsequent *ERC* resolutions extending the effectivity of the *WESM* price cap. On July 21, 2014, *MERALCO* filed its Motion for Leave to Intervene and to Admit Attached Comment-in-Intervention. The *RTC-Pasig* admitted *MERALCO*'s intervention and comment in its Order dated October 28, 2014. However, in a Motion for Leave to Admit Supplement Petition, *PIPPA* moved for leave to file a supplemental petition to include *ERC* Resolution No. 20, Series of 2014 which provides for a permanent mitigating measure in the *WESM*. In an Order dated May 5, 2015, the *RTC* denied the Motion for Leave to File and Admit Supplemental Petition. *PIPPA* filed a Motion for Partial Reconsideration which was denied by the *RTC* in its Resolution dated September 10, 2015. *PIPPA* filed a Petition for Certiorari with the *CA*. The parties have filed their respective memoranda and are awaiting the decision of the *CA*.

On December 7, 2015, the *RTC* rendered a Decision dismissing the Petition for Declaratory Relief. The motion for reconsideration filed by *PIPPA* was denied in a Resolution dated June 16, 2016.

On September 29, 2015, the *WESM* Tripartite Committee issued a joint resolution further extending the interim offer price cap of ₱32,000 per *MWh* until December 31, 2015. In its Joint Resolution No. 3, Series of the 2015, the *WESM* Tripartite Committee resolved to set the *WESM* offer price cap at ₱32,000 per *MWh* and the *WESM* offer price floor of negative ₱10,000 per *MWh* effective January 2016, provided that an annual review shall be undertaken considering the relevant costs assumptions at the time of review.

PEZA – ERC Jurisdiction

On September 13, 2007, *PEZA* issued “Guidelines in the Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones” and “Guidelines for the Supply of Electric Power in Ecozones”. Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *DUs* which are under the legislatively-authorized regulatory jurisdiction of the *ERC*. The Guidelines are the subject of an injunction case filed by the *DUs* at the *RTC-Pasig*.

On February 4, 2015, the Court issued an Order setting a clarificatory hearing on April 15, 2015. During the said hearing, *MERALCO* manifested that it previously filed a Motion to Withdraw as Plaintiff on the basis of letter agreements between *MERALCO* and *PEZA*, which is pending before the Court. *MERALCO* submitted the Tripartite Agreement among *PEZA*, *PEPOA* and *MERALCO* for approval of the Court. In a Decision dated July 3, 2015, the *RTC* approved the Compromise Agreement between *PEZA*, *PEPOA* and *MERALCO*. In the hearing on February 10, 2016, the *RTC* dismissed the petition upon motion by *PEZA*. The *ERC* filed a motion for reconsideration which is pending resolution by the *RTC*.

Purchase of Subtransmission Assets (“STAs”)

On April 17, 2012, *MERALCO* and *TransCo* filed a joint application for the approval of the Batch 4 contract to sell with the *ERC*. On April 22, 2013, the *ERC* issued a Decision on *MERALCO*'s joint application for the acquisition of the Batch 4 contract to sell. On June 21, 2013 and July 3, 2013, *MERALCO* and *TransCo* filed a Motion for Partial Reconsideration and *MR*, respectively, regarding the exclusion of certain facilities for acquisition.

On May 22, 2014, *MERALCO* and *TransCo* received an *ERC* Order dated May 5, 2014 denying *MERALCO* and *TransCo*'s Motions. On June 5, 2014, *MERALCO* filed a clarificatory motion and an *MR* of the May 5, 2014, *ERC* Order, which was denied by the *ERC* through an Order dated June 16, 2014. On October 10, 2014, *MERALCO* filed a Motion to Reopen Proceedings for the reception of new evidence to support *MERALCO*'s position on the acquisition of excluded *STAs*. The Motion was heard by the *ERC* on October 17, 2014. After the parties have submitted their respective comments and pleadings, the *ERC* conducted another hearing on February 23, 2015.

During the hearing, *NGCP* was given three (3) days from the said date to file its Comment on the subsequent pleadings filed, after which the case is deemed submitted for resolution.

In an Order dated March 4, 2015, the *ERC* considered but denied the new and substantive allegations in *MERALCO*'s Motion to Reopen Proceedings. *MERALCO* then filed a Petition for Review with the *CA* to question the Orders of the *ERC*. In a Resolution dated September 21, 2015, the *CA* required the parties to submit their respective memoranda. Thereafter, the case is submitted for decision.

On March 20, 2015, *MERALCO* filed a case for "Interpleader with Consignation and Specific Performance" against *TransCo* and the Municipality of Labrador, Pangasinan ("*Labrador*") with the *RTC* -Branch 155 of Pasig, praying for the Court to: accept and approved the consignation of the amount of ₱194.1 million; declare *MERALCO* to have paid in full the purchase price of the sale of *TransCo*'s assets; direct *TransCo* to execute the corresponding Deeds of Absolute Sale; and direct *Labrador* and *TransCo* to interplead their respective claims. On April 14 and 20, 2015, *Labrador* and *TransCo* filed their respective Motions to dismiss on the ground of impropriety of the filing of the Interpleader and on the ground of *litis pendentia*. *MERALCO* received an Order from Branch 155, *RTC*-Pasig granting the Motions to Dismiss of both *TransCo* and *Labrador*. *MERALCO* filed a Motion for Reconsideration which is pending resolution.

On December 12, 2011, *MERALCO* signed various agreements for the acquisition of certain sub-transmission assets of *TransCo* within the *MERALCO* franchise area for its sole account, as well as through a consortium with Batangas II Electric Cooperative, Inc., ("*BATELEC II*") and First Bay Power Corporation ("*FBPC*"). On September 18, 2012, an amended consortium agreement was executed between *MERALCO* and *FBPC*. On October 17, 2012, *MERALCO* signed two separate amended consortium agreements with *BATELEC II*, and with *FBPC* and *BATELEC II*. These amended consortium agreements superseded the agreements signed on December 12, 2011. On December 27 and 28, 2012, the Contract to Sell and Consortium Agreements, respectively, covering these sub-transmission assets were filed with the *ERC* for approval.

The applications for approval of the Consortium Agreement between *MERALCO* and *BATELEC II* and the Contract to Sell among *TransCo*, *MERALCO* and *BATELEC II* are submitted for resolution of the *ERC*.

MERALCO's POP Program

On November 15, 2012, *MERALCO* filed an application with the *ERC* for the approval of its revised *TOU* rates program, also known as the *POP* Program. The *POP* is a rate program being offered by *MERALCO* to customers whose load characteristics can benefit from *TOU* rates as well as to those that can shift their loads from peak to off-peak hours. The proposed revised *POP* Rate aims to provide better savings to avalees by providing them with a *TOU* program that has a wider pricing difference between peak and off-peak rates.

In an Order dated December 17, 2012, the *ERC* provisionally approved the *POP* Program. *MERALCO* started implementing the program on February 1, 2013.

FiT

Pursuant to *RA* No. 9513, or the Renewable Energy Act of 2008 (“*RE Act*”), the *ERC* issued Resolution No. 16, Series of 2010, Adopting the *FiT* Rules, on July 23, 2010. As defined under the *FiT* Rules, the *FiT* system is as a renewable energy policy that offers guaranteed payments on a fixed per *kWh* for electricity from wind, solar, ocean, hydropower and biomass energy sources, excluding any generation for own use.

On May 16, 2011, the National Renewable Energy Board (“*NREB*”) filed its Petition to Initiate Rule Making for the Adoption of *FiT*. The Petition proposed a specific *FiT* Rate for each emerging renewable resource. On July 27, 2012, after undergoing several public consultations and public hearings, the *ERC* approved *FiT* Rates lower than the rates applied by the *NREB*.

To fund the *FiT* payments to eligible *RE* developers, a *FiT*-Allowance charge will be imposed on all end-users. The *FiT*-All will be established by the *ERC* upon petition by the *TransCo*, which had been designated as the *FiT* Fund Administrator.

On February 5, 2014, the *ERC* released the *FiT*-Allowance Disbursement and Collection Guidelines to supplement the *FiT* Rules. This set of guidelines will govern how the *FiT*-All will be calculated using the formulae provided. It will also outline the process of billing and collecting the *FiT*-All from the electricity consumers, the remittance to a specified fund, the disbursement from the *FiT*-All fund and the payment to eligible *RE* developers.

On July 30, 2014, *TransCo* filed its Application for Approval of the *FiT*-All for calendar years 2014 and 2015. On October 7, 2014, the *ERC* provisionally approved a *FiT*-Allowance of ₱0.0406 per *kWh* effective in the January 2015 billing as a separate line item in the bills of end consumers. In its letter to *MERALCO* dated December 18, 2014, the *ERC* clarified that the January 2015 billing covers consumption of customers for the period December 26, 2014 to January 25, 2015.

On December 23, 2014, *MERALCO* received a copy of a Petition for Prohibition and Certiorari filed with the *SC* against the *ERC*, *DOE*, *TransCo*, *NREB* and *MERALCO*. The Petition seeks (i) the issuance of a *TRO* and/or Writ of Preliminary Injunction, and after giving due course to the Petition, a Writ of Prohibition to enjoin the respondents from implementing the *FiT*-Allowance, the *FiT* Rules and *FiT* Guidelines; and (ii) the annulment of the *FiT* Rules and *FiT* Guidelines. Through a Notice dated March 17, 2015, the *SC* required the adverse parties to submit their comments within ten (10) days from receipt. The *ERC* and *DOE* filed a Consolidated Comment dated July 23, 2015 while the *NREB* filed its Comment dated July 14, 2015.

On April 30, 2014, the *DOE* issued a Certification revising the installation target for solar from 50 *MW* to 500 *MW*, an additional capacity of 450 *MW*. In its Certification, the *DOE* stated that “solar energy generation projects given their short installation period can greatly contribute in providing additional generating and reserve capacity in the summer seasons of 2015 and 2016”.

On January 28, 2015, the *ERC* conducted a public consultation on the increase of the installation target for solar renewable energy generation (additional 450 *MW*) and the *FiT* Rate for the additional solar capacity. In the said hearing, it was clarified that the additional 450 *MW* installation capacity for solar is already approved by the *DOE*. On April 28, 2015, the *ERC*

issued a Decision dated March 27, 2015 setting the new solar *FiT* Rate at ₱8.69 per *kWh*, which shall apply prospectively.

On April 7, 2015, the *DOE* issued a Certification revising the installation target for wind from 200 *MW* to 400 *MW*. On April 13, 2015, the *ERC* initiated the review of the *FiT* for wind technology. In a letter dated April 15, 2015, the *ERC* directed the *NREB* to submit a proposal regarding the review of *FiT* for wind technology beyond the original 200 *MW* installation target. The *NREB* proposed a Wind *FiT* of ₱8.49 per *kWh*. On July 30, 2015, the *ERC* conducted a public consultation on the new proposed Wind *FiT*. In a Decision dated October 6, 2015, the *ERC* set the Wind *FiT* at ₱7.40 per *kWh*. *MERALCO* filed a motion for reconsideration of the Decision.

On December 22, 2015, *TransCo* filed its Application for Approval of the *FiT*-All for calendar year 2016. In an Order dated February 16, 2016, The *ERC* provisionally approved a *FiT*-Allowance of ₱0.1240 per *kWh* effective in the succeeding billing period after *TransCo* received the Order. The *FiT*-All was implemented starting April 2016 billing month.

Net Metering Program

The *RE Act* mandates the *DUs* to provide the mechanism for the “physical connection and commercial arrangements necessary to ensure the success of the *RE* programs”, specifically the Net Metering Program. The *RE Act* defines Net Metering as “a system, appropriate for distributed generation, in which a distribution grid user has a two-way connection to the grid and is only charged for his net electricity consumption and is credited for any overall contribution to the electricity grid”. By their nature, net metering installations will be small (less than 100 *kW*) and will likely be adopted by households and small business end-users of *DUs*.

After consultations with stakeholders, the *ERC* issued on July 3, 2013 its Resolution No. 09, Series of 2013, entitled, “A Resolution Adopting the Rules enabling the Net Metering Program for Renewable Energy”. The rules will govern the *DUs*’ implementation of the Net Metering Program. Included in the Rules are the Interconnection Standards that shall provide technical guidance to address engineering, electric system reliability, and safety concerns for net metering interconnections. The final pricing methodology, however, will be addressed in another set of rules and will be endorsed to the *ERC* in due course. In the meantime, the *DUs*’ blended generation cost equivalent to the generation charge, shall be used as the preliminary reference price in the net metering agreement. The rules took effect on July 24, 2013. As at September 30, 2016, *MERALCO* has already installed 647 meters and energized 573 Net Metering customers. *MERALCO* is the first *DU* in the country which implemented the Net Metering Program.

Interruptible Load Program (“ILP”)

In an *ERC* Order dated April 11, 2014, the *ERC* approved with modification *MERALCO*’s request that it be allowed to adopt and implement the “Rules to Govern the Interruptible Load Program of Distribution Utilities” promulgated under Resolution No. 08, Series of 2010, as amended by Resolution No. 08, Series of 2013 and Resolution No. 05, Series of 2015.

MERALCO is working with the *DOE*, the *ERC* and other stakeholders on the mechanics to implement the expanded *ILP* to cover not only captive customers but also contestable customers with demand of one (1) *MW* or higher who have standby generating units. A forum in coordination with the *DOE* and Retail Electricity Suppliers Association was conducted last

March 30, 2016 to provide an update on the Luzon power situation outlook and to refresh participants on the *ILP* protocols.

As at September 30, 2016, there are 221 companies with a total committed de-loading capacity of 792.70 MW that have signed up with *MERALCO*, *MPower* and with other retail electricity supplier as *ILP* participants.

Long Term Indebtedness Application

On June 25, 2015, *MERALCO* filed an Application, with prayer for provisional authority, for continuing authority to (a) issue bonds or other evidence of indebtedness for as long as it maintains 50:50 long-term debt to equity ratio; and (b) whenever necessary, to mortgage, pledge or encumber any of its property to any creditor in connection with its authority to issue bonds or any other evidence of long-term indebtedness. The hearing on the application was conducted on October 6, 2015. In an Order dated October 12, 2015, the *ERC* directed *MERALCO* to submit additional documents in support of its Application which *MERALCO* complied with. However, due to changes in the financial climate which may affect the terms and conditions of any financial borrowings, *MERALCO* has filed a motion to withdraw the application without prejudice to its refiling at a later date. In an Order dated March 22, 2016, the *ERC* granted *MERALCO*'s motion to withdraw but still required *MERALCO* to submit certain documents. *MERALCO* filed a Motion for Partial Reconsideration questioning the requirement which is pending before the *ERC*. As at September 30, 2016, the *ERC* has yet to resolve *MERALCO*'s Motion for Partial Reconsideration.

Prepaid Retail Electricity Service ("PRES")

On December 12, 2014, *MERALCO* filed an application for authority to offer and provide *PRES* to its customers as well as the applicable rules to govern *PRES*. In a Decision dated April 27, 2015, the *ERC* approved the application with modification. As at September 30, 2016, there are 35,074 customers availing of *PRES*.

Competitive Selection Process ("CSP") for Power Supply Agreements

As early as February 2013, the *ERC* posted the first draft of rules on *PSA* Approval, solicited comments from stakeholders thereon and conducted various focused group discussions. Said draft required *DUs* to undergo *CSP* in their supply procurement, required a specific procedure for such and prescribed a *PSA* template.

Meanwhile, in October 2014, the *DOE* issued for comments its draft Circular on Demand Aggregation and Supply Auctioning Policy ("*DASAP*"). This was likewise subjected to public consultations.

In June 2015, *DOE* promulgated *DOE* Circular No. 2015-06-0008, "Providing Policies for Further Enhancement of the *WESM* Design and Operations", prescribing *DUs* to procure all its uncontracted demand through *CSP*, through the participation of a Third Party and which may be done by *DUs* on an aggregated basis. The *DOE* Circular gave *DOE* and *ERC* 120 days to issue the necessary Implementing Guidelines ("*IG*"). Instead of issuing an *IG*, in a Joint Resolution dated October 20, 2015, it was agreed by *DOE* and *ERC* that the latter shall be the one to issue the relevant *CSP* regulations. On even date, *ERC* promulgated Resolution No. 13, Series of 2015.

ERC Resolution No. 13, Series of 2015 included the following provisions:

All *DUs* are required to undergo *CSP*. Pending the *ERC*'s issuance of a prescribed process, *DUs* may adopt any accepted form of *CSP*, provided that the terms of reference shall include, among others, the following – (a) contract capacity or energy volume, (b) generation source, (c) method of fuel procurement, (d) contract period, (e) tariff structure, (f) Philippine peso or foreign currency denominated payment, (g) penalties, (h) applicable transmission projects, and (i) other key parameters.

A *CSP* is successful if there are at least two (2) qualified bids. Should there be at least two (2) failed bids, then a *DU* can proceed with direct negotiation.

The *CSP* requirement shall apply to *PSAs* that although executed, have not yet been filed for approval before the *ERC*.

On March 15, 2016, *ERC* released Resolution No. 1, Series of 2016 entitled, "A Resolution Clarifying the Effectivity of *ERC* Resolution No. 13, Series of 2015." In this new Resolution, *ERC* clarified that after judicious study and due consideration of views raised by different industry stakeholders, it has resolved that:

The effectivity of *ERC* Resolution No. 13, Series of 2015 is hereby restated to be April 30, 2016.

On the other forms of *CSP* referred to in Section 2 of the *ERC* Resolution No. 13, Series of 2015, these should likewise comply with the minimum terms of reference and the requirement of at least two qualified bids for the *CSP* to be considered successful.

In reference to *PSAs* with provisions allowing the automatic renewal or extension of their term, *PSAs* that were previously approved by the *ERC* or filed with the *ERC* before the effectivity of this Resolution may have one (1) automatic renewal or extension for a period not exceeding one (1) year from the end of their respective terms. However, upon effectivity of this Resolution, automatic renewal clauses or extension of *PSAs* shall no longer be permitted.

33. Subsequent Event

On October 12, 2016, *MERALCO* signed A Joint Venture Agreement ("*JVA*") and Shareholders' Agreement ("*SHA*") with Blue Energy Holdings and Management Corp. ("*Blue Energy*").

Under the *JVA*, *MERALCO* and *Blue Energy* shall put up a Joint Venture Company ("*JVC*") through which *MERALCO* and *Blue Energy* will jointly pursue and undertake the development of various hydroelectric power projects. Under the *SHA*, *MERALCO* agreed to subscribe to new shares of the *JVC* to be incorporated by the Parties amounting to ₱3,124,999 divided into 3,124,999 shares with a par value of ₱1.00 per share. Said shares represent fifty percent of the authorized capital stock of the proposed *JVC*.