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	Department requiring the report	Secondary License Type, If Applicable
17-Q		

COMPANY INFORMATION

Company's Email Address	Company's Telephone Number/s	Mobile Number
N/A	6312222/16220	N/A

No. of Stockholders	Annual Meeting Month/Day	Fiscal Year Month/Day
43,671	Last Tuesday of May	December 31

CONTACT PERSON INFORMATION

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

Name of Contact Person	Email Address	Telephone Number/s	Mobile Number
Atty. William S. Pamintuan	wspamintuan@meralco.com.ph	632-8014	N/A

Contact Person's Address

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

Note: In case of death, resgination 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, 2017*

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
	Amount of Debt Outstanding
Debt Securities – bonds	PhP18.5 billion

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

    Yes [x] 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 [x] No [ ]

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

Yes [x] No [ ]

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

The 3Q 2017 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 2017 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 16, 2017

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 ("*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, 2017 and December 31, 2016 and for the nine months ended September 30, 2017 and 2016. 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 peso, *MERALCO Group's* functional and presentation currency, as defined under *PFRS*. All values are rounded to the nearest million peso, 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 ₱50.82, the closing rate as at September 29, 2017 (the last trading day in September 2017) quoted through the Philippine Dealing System.

Financial Highlights and Key Performance Indicators

(Amounts in millions, except earnings per share, and operational data)	September 30, 2017	December 31, 2016	Increase (Decrease) Amount	%
	(Unaudited)	(Audited)		
Condensed Statements of Financial Position				
Total assets	₱304,553	₱296,037	₱8,516	3
Current assets	98,163	88,008	10,155	12
Cash and cash equivalents	46,699	46,656	43	-
Equity attributable to equity holders of the parent	70,714	74,417	(3,703)	(5)
Total debt	40,150	40,347	(197)	(1)
Current liabilities	113,838	104,602	9,236	9

	Nine Months Ended September 30		Increase (Decrease)	
	2017	2016	Amount	%
Condensed Statements of Income				
Revenues	₱214,389	₱195,164	₱19,225	10
Costs and expenses	193,808	174,941	18,867	11
Other income, net of expenses	1,657	1,768	(111)	(6)
Income before income tax	22,238	21,991	247	1
Net income	16,018	15,820	198	1
Net income attributable to equity holders of the parent	15,928	15,676	252	2
Earnings per share attributable to equity holders of the parent	14.13	13.91	0.22	2
Condensed Statements of Cash Flows				
Net cash provided by operating activities	26,405	26,094	311	1
Net cash used in investing activities	6,520	24,315	(17,795)	(73)
Net cash used in financing activities	19,842	16,038	3,804	24
Operational Data				
Number of customers (in thousands):				
Residential	5,741	5,479	262	5
Commercial	496	484	12	3
Industrial	10	10	-	-
Streetlight	5	5	-	-
Electricity sales volume (in *GWh*)	31,401	30,103	1,298	4
System loss [1]:				
MERALCO	6.05%	6.40%	(0.35%)	(6)
Clark Electric Distribution Corporation ("*CEDC*")	2.35%	3.84%	(1.49%)	(39)

[1] Based on 12-month moving average

The Key Performance Indicators ("*KPI*") of *MERALCO* are as follows:

Financial KPI	Definition	September 30, 2017	December 31, 2016
Debt to Equity	Total debt / Equity attributable to equity holders of the parent	0.57	0.54
Current Ratio	Current assets / Current liabilities	0.86	0.84
		Nine Months Ended September 30	
		2017	**2016**
Profit Margin	Net income attributable to equity holders of the parent / Revenues	7%	8%
Return on Equity	Net income attributable to equity holders of the parent / Equity attributable to equity holders of the parent	23%	21%
Asset Turnover	Revenues / Average total assets	0.71	0.69

OVERVIEW

MERALCO is the Philippines' largest electric power distribution company, with franchise area covering 9,685 square kilometers. It provides power to more than six (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 more than 50% of the country's Gross Domestic Product ("*GDP")*.

Through *CEDC*, a 65%-owned 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 it services 2,089 customer accounts as at September 30, 2017. *CEDC* is a registered private distribution utility granted 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 Clark Development Corporation (*"CDC")* and Meralco Industrial Engineering Services Corporation ("*MIESCOR*") on February 19, 1997.

The *MERALCO Group*'s business is grouped into two (2) segments, namely, power and other services.

- 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 on a pass-through basis covering all captive customers in the *MERALCO* and the *CEDC* franchise areas in Luzon. 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 into power generation is through investments in operating companies or participation in the development of 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*") effective June 30, 2016. *GBPC* owns a total of 859 MegaWatt ("*MW*") (gross) of coal and diesel-fired power plants.

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

  MGen, through San Buenaventura Power Ltd. Co. ("*SBPL*"), is in the process of constructing a 455 *MW* (net) capacity supercritical coal-fired power plant in Mauban, Quezon. The Power Supply Agreement ("*PSA*") with *MERALCO* was approved by the Energy Regulatory Commission ("*ERC*") on May 19, 2015.

  MGen is developing a 2 x 600 *MW* (net) ultra supercritical coal-fired power plant in Atimonan, Quezon through Atimonan One Energy, Inc. ("*A1E*"). *A1E* is in the final stage of selection for an Engineering, Procurement and Construction (*"EPC"*) contractor. The expected completion of the first unit is 2021 and the second 600 *MW* by early 2022. A *PSA* has been executed between *A1E* and *MERALCO* for the full capacity. The *PSA* was filed with the *ERC* for approval.

  MGen is also developing (i) a 2 x 300 (net) *MW* Circulating Fluidized Bed *("CFB"),* coal-fired power plant in the Subic Freeport Zone through Redondo Peninsula Energy, Inc. *("RP Energy")*, and (ii) a 2 x 350 *MW* (net) sub-critical pulverized coal-fired power plant in Calaca, Batangas through St. Raphael Power Generation Corporation ("*St. Raphael*"), and among others.

  In 2016, *MERALCO* also subscribed to a 50% equity interest in Pure Meridian Hydropower Corporation ("*Pure Meridian*"), which is primarily engaged in the development of mini hydroelectric power projects.

RES – This covers the sourcing and supply of electricity to qualified contestable customers. *MERALCO* serves as a local retail electricity supplier 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 elect to be among the contestable customers, may source their electricity from any retail electricity suppliers. Refer to Page 37 on related developments on *RCOA*.

The *ERC* granted the following subsidiaries distinct *RES* licenses to operate as retail electricity suppliers within Luzon and Visayas: Vantage Energy Solutions and Management, Inc. ("*Vantage*"), a wholly-owned subsidiary of *MERALCO*; Solvre, Inc., ("*Solvre"*) a wholly owned subsidiary of *MGen;* MeridianX Inc. ("*MeridianX*"), a wholly owned subsidiary of Comstech Integration Alliance, Inc. *("Comstech")*, on January 10, 2017, February 9, 2017 and February 9, 2017, respectively. Clarion Energy Management, Inc. ("*Clarion*") has submitted the requirements for its *RES* licensing to *ERC*. The approval of the *RES* licensing is pending with the *ERC*.

- 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*"), eMERALCO Ventures, Inc. ("*e-MVI")*, Paragon Vertical Corporation and Radius Telecoms, Inc. (collectively referred to as "*e-MVI Group*"), MRAIL, Inc. *("MRail")*, Republic Surety and Insurance Corporation *("RSIC")*, Lighthouse Overseas Insurance Limited *("LOIL"),* Meralco Financial Services, Inc. *("Finserve")*, Meralco Energy, Inc. ("*MServ")*, *Comstech*, and MSpectrum, Inc. ("*Spectrum*").

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

BUSINESS SEGMENTS	
Power	**Other Services**
Electricity distribution • *MERALCO* • *CEDC* Power generation • *MGen* and its subsidiaries • *Pure Meridian* *RES* • *MERALCO* through *MPower* business unit • *Vantage* • *Solvre* • *MeridianX* • *Clarion*	• *CIS Group* • *Comstech* • *e-MVI Group* • *Finserve* • *LOIL* • *MIESCOR Group* • *MRail* • *MServ* • *RSIC* • *Spectrum*

RESULTS OF OPERATIONS

The tables below summarize the consolidated results of operations and the contribution of each business segment to *MERALCO Group*'s revenues, costs and expenses, other income, and net income for the nine months ended September 30, 2017 and 2016.

	For the Nine Months Ended September 30, 2017			
	Power[2]	Other Services	Inter-segment Transactions	Consolidated
	(Amounts in millions)			
Revenues	₱208,848	₱6,845	(₱1,304)	₱214,389
Costs and expenses	189,467	5,645	(1,304)	193,808
Other income (expense) - net	1,691	(34)	-	1,657
Net income attributable to equity holders of the parent	15,260	758	(90)	15,928

	For the Nine Months Ended September 30, 2016			
	Power[3]	Other Services	Inter-segment Transactions	Consolidated
	(Amounts in millions)			
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

2017 compared with 2016

REVENUES

The following table shows the composition of *MERALCO Group'*s consolidated revenues for the nine months ended September 30, 2017 and 2016 by business segment.

	September 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[4]	₱208,848	97	₱189,135	97	₱19,713	10
Other services	6,845	3	7,262	4	(417)	(6)
Inter-segment transactions	(1,304)	-	(1,233)	(1)	(71)	6
Total	**₱214,389**	**100**	**₱195,164**	**100**	**₱19,225**	**10**

Consolidated electric revenues, which accounted for 97% of total revenues, increased by 10% mainly as a result of the 4% growth in sales volume across all customer classes. Pass-through revenues grew by 12% compared with the same period in 2016 due to higher generation charge resulting from the combined effects of (i) increased price of coal, oil and gas; and (ii) depreciation of Philippine peso versus the U.S. dollar.

Non-electric revenues, which accounted for 3% of consolidated revenues, decreased by 6% as volume of transactions from *MServ*, *RSIC*, and *MRail* were lower compared with 2016.

[2] *Principally electricity distribution*
[3] *Ibid*
[4] *Ibid*

The decrease was partially offset by (i) increased bills payment volumes of *Bayad Center* from almost 6,900 sites and collection partners supplemented by spot billing volumes; and (ii) higher recurring revenues of *Radius* as a result of expanding customer base and high service reliability.

Power

Revenues from the power segment consist of generation, transmission, distribution, subsidies and other charges related to electricity distribution and energy trading. *MERALCO* and *CEDC* distribute electricity to industrial, commercial and residential customers while *MPower* and *Vantage* supply electricity to their respective contestable customers.

Generation charge, which is the single largest component, represents 61% of electricity revenues for the nine months ended September 30, 2017. The average generation charge to captive customers was at ₱4.30 per *kWh* for the nine months ended September 30, 2017 against ₱3.87 per *kWh* in the same period in 2016. Transmission charge, which is billed by National Grid Corporation of the Philippines ("*NGCP*"), represents 12% of the electricity revenues or equivalent to ₱0.82 per *kWh* for the nine months ended September 30, 2017, 7% lower compared with ₱0.88 per *kWh* in the same period in 2016.

The higher generation charges are attributable to (i) increased price of coal, oil and gas, and (ii) continuous depreciation of Philippine peso versus U.S. dollar in 2017.

The average coal price as at August 2017 was at US$83.71 per metric ton ("*MT*") compared with US$56.40 per *MT* for the nine months of 2016; Malampaya gas was at an average of US$7.11 per gigajoule ("*GJ*") compared with US$6.17 per *GJ* in 2016. Oil prices averaged at US$51.09 per barrel (Dubai crude) for the nine months of 2017 versus US$38.98 per barrel in 2016. These drove *MERALCO*'s average generation charge to ₱4.30 per *kWh* from ₱3.87 per *kWh* as at September 30, 2016. Average purchased price from Wholesale Electricity Spot Market ("*WESM*") was at ₱4.34 per *kWh*.

Distribution revenues, which accounted for 21% of the total electricity revenues, increased by 4% mainly due to the growth in energy sales volume.

MERALCO's 12-month moving average system loss ("*SL*") rate was at "record best" of 6.05% as at September 30, 2017. This is 2.45 percentage points below the *SL* regulatory cap of 8.50%, and 0.35 percentage point lower than the *SL* rate for the same period in 2016. *CEDC*'s 12-month moving average *SL* rate was at 2.35%, 6.15 percentage points below the regulatory cap and 1.49 percentage points lower than the same period last year.

The following table summarizes the customer count as at September 30, 2017 and 2016 and the corresponding electric consumption per customer class for the first nine months of 2017 and 2016:

	No. of Customers		**Electricity Sales**		**% Change**	
	(in thousands)		*(in GWh)*		**No. of**	**Electricity**
Customer Class	**2017**	**2016**	**2017**	**2016**	**Customers**	**Sales**
Residential	5,741	5,479	9,815	9,412	5	4
Commercial	496	484	12,382	11,856	3	4
Industrial	10	10	9,102	8,735	-	4
Streetlights	5	5	102	100	-	2
Total	**6,252**	**5,978**	**31,401**	**30,103**	**5**	**4**

MERALCO's customer base grew by 5% to almost 6.3 million. Residential and commercial customer accounts rose by 5% and 3%, respectively. Residential customers continue to represent 92% of the total customer accounts.

Growth in energy sales volume was noted across all customer classes. Residential sales volume rose by 4% to 9,815 *GWh*, 403 *GWh* more than in 2016, supported by strong consumer confidence particularly in the

National Capital Region ("*NCR*"), despite the slight uptick in inflation. New builds for apartments, condominium units, single detached houses and government housing continue to increase.

Commercial customers' sales volume continued to expand, underpinned by a healthy demand for office spaces for the Business Process Outsourcing ("*BPO*") sector as their tax exemption is expected to be retained under the proposed House Bill on Tax Reform for Acceleration and Inclusion ("*TRAIN*"), and the growing Philippine Offshore Gaming Operators ("*POGO*") sector, which is providing meaningful incremental demand for space. Total sales volume for the nine months ended September 30, 2017 amounted to 12,382 *GWh*, more than 4% higher in the same period last year. Real estate continued to grow rapidly. Retail trade remains a strong pillar for commercial sales growth with contributions from tourism spurred by continuing airline promotions, budget airfares from carriers and competitive hotel pricing. In addition, restaurants, especially those providing quick service, benefit from the growing population.

Industrial sales volumes sustained its growth momentum, anchored on the robust performance of the semiconductor, food and beverage, and basic metals industries. Industrial sales volume were up by more than 4%. Electronics continues to be the major export for the country as demand for electronic devices for automotive and wearables remain robust. Growth in food and beverage is reflective of healthy consumer demand. The sales growth in basic metals mirrors the sustained strength of the construction sector, driving steel plants to ramp up with increased running hours.

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 volumes.

RCOA continues to experience increasingly intense pricing and service offering competitions. Total *RES* volumes within the *MERALCO* franchise area was over 7,700 *GWh*, reflecting an increase in energy sales of 33% compared with 2016. As of September 30, 2017, there are a total of 691 customers within the franchise area who have opted for contestability with total consumption of over 970 *GWh*. *MPower* and *Vantage* serve a combined 41% of the total count of the contestable market with competitive product and pricing offers, which suit the needs of customers.

Other Services

Revenues from other services pertain mainly to revenues of non-electric subsidiaries. Revenues generated from other services decreased to ₱6,845 million for the nine months ended September 30, 2017 from ₱7,262 million in the same period last year. The 6% decrease in revenues from other services is the net effect of (i) the delayed award of projects and slow validation of work accomplishments of *MServ*; partly offset by (ii) increased bills payment volumes of *Bayad Center* from almost 6,900 sites and collection partners supplemented by spot billings volumes; and (iii) higher recurring revenues of *Radius* as a result of an expanding customer base and better service reliability following the bandwidth upgrade.

The bills volume handled by *Bayad Center* grew to 68.3 million for the nine months ended September 30, 2017, 10% or 6.2 million higher compared with the same period in 2016. It now serves a total of 265 biller brands, including government institutions, telecommunications companies, utilities, schools and insurance companies, among others.

Radius continuously delivers data, internet and value-added services on an-end-to-end fiber optic platforms. Its performance continues to be boosted by the increasing billed monthly recurring revenues, which grew 21% during the first nine months of 2017. *Radius* provides back-up telecommunications services to other carriers and business with private leased line circuit solutions that enable connection to multiple sites globally.

COSTS AND EXPENSES

Consolidated costs and expenses for the nine months ended September 30, 2017 amounted to ₱193,808 million, higher by ₱18,867 million compared with ₱174,941 million in 2016. The following table shows the breakdown of consolidated costs and expenses for the nine months ended September 30, 2017 and 2016 by business segment:

	September 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[5]	₱189,467	98	₱170,300	97	₱19,167	11
Other services	5,645	3	5,874	3	(229)	(4)
Inter-segment transactions	(1,304)	(1)	(1,233)	-	(71)	6
Total	**₱193,808**	**100**	**₱174,941**	**100**	**₱18,867**	**11**

Power

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

	September 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Purchased power	₱162,777	86	₱144,423	85	₱18,354	13
Salaries, wages and employee benefits	7,523	4	7,818	5	(295)	(4)
Depreciation and amortization	4,943	3	4,972	3	(29)	(1)
Contracted services	4,202	2	3,652	2	550	15
Others	10,022	5	9,435	5	587	6
Total	**₱189,467**	**100**	**₱170,300**	**100**	**₱19,167**	**11**

Costs and expenses of power segment for the nine months ended September 30, 2017 amounted to ₱189,467 million, 11% higher compared with ₱170,300 million in the same period in 2016.

Purchased power accounted for 86% of the total costs and expenses for the nine months ended September 30, 2017. *MERALCO* and *CEDC* do not operate their own generation capacity. All of the electricity distributed are contracted through *PSA*s with generators and long-term Power Purchase Agreements *("PPA")* with Independent Power Producers ("*IPP*"). The remaining balance is purchased from the *WESM*.

The purchased power cost for the nine months ended September 30, 2017 increased by 13% due to (i) increased prices of coal, oil and gas; and (ii) depreciation of Philippine peso versus U.S. dollar.

The increase was offset by lower volume purchased from 29,868 *GWh* in 2016 to 29,376 *GWh* in 2017. The volume of energy purchased under long-term *PPA*s with *IPPs*, namely, First Gas Corporation *("*the *Sta. Rita Power Plant"*), *FGP* Corp. *("*the *San Lorenzo Power Plant"*) and *QPPL*, represents 34% of *MERALCO*'s Net System Input ("*NSI*"). Purchases from power generators under *PSA*s, and other special programs accounted for 53%, while purchases from *WESM* accounted for 13% of *NSI*.

Contracted services increased by 15% from ₱3,652 million in 2016 to ₱4,202 million in 2017 on account of higher spending for information system/information technology services, cloud subscriptions and consultancy for various system enhancements and customer-centric projects. Customer-related expenses such as collection services and meter reading services also increased due to 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.

[5] *Ibid.*

Other Services

Costs and expenses of other services business segment for the nine months ended September 30, 2017 amounted to ₱5,645 million, 4% lower compared with ₱5,874 million in the same period in 2016.

	September 30					
	2017		2016		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Salaries, wages and employee benefits	₱2,132	38	₱1,820	31	₱312	17
Contracted services	1,199	21	1,356	23	(157)	(12)
Depreciation and amortization	288	5	234	4	54	23
Others	2,026	36	2,464	42	(438)	(18)
Total	**₱5,645**	**100**	**₱5,874**	**100**	**(₱229)**	**(4)**

Salaries, wages and employee benefits increased by ₱312 million due to increase in manpower count and project-hired personnel of *MRail, Bayad Center*, and *Radius.*

Contracted services decreased by ₱157 million consistent with the decrease in revenues of *MServ* and *RSIC*.

Other expenses, which consisted mainly of materials, transportation and travel, rental and utility expenses, decreased by ₱438 million in 2017 due to lesser project completions of *MServ*.

OTHER INCOME

The following table shows the breakdown of other income, net of expenses, for the nine months ended September 30, 2017 and 2016 by business segment:

	September 30			
			Increase/Decrease	
	2017	2016	Amount	%
	(Amounts in millions)			
Power[6]	₱1,691	₱1,718	(₱27)	(2)
Other services	(34)	50	(84)	(168)
Total	**₱1,657**	**₱1,768**	**(₱111)**	**(6)**

Power

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

	September 30			
			Increase/Decrease	
	2017	2016	Amount	%
	(Amounts in millions)			
Interest and other financial income	₱1,612	₱1,498	₱114	8
Interest and other financial charges	(1,089)	(949)	(140)	15
Equity in net earnings (losses) of associates and joint ventures	380	(40)	420	(1,050)
Foreign exchange gains	371	465	(94)	(20)
Others	417	744	(327)	(44)
Total	**₱1,691**	**₱1,718**	**(₱27)**	**(2)**

Interest and other financial income increased by ₱114 million due to higher yields compared with the same period last year.

[6] *Ibid.*

Interest and other financial charges increased by ₱140 million in 2017 compared with the same period last year as a result of prepayment of the floating interest rate loan from a local bank and availment of ₱10,000 million notes payable in June 2016.

Other income decreased by ₱327 million as a result of lower volume of *AFS* and *HTM* transactions during the period due to maturity of *AFS* and *HTM* in prior year.

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, 2017 and 2016 by business segment:

	September 30					
	2017		**2016**		**Increase/Decrease**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
	(Amounts in millions)					
Power[7]	₱15,260	96	₱14,812	94	₱448	3
Other services	758	5	1,008	7	(250)	(25)
Inter-segment transactions	(90)	(1)	(144)	(1)	54	(38)
Total	**₱15,928**	**100**	**₱15,676**	**100**	**₱252**	**2**

Net income attributable to equity holders of the parent for the nine months ended September 30, 2017 increased by 2% mainly due to higher sales volume resulting in higher distribution revenues compared with the same period last year.

CHANGES IN FINANCIAL POSITION

Utility Plant and Others

The increase in utility plant and others was due to completed construction of new electric distribution-related facilities and upgrade in major rehabilitation of existing electrical facilities, offset by the depreciation and amortization for the period.

Investments in Associates and Interests in Joint Ventures

The increase in investments in associates and interests in joint ventures was primarily due to infusion of additional capital into *RP Energy*, AF Payments, Inc. ("*AFPI*") and *Pure Meridian*, and new equity investment in Powersource First Bulacan Solar, Inc. ("*First Bulacan*"), the solar power entity of *MERALCO*.

Deferred Tax Assets

The increase in deferred tax assets was mainly related to tax effect of provisions recognized in 2017.

Other Noncurrent Assets

The decrease in other noncurrent assets was due to the combined effects of (i) sale of *AFS* and *HTM* investments; and (ii) higher net under-recovery of generation charge in 2017; (iii) reclassification of ₱4,919 million approved net over-recoveries to trade and other current liabilities account which was refunded to the customers during the period; and (iv) reclassification of *HTM* investments maturing within a year to other current assts.

Cash and Cash Equivalents

The increase in cash and cash equivalents was due to the combined effects of (i) cash generated from operations amounting to ₱26,405 million; (ii) proceeds from sale of *AFS* and *HTM* investments of ₱30,285 million; and(vii) availment of notes payable and interest-bearing loans of ₱4,874 million. This was partially offset by (i) investment in *AFS* and *HTM* investments of ₱25,285 million (ii) payment of cash dividends of ₱20,586 million, (iii) payment for capital expenditures of ₱7,962 million; and (iv) payment of notes payable and interest-bearing loans of ₱5,089 million.

[7] *Ibid.*

Trade and Other Receivables

Trade and other receivables increased due to the higher average customer retail rate in September 2017 compared with the average retail rate in December 2016.

Other Current Assets

The increase in other current assets was due to reclassification of maturing *HTM* investments from noncurrent assets.

Retained Earnings

The increase was mainly due to net income generated for the period, which was offset by the declaration of cash dividends out of interim core net income and special dividends to stockholders amounting to ₱20,541 million.

Provisions

The decrease in provisions represents the net settlement during the period.

Other Noncurrent Liabilities

Other noncurrent liabilities pertain to estimated liabilities for regulatory and tax matters, among others. Additional obligations were recognized during the period.

Trade and Other Current Liabilities

The increase in trade and other current liabilities was due to increased liabilities for purchased power as a result of a) higher average purchased power cost; b) higher *kWh* purchased for the month of September 2017 compared with purchase for the month of December 2016; and c) reclassification of ₱4,919 million approved net over-recoveries from other noncurrent assets. Such net over-recoveries were refunded to the customers during the period.

2016 compared with 2015

RESULTS OF OPERATIONS

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.

	September 30					
	2016		2015		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[8]	₱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 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 Second Regulatory Period ("2*RP*") under recovery charges included in the Third Regulatory Period ("3*RP*"). The 3*RP* ended June 30, 2015; and (ii) lower pass-through generation and other charges as a result of continuing downward trend of global fuel prices, higher availability of *MERALCO*'s contracted power plants, and lesser forced outages incidents and lower *WESM* prices compared

[8] *Ibid.*

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*; 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 to 3.84% in 2016.

The lower generation charges are attributable to the significantly lower fuel costs and higher availability of contracted plants. In addition, the *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 3*RP* 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:

	No. of Customers		**Electricity Sales**		**% Change**	
	(in thousands)		*(in GWh)*		**No. of**	**Electricity**
Customer Class	**2016**	**2015**	**2016**	**2015**	**Customers**	**Sales**
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, relatively 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:

	September 30					
	2016		2015		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[9]	₱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)**	**-**

Power

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

	September 30					
	2016		2015		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
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%

[9] *Ibid.*

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 *PSA*s with generators and long-term Power *PPA* with *IPP*s. 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 *PPA*s with *IPP*s represents 33% of *MERALCO*'s *NSI*. Purchases from power generators under *PSA*s, 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.

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.

	September 30					
	2016		**2015**		**Increase/Decrease**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
	(Amounts in millions)					
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:

	September 30			
			Increase/Decrease	
	2016	2015	Amount	%
	(Amounts in millions)			
Power[10]	₱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 in the following table:

	September 30			
			Increase/Decrease	
	2016	2015	Amount	%
	(Amounts in millions)			
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**

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:

	September 30					
	2016		2015		Increase/Decrease	
	Amount	%	Amount	%	Amount	%
	(Amounts in millions)					
Power[11]	₱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.

[10] *Ibid.*

[11] *Ibid.*

CHANGES IN FINANCIAL POSITION

Utility Plant and Others

The increase in utility plant and others was due to completed construction of new electric distribution-related facilities and upgrade in major rehabilitation of existing electrical facilities, offset by the depreciation and amortization for the period.

Investments in Associates and Interests in Joint Ventures

The decrease in investments in associates and interests in joint ventures was primarily due to the partial divestment of *MGen*'s interest in *GBPC.*

Deferred Tax Assets

The increase in deferred tax assets was mainly related to provisions recognized during the period.

Other Noncurrent Assets

The increase in other noncurrent assets was due to additions in *AFS* financial assets and *HTM* investments.

Cash and Cash Equivalents

The decrease in cash and cash equivalents was due to the combined effects of a) cash flows from operating activities of ₱26,094 million; b) cash disbursements for capital expenditures of ₱7,509 million; c) investments in *AFS* and *HTM* investments of ₱82,283 million; d) proceeds from sale of *AFS* and *HTM* investments of ₱62,067 million; e) proceeds from partial divestment of interest in an associate amounting to ₱3,151 million; f) availment of notes payable of ₱10,222 million; and g) payment of dividends amounting to ₱28,110 million.

Trade and Other Receivables

The decreased in trade and other receivables was due to the lower customer retail rates driven by lower generation charges and collection of approved under-recoveries.

Other Current Assets

The decrease in other current assets pertains to lower *HTM* investment which will be realized within a year.

Retained Earnings

The decrease in the balance of retained earnings is the combined effects of net income and cash dividends declared for the period.

Other Noncurrent Liabilities

Other noncurrent liabilities pertain to estimated liabilities for regulatory and tax matters. Additional obligations were recognized during the period.

Trade Payables and Other Current Liabilities

The decrease in trade payables and other current liabilities was due to settlements of local business taxes in 2016.

LIQUIDITY AND CAPITAL RESOURCES

The following tables show the cash flows for the nine months ended September 30, 2017 and 2016 as well as the capitalization and other selected consolidated financial data as at September 30, 2017 and December 31, 2016:

	For the Nine Months Ended September 30	
	2017	**2016**
	(Amounts in millions)	
Cash Flows		
Net cash provided by operating activities	₱26,405	₱26,094
Net cash used in financing activities	19,842	16,038
Net cash used in investing activities	6,520	24,315
Net increase (decrease) in cash and cash equivalents	43	(14,259)
Capital Expenditures	7,962	7,509

	September 30, 2017	**December 31, 2016**
	(Amounts in millions)	
Capitalization		
Interest-bearing long-term financial liabilities		
Current	₱1,845	₱1,873
Noncurrent	24,836	26,999
Notes payable	13,469	11,475
Equity attributable to equity holders of the parent	70,714	74,417
Other Selected Financial Data		
Total assets	304,553	296,037
Utility plant and others	132,022	128,814
Cash and cash equivalents	46,699	46,656

As at September 30, 2017, cash and cash equivalents amounted to ₱46,699 million, ₱43 million higher compared with ₱46,656 million as at December 31, 2016. Following are the significant cash flow activities for the nine months ended September 30, 2017: (i) cash generated from operations amounting to ₱26,405 million; (ii) payment of cash dividends of ₱20,586 million; (iii) payment for capital expenditures of ₱7,962 million; (iv) payment of notes payable and interest-bearing loans of ₱5,089 million; (v) proceeds from sale of *AFS* and *HTM* investments of ₱30,285 million; (vi) investment in *AFS* and *HTM* investments of ₱25,285 million and (vii) availment of notes payable and interest-bearing loans of ₱4,874 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 ("*Bonds*"), respectively. The 12-year corporate bonds also include a call option, whereby *MERALCO* may redeem (in whole but not in part) 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 are listed on and traded through 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 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, 2017, *MERALCO* is in compliance with all of the 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 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, 2017 and December 31, 2016. Interest is no longer accrued when the preferred shares have been called.

As at September 30, 2017 and December 31, 2016, *MERALCO*'s capital stock consists of: (Amount in millions except par value and number of shares)

Common stock - ₱10 par value	
Authorized - 1,250,000,000 shares	₱12,500
Issued - 1,127,271,117 shares	11,273
Treasury - 172,412 shares	(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* repurchased.

The table below summarizes the cash dividends declared during the nine months ended September 30, 2017 and 2016:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
August 3, 2017	August 30, 2017	September 22, 2017	₱8.93	₱10,059
February 27, 2017	March 27, 2017	April 21, 2017	9.30	10,482
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

The board of directors ("*BOD*")-approved dividends policy of *MERALCO* consists of (i) regular cash dividends equivalent to 50% of consolidated core net income (*"CCNI"*) for the period, and (ii) 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 at rates that allow a reasonable rate of return on investments. *MERALCO* and *CEDC*'s rate structure also allows pass-through of certain purchased power costs, *SL* 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 (2) other private distribution utilities ("*DU*s").

Rate setting under *PBR* is governed by the Rules for Distribution Wheeling Rates ("*RDWR*"). The *PBR* scheme sets tariffs once every Regulatory Period *("RP")* based on the *RAB* of each *DU*, 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 ("*RY*s"). A *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. The 4*RP* for the Group A *DU*s began on July 1, 2015 and shall end on June 30, 2019.

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*. A *RY* for *CEDC* begins on October 1 and ends on September 30. The 3*RP* for CEDC began October 1, 2015 and shall end on September 30, 2019. *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 3*RP* reset application.

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 Generation Rate Adjustment Mechanism ("*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 *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 *SL* charges beginning July 2007.

On July 13, 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 and inter-class rate subsidies, local franchise tax *("LFT*") and business tax.

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 *DU*s, 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 (3) years thereafter.

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

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 *DU*s and of their suppliers in the confirmation of the *SL*. However, the *ERC* did not adopt *MERALCO*'s proposed modification to the formula and instead prescribed a new formula. *ERC* Resolution No. 21, Series of 2010 adopted the new formula and correspondingly amended a prescribed in Resolution No. 16, Series of 2009. The Resolution also prescribed the period of filing for a *DU*'s consolidated applications, which for Luzon *DU*s shall be by March 31, 2011. Further, March 31, 2011 (covering adjustments implemented from the rate unbundling until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) were set as the new deadlines for *DU*s in Luzon to file their respective applications. Subsequent filings shall likewise be every three (3) years thereafter.

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 *DU* can pass on to its customers. The revised *SL* cap is 8.5% for private utilities, starting with the January 2010 billing. The said cap is one (1) 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 recognized as 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*.

MERALCO's 12-month moving average *SL* rate as at September 30, 2017 was at 6.05%, 0.35 percentage points lower compared with the 6.40% *SL* rate as at September 30, 2016. *CEDC*'s 12-month moving average *SL* rate of 2.35% as at September 30, 2017, improved by 1.49 percentage points from the 3.84% registered in the same period in 2016.

On October 4, 2016, a legislator proposed a bill to lower the current cap of *SL* rate from 8.5% to 5% for private *DU*s and from 13% to 10% for electric cooperatives and to exclude non-technical *SL* and electricity used by the private *DU*s and electrical cooperatives from what may be passed on to consumers as *SL* charges. As at October 27, 2017, this proposed bill is still subject for deliberation of the Senate.

On May 9, 2017, the *ERC* posted on its website the draft rules on the *Proposed Rules for Setting the Distribution System Loss Cap and Establishing Performance Incentive Scheme for Distribution Efficiency*. *ERC* engaged a third party to conduct the study on the *SL* of *DU*s and propose new caps. Said rules proposed different *SL* caps according to four (4) clusters. Electric cooperatives were grouped in Clusters 1 to 3 and private *DU*s in Cluster 4. *DU*s in clusters 1 to 4 have proposed *SL* caps of 11.5%, 10%, 7.75%, and 4%, respectively. These caps, which include feeder technical loss and nontechnical loss but exclude sub-transmission and substation technical losses, are proposed to be implemented based on the *DU*'s next regulatory reset schedule. For *MERALCO*, the proposed implementation date is July 2019. A series of public consultations and focus grouped discussions followed, the latest of which was a public consultation for Mindanao stakeholders held in Pasig City last August 9, 2017. In said public consultation, the third party

consultant proposed a graduated reduction in *SL* caps per cluster. Beginning 2018, *DU*s in clusters 1 to 3 shall have a cap of 12% and *DU*s in cluster 4 shall have a cap of 8%, all of which exclude sub-transmission and substation *SL*. The caps of cluster 1 to 3 will remain or be lowered to 12%, 10.25%, 8.25% by 2022, respectively. For private *DU*s, the cap will be reviewed based on their submission of annual feeder data to the *ERC*. If private *DU*s fail to submit one (1) year's data (from 2018-2020), its cap in 2022, shall be set at 4.75% excluding subtransmission and substation *SL*. The latest proposal of the third party consultant also includes a 1% cap on subtransmission and substation *SL* which was not previously capped in the original draft rules. The final recommendations are being planned for presentation to the *ERC* in September or October 2017.

Sales Volume and Philippine Economic Conditions

The sale of electricity is driven mainly by prevailing economic conditions and the number of customers being served by *MERALCO*. The output from *MERALCO*'s franchise area accounts for more than 50% of the Philippines' *GDP*, with 37% of the total sales generated in Metro Manila.

For the nine months ended September 30, 2017, *MERALCO* and *CEDC*'s combined energy sales volume was 31,401 *GWh*, 4% higher compared with 30,103 *GWh* in 2016. The growth is due to the expansion in *MERALCO*'s customer base and strong consumer spending spurred by inward remittances from overseas Filipinos and the continuing growth of the *BPO*.

Average temperature for the nine months ended September 30, 2017 is lower by 0.3ºC from 28.7ºC in 2016 to 28.4ºC in 2017.

Electricity Supply

MERALCO and *CEDC* do not operate their own generation capacity. Both purchase all of the power they distribute from the power generators under *PSA*s and *PPA*s or through the *WESM*. *WESM* is a venue where suppliers and buyers trade electricity as a commodity. For the nine months ended September 30, 2017, *MERALCO* purchased 34% of its requirements from *PPA*s, which are 25-year contracts with three (3) *IPP*s, 53% from power supply generators under *PSA*s, and 13% from the *WESM*.

IPPs

First Gas Power Corporation ("*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 required to contract 1,500 *MW* of the 2,700 *MW* output of the Malampaya gas field.

Accordingly, *MERALCO* entered into separate 25-year *PPA*s 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 *PPA*s. The negotiations resulted in certain new conditions including the assumption by *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 *PPA*s with *FGP* and *FGPC* were approved by the *ERC* on May 31, 2006.

Under the respective *PPA*s 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* 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* 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*.

Committed Energy Volume to be Purchased

The following are forecasted *Committed Energy Volume* 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	***MEQ***	**Equivalent Amount**
	(In million kWh)	*(In Million)*
2018	14,980	₱21,113
2019	14,980	20,745
2020	14,980	20,882
2021-2025	14,980	106,587
2026-2027	7,203	34,378

Power Supply Generators Under PSAs

The table below summarizes the salient features of the signed *PSA*s/Contract to Sell of Electricity ("*CSE")* with power supply generators, some of which are still pending approval by the *ERC*:

Date	**Power Supplier**	**Plant/Contracted Capacity**	**Terms of *PSA/CSE***
October 6, 2017	Solar Philippines Tarlac Corporation ("*Solar Philippines Tarlac*")	Solar power plant for contracted capacity of 85 *MW*	Term of 20 years
September 16, 2016	*First Bulacan*	Solar power plant for contracted capacity of 50 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
September 16, 2016	Solar Philippine Tanauan Corporation ("*Solar Philippines Tanauan*")	Solar power plant for contracted capacity of 50 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.

Date	Power Supplier	Plant/Contracted Capacity	Terms of *PSA/CSE*
April 27, 2016	Global Luzon Energy Development Corporation ("*GLEDC*")	Coal-fired power plant for contracted capacity of 600 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	*A1E*	Supercritical coal-fired power plant for contracted capacity of 2 x 600 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	Central Luzon Premiere Power Corporation ("*Central Luzon Power*")	*CFB* coal-fired power generating facility for contracted capacity of 4 x150 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	*Mariveles Power*	*CFB* coal-fired power generating facility for contracted capacity of 528 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	Panay Energy Development Corporation ("*PEDC*")	Coal-fired power generating facility for contracted capacity of 70 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 26, 2016	*St. Raphael*	Coal-fired power plant for contracted capacity of 400 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
April 20, 2016	*RP Energy*	Coal-fired power plant for contracted capacity of 225 *MW*	Term of 20 years, extendible for another five (5) years upon mutual agreement of the parties.
November 25, 2014	Bacman Geothermal, Inc. *("BGI")*	Geothermal power plants for contracted capacity of 50 *MW*	Term of five (5) years pending approval extendable for another two (2) years upon mutual agreement of the 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*.
May 15, 2014	Philippine Power and Development Corporation *("Philpodeco")*	1 *MW* hydro power plants	Term of five (5) years which may be extended upon mutual agreement of parties.
September 27, 2013	Therma Mobile, Inc. *("TMO")*	Output of the barged-mounted, bunker oil-fired diesel engines moored at the Fishport Complex in Novatas, Manila.	Term expired on June 25, 2017, which may be extended upon mutual agreement of parties.

Date	Power Supplier	Plant/Contracted Capacity	Terms of *PSA/CSE*
June 26, 2012	San Miguel Energy Corporation *("SMEC")*	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.
May 31, 2012	Pangea Green Energy Philippines, Inc. *("PGEP")*	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.
February 29, 2012	Therma Luzon, Inc. *("TLI")*	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.
December 21, 2011	Masinloc Power Partners Co., Ltd. *("MPPCL")*	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*	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.
December 12, 2011	South Premiere Power Corporation *("SPPC")*	Ilijan Power Plant in Batangas, for the full 1,180 *MW* net capacities	Under the *PSA*, *MERALCO* shall procure power from *SPPC* until December 25, 2019, with an option to extend the term for another three (3) years.
November 12, 2010	Bacavalley Energy, Inc. *("BEI")*	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, *MERALCO* and *BEI* executed a letter of Agreement extending the *CSE* until March 16, 2016.

Date	Power Supplier	Plant/Contracted Capacity	Terms of *PSA/CSE*
			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 *PSA*s of *MERALCO* with *SPPC*, *Sem-Calaca*, *MPPCL*, *TLI* and *SMEC*.

Motions for Reconsideration (*"MR"*) were filed regarding the *ERC* decisions on the *PSA*s with *SPPC*, *Sem-Calaca* and *SMEC*. *MERALCO* is awaiting the decision of the *ERC* on the *SPPC* and *Sem-Calaca MR*s. 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 *PSA*s for an additional period of three (3) years up to December 25, 2022. Thereafter, relevant Manifestations with Motion for Approval of the Supplemental Agreements were filed with the *ERC*.

Under the *PSA*s approved by the *ERC*, fixed capacity fees and fixed operating maintenance fees are recognized monthly based on their contracted capacities. The annual projections for these payments are shown in the table below:

Year	Contracted Capacity	Fixed Payment Amount
	(In Megawatt)	*(In Million)*
2018	3,150	₱42,526
2019	2,530	34,620
2020	1,305	22,321
2021	525	9,210
2022-2036	525	144,695
2037-2039	455	27,085

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 October 27, 2017, the case is pending decision by the *ERC*. However, the contract term has expired while the decision is pending with 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 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 5, 2016, respectively, *MERALCO* and *TMO* filed a Motion for Clarification of the *ERC* Order dated April 5, 2016. Said motions are still pending decision by the *ERC*. On January 3, 2017, *MERALCO* filed a Manifestation with Motion informing the *ERC* of the extension of the term of the *PSA* from June 26, 2017 to June 25, 2018. In an Order dated June 6, 2017, the *ERC* noted *MERALCO*'s Manifestation and Motion and confirmed the one (1) year extension of the *PSA*. *MERALCO* and *TMO* were further directed to strictly comply with the provisions of *ERC* Resolution No. 1, Series of 2016, in particular the one (1) time limit for renewal of the *PSA*.

Philpodeco

On May 15, 2014, *MERALCO* and *Philpodeco* executed a *PSA*. *Philpodeco* operates three (3) run-of-river hydro power plants, namely: (i) Palakpakin, a 448 *kW* hydro power plant located at Barangay Prinza, Calauan, Laguna; (ii) Calibato, a 75 *kW* Calibato hydro power plant located at Barangay Sto. Angel, San Pablo City, Laguna; and (iii) 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 *Philpodeco*. This *PSA* provides that *MERALCO* shall accept all the energy deliveries of *Philpodeco* as measured by the latter's billing meter. Hearings on this case have been completed. As at October 27, 2017, the case has been 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 the approval of its *PSA* with *SBPL*. 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* expires 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 October 27, 2017, the case is submitted for decision.

RP Energy

On April 20, 2016, *MERALCO* signed a 20-year *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*. Hearings have been completed. *MERALCO* and *RP Energy* have both filed their respective *FOE*. The case is submitted for decision. Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *RPE* and *MERALCO* filed their oppositions. *MERALCO* and *RPE* likewise filed motions for the resolution of the pending case. As at October 27, 2017, the motions are still pending before the *ERC*.

A1E

On April 26, 2016, *MERALCO* signed a 20-year *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*. Hearings have been completed. *MERALCO* and *A1E* have both filed their respective *FOE* on March 8, 2017. Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* files its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *A1E* and *MERALCO* filed their oppositions. *MERALCO* and *A1E* likewise filed motions for the resolution of the pending case. As at October 27, 2017, the motions are still pending before the *ERC*.

St. Raphael

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *St. Raphael* for the purchase of up to 400 *MW* of electrical output from the 2 x 350 *MW* coal-fired power generating facility that *St. Raphael* 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*. Hearings have been completed and *MERALCO* has filed its *FOE*. As at October 27, 2017, the case is submitted for decision. Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* files its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *St. Raphael* and *MERALCO* filed their oppositions. *MERALCO* and *St. Raphael* likewise filed motions for the resolution of the pending case. As at October 27, 2017, the motions are still pending before the *ERC*.

Central Luzon Power

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Central Luzon Power* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW CFB* coal-fired power generating facility that *Central Luzon* Power 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*. In its Order dated January 25, 2017, the *ERC* held the processing of the application in abeyance. On February 9, 2017, *Central Luzon* filed a *MR* of the said *ERC* Order. Several other consumer groups subsequently filed their petitions to intervene. On July 22, 2017, *MERALCO* filed its consolidated comment to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. As at October 27, 2017, the case is still awaiting further action from *ERC*.

Mariveles Power

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Mariveles Power* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW CFB* coal-fired power generating facility that *Mariveles Power* 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*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On September 30, 2016, *Mariveles Power* filed a *MR* of the August 9, 2016 Order of the *ERC*. On October 3, 2016, *MERALCO* filed a Manifestation alleging that *ERC* can validly proceed with the hearing and evaluation of the Joint Application. The said *MR* is pending resolution by the *ERC*. Several other consumer groups subsequently filed their petitions to intervene. On July 22, 2017, *MERALCO* filed its consolidated comment to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. As at October 27, 2017, the case is still awaiting further action from the *ERC*.

PEDC

On April 26, 2016, *MERALCO* signed a 20-year *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. In its letter dated November 23, 2016, the *ERC* informed *MERALCO* that *ERC* has provisionally approved the *PSA* between *MERALCO* and *PEDC* in its order dated July 11, 2016. Hearings have been completed. On October 4, 2016, *MERALCO* received a Petition from a consumer group seeking to intervene in the case. On October 11, 2016, *MERALCO* filed an Opposition to the consumer group's Petition for Intervention on the ground that the same was defective and filed out of time. On January 10, 2017, *MERALCO* and *PEDC* filed their Joint Motion to Admit *FOE* with Joint Urgent Motion for Early Resolution of the Application, seeking to, among other things, already source 70 *MW* from *PEDC* beginning January 28, 2017 in order to temper the anticipated additional burden that the *SPEX*-Malampaya Outage may bring to end-users. On January 16, 2017, *MERALCO* filed a Manifestation with the *ERC*. On January 23, 2017, *MERALCO* received two (2) Orders from the *ERC*, both dated December 8, 2016: (i) treating the consumer group's Petition for Intervention as an Opposition; and (ii) setting another hearing for the continuation of the presentation of *MERALCO* and *PEDC*'s evidence. During the hearing on February 23, 2017, *PEDC* presented its evidence and *MERALCO* was directed to answer additional clarificatory questions from, and submit additional documents to, the *ERC*. *MERALCO* filed its Compliance with said *ERC* directive on April 17, 2017. Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *PEDC* and *MERALCO* filed their oppositions. As at October 27, 2017, the motions are still pending before the *ERC*.

GLEDC

On April 27, 2016, *MERALCO* signed a 20-year *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*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On October 4, 2016, *MERALCO* received a Petition from a consumer group seeking to intervene in the case. On October 21, 2016, *MERALCO* received *GLEDC*'s *MR* of the August 9, 2016 *ERC* Order. Several other consumer groups subsequently filed their petitions to intervene. On July 21, 2017, *MERALCO* filed its consolidated comment to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. As at October 27, 2017, the case is still awaiting further action from *ERC*.

First Bulacan

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *First Bulacan* for the purchase of 50 *MW* of electrical output from its solar plant in San Miguel, Bulacan. The *PSA*'s effectivity is subject to a competitive selection process ("*CSP*"), and if *First Bulacan* declared as the winning power supplier, upon approval of the *ERC*. The Application for approval of the *PSA* with *First Bulacan* was filed on February 23, 2017. The application is set for hearing on June 23, 2017. *MERALCO* filed its *FOE* on July 12, 2017. *First Bulacan* has filed urgent motions for the resolution of the Application. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. *MERALCO* and *First Bulacan* filed their oppositions to the petition. As at October 27, 2017, the case is pending decision with the *ERC*.

Solar Philippines Tanauan

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tanauan* for the purchase of 50 *MW* of electrical output from its solar plant in Tanauan, Batangas. The *PSA*'s effectivity is subject to a *CSP*, and if *Solar Philippines Tanauan* will be declared as the winning power supplier, upon approval of the *ERC*. The Application for approval of the *PSA* with *Solar Philippines Tanauan* was filed on February 27, 2017. Hearings have been completed and *MERALCO* filed its *FOE* on July 12, 2017. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. *MERALCO* and *Solar Philippines Tanauan* filed their oppositions to the petition. As at October 27, 2017, the case is pending decision with the *ERC*.

Solar Philippines Tarlac

After being declared the winner bidder in a *CSP*, on October 6, 2017, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tarlac* for the purchase of up to 85 *MW* of electrical output from its solar plant in Tarlac. The Application for approval of the *PSA* with *Solar Philippines Tarlac* was filed on October 19, 2017. As at October 27, 2017, the *ERC* has yet to schedule the Application for initial hearing.

Interim Power Supply Agreement ("IPSA")

On January 19, 2016, after the conduct of a price challenge in compliance with *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* 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 (1) year up to two (2) 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 *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed two (2) separate *IPSA*s with the following wholly-owned subsidiaries of *GBPC*, namely (1) Toledo Power Corp. (*"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 terms of the *IPSA* is until February 25, 2017, and shall be automatically extended for additional one (1) year up to four (4) times, unless terminated by either party prior to the expiration of its terms. Both *IPSA*s were filed for approval of 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 these *IPSA*s.

On January 26, 2017, considering the imminent Malampaya shutdown from January 28 until February 16, 2017, *MERALCO* agreed to extend the *IPSA*s with *TPC* and *PPC* until February 25, 2018, provided that beginning January 28, 2017, (i) supply from *TPC* and *PPC* will be through replacement energy at a price lower than the Contract Price and (ii) supply from *PPC* will be on a firm basis until August 25, 2017, and on a non-firm basis from August 26, 2017 until end of the term thereof. All other terms and conditions under the *IPSA*s, as may be approved by the *ERC*, remain the same.

On January 24, 2017, in view of the Malampaya shutdown that was to coincide with the scheduled outage of other plants, *MERALCO* signed an *IPSA* with Strategic Power Development Corporation ("*SPDC*") for the supply of 100 *MW* per hour of electric power from 0901H to 1000H and from 2001H to 2100H, and 150 *MW* per hour of electric power from 1001H to 2000H, from January 28 until February 16, 2017. An application for approval of such *IPSA* was filed before the *ERC* on February 9, 2017. The said *IPSA* was effective immediately, on the condition that disallowances and penalties that the *ERC* may impose as a result thereof shall be for the account of *SPDC*. *MERALCO* and *SPDC*, in a letter-agreement dated February 15, 2017, agreed to extend the term of the *IPSA* until March 25, 2017 under the same terms and conditions of the *IPSA*. On February 16, 2017, *MERALCO* and *SPDC* filed a Joint Manifestation with Motion with the *ERC* apprising the Honorable Commision of the extended term and praying that the same be duly considered and approved accordingly. The hearings on this case have been completed and *MERALCO* filed its *FOE* on July 21, 2017.

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. *Altenergy* 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 with respect to 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. In its Decision dated June 8, 2015, the *ERC* approved *ATN*'s application for authority to develop, own and operate a dedicated point-to-point lines and facilities.

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 *DU*s, 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 *DU*s, *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, and (e) *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 (2) other private *DU*s.

Rate-setting under *PBR* is governed by the *RDWR*. The *PBR* scheme sets tariffs once every *RP* based on the *RAB* of the *DU*s, 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) *RY*s. An *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. The 4th *RP* for Group A *DU*s began on July 1, 2015 and shall end on June 30, 2019.

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 groups.

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 October 27, 2017, 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 October 27, 2017, 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 October 27, 2017, 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 October 27, 2017, the application is pending final approval by the *ERC*.

4th RP Reset Application

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 on April 12, 2016, the *ERC* posted on its website the following draft issuance for comments:

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 *DU*s under *RDWR"*.

Under *ERC* Resolution No. 25, Series of 2016 dated July 12, 2016, the *ERC* promulgated a resolution modifying the *RDWR* for Privately-Owned *DU*s Entering *PBR*. The *ERC* has directed *MERALCO* and *PEPOA* to publish the Resolution, including the need to await the final decision of the *ERC* on the Petition for Rule Making filed by a consumer group to amend the *PBR*.

An initial hearing was originally set by the *ERC* for January 9, 2017 and all interested parties were to file their comments on the Petition by December 26, 2016.

Subsequently, however, the *ERC* reset the hearing to January 23, 2017 and deadline for filing comments was January 23, 2017. *MERALCO* filed its Comment to the Petition on January 9, 2017. Hearings were scheduled on May 15 and June 21, 2017. The *ERC* will issue an Order on the date of the next public consultation.

In a Notice dated November 16, 2016, the *ERC* approved the draft "Regulatory Asset Base Roll Forward Handbook for Privately Owned Electricity Distribution Utilities" ("*RAB Handbook*") for posting in its website. All interested parties were given until December 19, 2016 to submit their respective comments to the draft *RAB Handbook*. Thereafter, during the public consultation on January 9, 2017, the parties were given until February 9, 2017 to file their comments to the draft *RAB Handbook*. In an Omnibus Motion filed on February 9, 2017, *MERALCO* submitted its initial comments to the draft *RAB Handbook* but moved for the deferment of the proceedings until the consumer group's Petition as referred in the foregoing has been resolved. As at October 27, 2017, the *ERC* has yet to resolve *MERALCO*'s Omnibus Motion.

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. *MERALCO* has completed the presentation of its evidence and is set to file its *FOE* after the *ERC* rules on pending motions. As at October 27, 2017, the *ERC* has yet to resolve the pending motions.

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, *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*. On July 25, 2016, *MERALCO* has filed its opposition to the *MR*. As at October 27, 2017, the *ERC* has yet to rule on the *MR*.

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 the Public Service Act. 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 constituting a substantial part of the *CAPEX* program, subject to certain conditions. On August 16, 2016, *MERALCO* filed a Motion for Partial Reconsideration on the requirement to submit an accounting of the depreciation fund. Hearings on the application have been completed. On September 14, 2016, *MERALCO* filed a Motion for Resolution. Subsequently, on April 25, 2017, *MERALCO* filed a Very Urgent Motion for Resolution of the Application. Thereafter, on October 18, 2017, *MERALCO* filed a Manifestation and Urgent Motion for Resolution. As at October 27, 2017, *MERALCO* is awaiting the final decision of the *ERC*.

CAPEX for RY 2018

On April 3, 2017, *MERALCO* filed an application for approval of authority to implement its *CAPEX* program for *RY* 2018 (July 1, 2017 to June 30, 2018) pursuant to the Public Service Act. On May 26, 2017, *MERALCO* received the Order dated May 15, 2017, granting *MERALCO* provisional authority to implement the 18 major projects and 36 residual projects constituting a substantial part of the *CAPEX* program, subject to certain conditions. Hearings were conducted on June 22 and August 1, 2017, August 25, 2017 and September 22, 2017. A conference was also conducted with the *ERC* technical staff and the intervenor on October 12, 2017. As at October 27, 2017, *MERALCO* shall be filing its *FOE* and submitting the case for resolution.

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*. A *RY* for *CEDC* begins on October 1 and ends on September 30. The 3*RP* for CEDC began October 1, 2015 and shall end on September 30, 2019.

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 3*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 and *LFT*. 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 *DU*s 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 October 27, 2017, a total of ₱251 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 October 27, 2017, the amount has been fully recovered.

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. The next hearing will be scheduled after the *ERC* resolves pending incidents.

On January 29, 2016, *MERALCO* filed its application to confirm its under-recoveries of generation charge for special programs of ₱250.7 million, excluding carrying charge, covering the period March 2007 to December 2011. As at October 27, 2017, the application is pending approval by the *ERC*.

On March 31, 2017, *MERALCO* filed its application with the *ERC* to confirm its net generation charge over-recoveries of ₱4,919 million, net transmission charge over-recoveries of ₱632 million, net lifeline subsidy over-recoveries of ₱131 million, net *SL* over-recoveries of ₱1,243 million, net senior citizen discount over-

recoveries of ₱2 million from January 2014 to December 2016 and real property tax ("*RPT*") payments under-recoveries of ₱1,090 million from June 2014 to December 2016. On May 11, 2017, the *ERC* approved *MERALCO*'s application to refund the over-recoveries of pass through charges (generation costs, transmission costs, system loss, life line subsidies and senior citizen discount subsidy) for the period January 2014 to December 2016 amounting to ₱6,927 billion. The Order did not act on *MERALCO*'s application to recover the *RPT* payments, citing the absence of any rule or guideline providing for the process of confirmation, approval and recovery of *RPT*. The refund was included in the June 2017 billings to customers and until August 2017. As at October 27, 2017, hearings are ongoing.

Application for Approval of the Staggered Recovery and Payment of the Differential Generation Charge for February 2017 Supply

On January 31, 2017, *MERALCO* filed an Application seeking the *ERC*'s approval of the staggered recovery and payment scheme for the generation charge for the February 2017 supply month to mitigate the impact of scheduled outages and maintenance of certain generation power plants. On March 6, 2017, the *ERC* provisionally approved the recovery of the incremental fuel cost through a staggered scheme. The incremental fuel cost was included in the March 2017 billings to customers until May 2017. As at October 27, 2017, the next hearing will be set after the necessary pleadings are filed by the intervenors to give *MERALCO* time to prepare the corresponding documents and to comment on said motions and manifestations

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 of related cases involving generation costs for the November and December 2013 supply months and the regulated *WESM* prices for the said period. As at October 27, 2017, the proceedings remain suspended.

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*. In July 2016, the amount has been fully recovered.

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 October 27, 2017, 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, 2017, a total of ₱2,290 million *LFT* and carrying charges have been billed to affected customers.

On June 13, 2013, *MERALCO* filed an application with the *ERC* for authority to collect *LFT* from the customers of 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 the 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 the City of Trece Martires and the corresponding carrying cost. Hearings have been completed. 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.

On December 5, 2016, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Manila and Quezon City as well as for authority to refund the differential *LFT* for 2014 to 2016 under the *TRAC* formula. Hearings have been completed and *MERALCO* filed its *FOE* on June 2, 2017. However, a consumer filed a motion to intervene after the termination of the proceedings. As of October 27, 2017, *MERALCO* has filed its opposition thereto and is awaiting the resolution of the *ERC* of the motion to intervene.

On October 25, 2017, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Biñan as well as for authority to refund the differential *LFT* for 2017 under the *TRAC* formula.

3. Benefit Sharing Scheme to Lower *SL*

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 *DU*s to reduce *SL* levels

below the cap set by the *ERC* and benefit the end-users through lower *SL* 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 October 27, 2017, 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 operations 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 mandating all *DU*s to submit to the *ERC* and *CRB* information on end-users with (i) monthly average peak demand of at least 1 *MW* for the preceding 12 months; and (ii) monthly average peak demand of 750 *kW* but not greater than 999 *kW*. The *ERC* shall use this information as basis for 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 Cicular essentially provided for mandatory contestability.

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. Provides 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 Supplier of last resort ("*SOLR*"), or, if applicable, procures power from the *WESM;*
2. Prohibits *DU*s from engaging in the supply of electricity to the contestable market except in its capacity as a *SOLR;*
3. Mandates Local *RES*s to wind down their supply businesses within a period of three (3) years;
4. Imposes upon all *RES*s, including *DU*-affiliate *RES*s, 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 *RES*s 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 Regional Trial Court ("*RTC*")-Pasig, 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.

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*. A similar petition was subsequently filed by the *DOE* before the *SC*.

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. In a resolution dated November 9, 2016, the *SC* denied *MERALCO*'s *MR* of the October 10, 2016 Resolution.

On November 2, 2016, in relation to the Petition filed by the *ERC*, the *SC* issued a Resolution dated September 26, 2016, which partially granted the *ERC* Petition. While the *SC* allowed the *RTC*-Pasig to proceed with the principal case of declaratory relief, it nonetheless issued a Preliminary Mandatory Injunction ("*PMI*") against *RTC*-Pasig to vacate the preliminary injunction it previously issued, and Preliminary Injunction ("*PI*") ordering the *RTC*-Pasig to refrain issuing further orders and resolutions tending to enjoin the implementation of *EPIRA*. On November 14, 2016, *MERALCO* filed a Motion for Partial Reconsideration with Very Urgent Motion to lift *PMI/PI*.

On November 24, 2016, the *ERC* promulgated a resolution moving the contestability date of end users with an average monthly peak demand of at least one (1) *MW* from December 31, 2016 to February 26, 2017. On January 17, 2017, *MERALCO*, through counsel, received an *SC* Resolution dated December 5, 2016, which consolidated the *SC DOE* Petition with the *SC ERC* Petition. The same resolution also denied the Motion for Partial Reconsideration filed by *MERALCO*.

In relation to the *ERC* and *DOE* Petitions, a separate Petition for Certiorari, Prohibition and Injuction was filed by several institutional customers. In the said Petition, said customers sought to declare as null and void, as well as to enjoin the *DOE* and *ERC* from implementing *DOE* Circular No. 2015-06- 0010, Series of 2015, *ERC* Resolution Nos. 5, 10, 11 and 28, Series of 2016. Acting on the Petition, the *SC en banc* through a Resolution dated February 21, 2017, issued a *TRO* enjoining the *DOE* and the *ERC* from implementing *DOE* Circular No. 2015-06- 0010 Series of 2015, *ERC* Resolution Nos. 5, 10, 11 and 28 Series of 2016. Pursuant to the foregoing, *PEMC* has taken the position that the *TRO* enjoined the voluntary contestability of 750 *kW* to 999 *kW* customers and has not allowed them to switch to the contestable market. The *DOE*, in a press release, has advised that it is in the process, together with *PEMC* and *ERC*, of drafting a general advisory for the guidance of *RCOA* stakeholders. The *PCCI* petition was consolidated with two (2) other separate petitions filed by an educational institution and several distribution utilities. The *DOE* and *ERC* have also filed a consolidated comment on these petitions.

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, 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 (i) adopt a permanent pre-emptive mitigating measure that will be applied in the *WESM*; (ii) direct all interested stakeholders to submit their proposed measures within 20 days from effectivity of such Resolution; and (iii) 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 which shall be applied 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 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*-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*-Pasig denied the Motion for Leave to File and Admit Supplemental Petition. *PIPPA* filed a Motion for Partial Reconsideration which was denied by the *RTC*-Pasig 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 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 floor price 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.

On December 7, 2015, the *RTC*-Pasig rendered a Decision dismissing the Petition for Declaratory Relief. The *MR* filed by *PIPPA* was denied in a Resolution dated June 16, 2016. *PIPPA* appealed the *RTC*-Pasig Decision with the *CA*. *MERALCO* has filed its comment thereto.

On May 9, 2017, the *ERC* issued Resolution No. 4, Series of 2017, entitled, "A Resolution Adopting Amendments to the Pre-emptive Mitigating Measure in the *WESM*". They adopted a recalculated cumulative price threshold level of ₱1,080,000 and a shorter 5-day (120-hour) rolling average period. This is equivalent to ₱9,000 per *MWh* over said period.

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" ("Guidelines"). Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *DU*s which are under the legislatively-authorized regulatory jurisdiction of the *ERC*. The Guidelines are the subject of an injunction case filed by the *DU*s at the *RTC*-Pasig.

On February 4, 2015, the *RTC*-Pasig 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 *RTC*-Pasig. *MERALCO* submitted the Tripartite Agreement among *PEZA*, *PEPOA* and *MERALCO* for approval of the *RTC*-Pasig. In a Decision dated July 3, 2015, the *RTC*-Pasig approved the Compromise Agreement between *PEZA*, *PEPOA* and *MERALCO*. In the hearing on February 10, 2016, the *RTC*-Pasig dismissed the petition upon motion by *PEZA*. The *ERC* filed a *MR* which is pending resolution by the *RTC*-Pasig.

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 (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 the 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.

8. Purchase of Subtransmission Assets *("STA*s")

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 *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 *TranCo*'s Motions. On June 5, 2014, *MERALCO* filed a clarificatory motion and a *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 Comments 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 Decision dated August 12, 2016, the *CA* dismissed the Petition. On September 17, 2016, *MERALCO* filed a *MR* which is pending before the CA.

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*-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, *RTC*-Pasig granting the Motions to Dismiss of both *TransCo* and *Labrador*. *MERALCO* filed a *MR* 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 (2) 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*.

9. Feed-in-Tariff *("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 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 shall 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 *TRO* and/or *WPI*, 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. The parties have been directed to submit their respective memoranda.

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 *MR* 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-All* 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. On May 18, 2017, the *ERC* approved the final *FiT-All* for calendar year 2016 of ₱0.1830 per *kWh* effective in the succeeding billing period after *TransCo* received the Decision. The final *FiT-All* rate was implemented starting June 2017 billing.

On September 29, 2016, Alternergy Wind One Corporation, Petrowind Energy, Inc. and Trans-Asia Renewable Energy Corporation filed a Petition to Initiate Rule-Making to adjust the Wind *FIT* rate of ₱7.40 per *kWh* to ₱7.93 per *kWh*. *MERALCO* filed an intervention in the case. The hearing on the Petition was set on January 6, 2017. *MERALCO*'s motion on the propriety of the petition has been submitted for the resolution of the *ERC*.

In May 2017, *TransCo* filed for an application with the *ERC* seeking to collect a *FiT-All* rate of ₱0.2291 per *kWh* for 2017. As at October 27, 2017, hearings are ongoing.

10. Net Metering Program

The *RE* Act mandates the *DU*s 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 *DU*s.

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 *DU*s' 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, 2017, *MERALCO* has already installed 976 meters and energized 870 Net Metering customers. *MERALCO* is the first *DU* in the country which implemented the Net Metering Program.

11. 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 *ILP*. *ILP* protocols, compensation and recovery mechanism are governed by *ERC* Resolution No. 5, Series of 2015 "A Resolution Adopting the Amended Rules to Govern the Interruptible Load Program" and *DOE* Circular No. DC2015-06-0003 "Providing the Interim Manner for Declaring Bilateral Contract Quantities in the Wholesale Electricity Spot Market and Directing the Philippine Electricity Market Corporation to Establish Necessary Protocols to Complement the Interruptible Load Program".

To prepare for the scheduled maintenance of the Malampaya gas facility, *MERALCO*, as directed by the *DOE*, conducted a forum for its customers participating in the *ILP* on January 19, 2017. Under the *ILP*, a customer may voluntarily reduce its load requirement from the grid usually by shifting its requirement to its generator set.

As at September 30, 2017, there are 169 companies with a total committed de-loading capacity of 657 *MW* that have signed up with *MERALCO*, *MPower* and with other retail electricity supplier as *ILP* participants.

12. 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 October 27, 2017, the *ERC* has yet to resolve *MERALCO*'s Motion for Partial Reconsideration.

13. 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, 2017, there are 76,763 customer availing of *PRES*.

14. *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 *DU*s 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 *DU*s to procure all its uncontracted demand through *CSP*, through the participation of a Third Party and which may be done by *DU*s 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. The *ERC* promulgated Resolution No. 13, Series of 2015.

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

- All *DU*s are required to undergo *CSP*. Pending the *ERC*'s issuance of a prescribed process, *DU*s 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 *PSA*s 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 (2) qualified bids for the *CSP* to be considered successful.

In reference to *PSA*s with provisions allowing the automatic renewal or extension of their term, *PSA*s 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 *PSA*s shall no longer be permitted.

On November 18, 2016, *MERALCO* received a copy of the Petition dated April 28, 2016 filed by a consumer group in the *SC* against *ERC*, *DOE*, *MERALCO*, *Central Luzon*, *St. Raphael*, *PEDC*, *Mariveles Power*, *A1E*, *RP Energy* and the Philippine Competition Commission which sought to declare as void Resolution No. 1, Series of 2016 and to mandate the *ERC* to disapprove all *PSA* applications for failing to comply with the *CSP* requirement. In a Resolution dated November 16, 2016, the *SC* directed all parties to comment on the Petition. *MERALCO* has filed its comments to the Petition. In a Resolution dated June 17, 2017, the petitioners were directed to file their replies to the comments filed by respondents.

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 *MERALCO* to enter into a long-term supply power 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 (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 *BOD*s 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 *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*, 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*-Pasig 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 at October 27, 2017, *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 (2) 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 ("*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 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 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. As at October 27, 2017, *MERALCO* is awaiting further action of the *SC* on the matter.

3. *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 *LGC*. *MERALCO* did not appeal *SC* Decision. The cases of the other *LGUs* are pending with their respective administrative bodies or government offices.

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* began the process of settlement with the *LGU*s.

On January 30, 2017, *PEPOA* filed a Petition for rule-making proposing that *RPT* be allowed as a pass-through cost in the light of the *SC* Decision. In an Order dated June 7, 2017, the case was set for hearings on August 7, 9 and 11, 2017, respectively. *MERALCO* filed its intervention and submitted its comments. As of October 27, 2017, the Petition is pending before the *ERC*.

4. *LFT* Assessments of Municipalities

Certain municipalities have served assessment notices on *MERALCO* for *LFT*. 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 *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* 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 *MR* 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*, *COA* and the *ERC* have filed their respective comments to the Petition. On June 22, 2017, *MERALCO* received the Motion for Leave to Intervene and Admit Comment-in-Intervention [Re: Petition dated September 2016] filed by other distribution utilities that sought to intervene in the case. In a Resolution dated July 11, 2017, the *SC* required the parties to comment on the motion to intervene and comment in intervention. The intervenors filed their Comment [On Motion for Leave and Admit Comment-in-Intervention] dated September 19, 2017. *COA* filed a Motion for Extension of Time to File Comment dated September 28, 2017 asking for an additional period until

October 29, 2017 to file its Comment. *MERALCO* filed its Comment on October 18, 2017. The parties are awaiting further action of the SC on the matter.

(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.

2017 Capital Expenditure Requirements (*in millions)*

Electric capital projects	₱13,017
Non-electric projects and other capitalized items	8,983
Total capital expenditures	₱22,000

MERALCO has a management-approved capital expenditure budget of ₱22,000 million for the year ending December 31, 2017, of which about 59% represents planned expenditures for the electric capital 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 *SGC*s 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 *SGC*s: *MPPCL*, *APRI*, *TLI*, *SMEC*, *Sem-Calaca* and *SPPC;* and
6) Deny the respective *MR*s 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 A*d Cautelam* and Comment and Opposition *Ad Cautelam*, respectively, on *MERALCO*'s Manifestation and Motion. On November 4, 2013, *MERALCO* filed its reply. As at October 27, 2017, *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 *MR* of 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*. As at October 27, 2017, *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 *SGC*s, 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 *SGC*s' 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-Rejoiner dated November 4, 2013. As at October 27, 2017, the Joint Motion to Dismiss is pending resolution by the *ERC*.

4. *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 October 27, 2017, *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. The hearings on this case have been completed. As at October 27, 2017, 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 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 *DU*s 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 *MR*. In an Order dated October 15, 2014, the *ERC* denied the *MR*. 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 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 October 27, 2017, 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 *ERC* into two (2) 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 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 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. In an Order dated June 13, 2017, the *ERC* denied the motion to consolidate but upheld the authority of private counsel to represent the Complainants. *MERALCO* filed a Motion for Partial Reconsideration to question such authority.

In an Order dated February 2, 2017, the *ERC* denied the motion to dismiss. *MERALCO* filed its Motion for Reconsideration of the Order on February 23, 2017. In an Order dated June 20, 2017, the *ERC* denied the Motion for Reconsideration. On September 19, 2017, *MERALCO* filed a Petition for Certiorari with the *CA*. In a Resolution dated October 2, 2017, the *CA* required respondents to file their Comment on the Petition within 10 days and held in abeyance its resolution on the prayer for injunctive relief until the comments have been filed. *MERALCO* was likewise given a period of five (5) days to file its reply. *MERALCO* is awaiting the comment of the respondents. In the meantime, *TMO* also filed a separate Petition for Review on Certiorari with the *CA*.

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*-Mandaluyong 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 *MR* dated November 6, 2015 of the Order admitting *MERALCO*'s intervention. The court issued an Order dated June 27, 2016 denying the *MR*. *SPPC* has elevated these orders to the *CA* through a Petition for Certiorari.

(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 97% 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 2017 quarterly sales in *GWh*.

First Quarter	9,317
Second Quarter	11,021
Third Quarter	11,063
Fourth Quarter	-
Total	31,401

The businesses of all other subsidiaries are not highly seasonal.

● 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, 2017.

● 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 (5) 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, 2017 and 2016.

Financial Highlights and Ratios[11] of Major Subsidiaries
As at and for the Nine Months Ended September 30, 2017 and 2016
(Amounts in million pesos except for financial ratios and % change)

	CEDC			***MGen***			***MIESCOR***			***e-MVI***			***CIS***		
	2017	**2016**	**% change**	**2017**	**2016**	**% change**	**2017**	**2016**	**% change**	**2017**	**2016**	**% change**	**2017**	**2016**	**% change**
Percentage of ownership	65%	65%		100%	100%		99%	99%		100%	100%		95%	100%	(5%)
Condensed Statements of Financial Position															
Total assets	2,239	2,098	7	17,973	18,979	(5)	4,586	3,936	17	2,017	1,721	17	2,124	1,531	39
Current assets	1,255	1,329	(6)	7,331	8,002	(8)	3,769	3,057	23	924	629	47	2,009	1,415	42
Cash and cash equivalents	903	864	5	1,365	2,375	(43)	533	583	(9)	601	387	55	819	700	17
Equity	1,376	1,218	13	17,897	18,932	(5)	1,340	1,242	8	1,659	1,377	20	1,075	822	31
Total debt[12]	-	-	-	-	-	-	634	476	33	-	-	-	-	-	-
Current liabilities	478	494	(3)	35	12	192	2,964	2,434	22	299	292	2	1,033	676	53
Financial Ratios															
Debt-to-equity ratio	-	-	-	-	-	-	0.47	0.38	23	-	-	-	-	-	-
Current ratio	2.63	2.69	(2)	209.46	666.83	(69)	1.27	1.26	1	3.09	2.15	44	1.94	2.09	(7)
Condensed Statements of Income															
Revenues	2,254	2,491	(10)	-	-	-	2,761	2,727	1	788	653	21	1,140	990	15
Costs and expenses	2,082	2,280	(9)	421	375	12	2,678	2,573	4	418	341	23	874	732	19
Net income (loss)	166	203	(18)	-	(169)	(100)	58	144	(60)	278	252	10	193	179	8
Financial Ratios															
Profit margin	7.4%	8.1%	(10)	-	-	-	2.1%	5.3%	(60)	35.3%	38.6%	(9)	16.9%	18.1%	(6)
Return on equity	12.1%	16.7%	(28)	-	(0.9%)	(100)	4.3%	11.6%	(63)	16.8%	18.3%	(8)	18.0%	21.8%	(18)
Asset turnover	1.01	1.19	(15)	-	-	-	0.60	0.69	(13)	0.39	0.38	3	0.54	0.65	(17)

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, 2017

(Amounts in millions)

	T o t a l	**1 - 30 days**	**31 - 60 days**	**61 - 90 days**	**Over 90 days**
Trade receivables					
A) Billed trade receivables					
Residential	₱9,878	₱7,144	₱492	₱144	₱2,098
Commercial	7,930	6,818	213	51	848
Industrial	3,125	2,919	14	26	166
Flat Streetlights	268	150	12	8	98
Total billed trade receivables	21,201	17,031	731	229	3,210
B) Unbilled trade receivables	3,548	3,548	–	–	–
Total trade receivables	24,749	20,579	731	229	3,210
Other trade receivables	5,195	2,310	253	81	2,551
Gross trade receivables	**29,944**	**22,889**	**984**	**310**	**5,761**
Non-trade receivables	1,343	1,002	33	72	236
Total receivables	**31,287**	**23,891**	**1,017**	**382**	**5,997**
Allowance for doubtful accounts	(2,981)	–	–	–	(2,981)
Net receivables	**₱28,306**	**₱23,891**	**₱1,017**	**₱382**	**₱3,016**

Manila Electric Company and Subsidiaries

Consolidated Financial Statements As at September 30, 2017 (Unaudited) and December 31, 2016 (Audited)

and For the Nine Months Ended September 30, 2017 and 2016 (Unaudited)

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

	Note	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
		(Amounts in millions)	
ASSETS			
Noncurrent Assets			
Utility plant and others	*7, 10 and 15*	**₱132,022**	₱128,814
Investments in associates and interests in joint ventures	*8 and 22*	**11,710**	10,924
Investment properties	*9 and 15*	**1,510**	1,513
Deferred tax assets - net	*27*	**15,345**	13,019
Other noncurrent assets	*2, 7, 10, 14, 25, 26, 28 and 29*	**45,803**	53,759
Total Noncurrent Assets		**206,390**	208,029
Current Assets			
Cash and cash equivalents	*11, 24 and 26*	**46,699**	46,656
Trade and other receivables	*10, 12 and 26*	**28,306**	25,341
Inventories	*13 and 24*	**3,383**	2,792
Other current assets	*10, 14, 22 and 26*	**19,775**	13,219
Total Current Assets		**98,163**	88,008
Total Assets		**₱304,553**	₱296,037
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	*3*	**(126)**	(328)
Employee stock purchase plan	*15*	**1,049**	1,049
Unrealized fair value losses on available-for-sale (*AFS*) financial assets	*10*	**(63)**	(271)
Remeasurement adjustments on retirement and other post-employment liabilities	*25*	**3,934**	3,384
Share in remeasurement adjustments on associates' retirement liabilities	*8*	**(10)**	(12)
Cumulative translation adjustments of subsidiaries and associates	*8*	**1,033**	1,085
Treasury shares	*15*	**(11)**	(11)
Retained earnings	*15*	**49,524**	54,137
Equity Attributable to Equity Holders of the Parent		**70,714**	74,417
Non-controlling Interests		**800**	729
Total Equity		**71,514**	75,146

(Forward)

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
		(Amounts in millions)	
Noncurrent Liabilities			
Interest-bearing long-term financial liabilities - net of current portion	*16, 24 and 26*	**₱24,836**	₱26,999
Customers' deposits - net of current portion	*17, 21 and 26*	**23,548**	23,501
Long-term employee benefits	*25*	**4,165**	3,119
Provisions	*18, 21 and 28*	**18,055**	19,170
Refundable service extension costs - net of current portion	*21 and 26*	**5,590**	4,927
Deferred tax liabilities - net	*27*	**49**	36
Other noncurrent liabilities	*2, 5, 7, 23 and 28*	**42,958**	38,537
Total Noncurrent Liabilities		**119,201**	116,289
Current Liabilities			
Notes payable	*20, 24 and 26*	**13,469**	11,475
Trade payables and other current liabilities	*15, 16, 17, 18, 21, 22, 23, 26 and 28*	**90,516**	83,920
Customers' refund	*2, 19 and 26*	**4,626**	4,988
Income tax payable		**3,382**	2,346
Current portion of interest-bearing long-term financial liabilities	*16, 24 and 26*	**1,845**	1,873
Total Current Liabilities		**113,838**	104,602
Total Liabilities		**233,039**	220,891
Total Liabilities and Equity		**₱304,553**	₱296,037

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	**2017**	2016	**2017**	2016
		(Amounts in millions, except per share data)			
REVENUES					
Sale of electricity	*22, 23, 29 and 31*	**₱208,848**	₱189,135	**₱71,439**	₱64,366
Sale of other services	*9 and 22*	**5,541**	6,029	**1,918**	1,994
		214,389	195,164	**73,357**	66,360
COSTS AND EXPENSES					
Purchased power	*23 and 29*	**162,777**	144,423	**55,094**	48,985
Salaries, wages and employee benefits	*24 and 25*	**9,403**	9,393	**3,020**	3,101
Provision for probable losses and expenses from claims	*18, 23 and 28*	**7,541**	6,894	**3,492**	3,289
Depreciation and amortization	*7, 9 and 10*	**5,231**	5,206	**1,769**	1,740
Contracted services		**4,408**	4,067	**1,396**	1,430
Taxes, fees and permits		**707**	733	**134**	242
Other expenses	*22 and 24*	**3,741**	4,225	**1,360**	1,315
		193,808	174,941	**66,265**	60,102
OTHER INCOME (EXPENSES)					
Interest and other financial income	*11 and 24*	**1,633**	1,528	**558**	558
Interest and other financial charges	*7, 16, 17, 20 and 24*	**(1,147)**	(984)	**(397)**	(369)
Foreign exchange gains		**393**	477	**112**	424
Equity in net earnings (losses) of associates and joint ventures	*8*	**322**	(133)	**92**	(158)
Others	*2, 22 and 29*	**456**	880	**192**	267
		1,657	1,768	**557**	722
INCOME BEFORE INCOME TAX		**22,238**	21,991	**7,649**	6,980
PROVISION FOR (BENEFIT FROM) INCOME TAX	*27*				
Current		**8,799**	8,008	**3,410**	2,972
Deferred		**(2,579)**	(1,837)	**(1,211)**	(937)
		6,220	6,171	**2,199**	2,035
NET INCOME		**₱16,018**	₱15,820	**₱5,450**	₱4,945
Attributable To					
Equity holders of the Parent	*30*	**₱15,928**	₱15,676	**₱5,427**	₱4,908
Non-controlling interests		**90**	144	**23**	37
		₱16,018	₱15,820	**₱5,450**	₱4,945
Earnings Per Share Attributable to Equity Holders of the Parent	*30*				
Basic		**₱14.13**	₱13.91	**₱4.82**	₱4.35
Diluted		**14.13**	13.91	**4.82**	4.35

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	**2017**	2016	**2017**	2016
		(Amounts in millions)			
NET INCOME		**₱16,018**	₱15,820	**₱5,450**	₱4,945
OTHER COMPREHENSIVE INCOME					
Items that will be reclassified to profit or loss in subsequent period:					
Unrealized fair value gain on available-for-sale financial assets	*10*	**231**	757	**(30)**	(136)
Income tax effect		**(23)**	(76)	**3**	13
		208	681	**(27)**	(123)
Cumulative translation adjustments of subsidiaries and associates	*8*	**(52)**	559	**218**	99
Items that will not be reclassified to profit or loss in subsequent period:					
Remeasurement adjustments on retirement and other post-employment liabilities	*25*	**789**	(24)	**815**	–
Income tax effect		**(237)**	7	**(245)**	–
		552	(17)	**570**	–
Share in remeasurement adjustments on associates' retirement liabilities		**2**	–	**–**	–
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAX		**710**	1,223	**761**	(24)
TOTAL COMPREHENSIVE INCOME, NET OF INCOME TAX		**₱16,728**	₱17,043	**₱6,211**	₱4,921
Total Comprehensive Income Attributable To					
Equity holders of the Parent		**₱16,636**	₱16,899	**₱6,186**	₱4,884
Non-controlling interests		**92**	144	**25**	37
		₱16,728	₱17,043	**₱6,211**	₱4,921

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, 2017 AND 2016

	Equity Attributable to Equity Holders of the Parent													
	Common Stock (Note 15)	**Additional Paid-in Capital**	**Excess of Acquisition Cost Over Carrying Value of Non-controlling Interest Acquired**	**Employee Stock Purchase Plan** (Note 15)	**Unrealized Fair Value Gains (Losses) on AFS Financial Assets** (Note 10)	**Remeasure-ment Adjustments on Retirement and Other Post-Employment Liabilities** (Note 25)	**Share in Remeasure-ment Adjustments on Associates' Retirement Liabilities** (Note 8)	**Cumulative Translation Adjustments of Subsidiaries and Associates** (Note 8)	**Treasury Shares** (Note 15)	**Appropriated Retained Earnings** (Note 15)	**Unappro-priated 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, 2017	**₱11,273**	**₱4,111**	**(₱328)**	**₱1,049**	**(₱271)**	**₱3,384**	**(₱12)**	**₱1,085**	**(₱11)**	**₱–**	**₱54,137**	**₱74,417**	**₱729**	**₱75,146**
Net income	–	–	–	–	–	–	–	–	–	–	**15,928**	**15,928**	**90**	**16,018**
Other comprehensive income (loss)	–	–	–	–	**208**	**550**	**2**	**(52)**	–	–	–	**708**	**2**	**710**
Total comprehensive income (loss)	–	–	–	–	**208**	**550**	**2**	**(52)**	–	–	**15,928**	**16,636**	**92**	**16,728**
Additional investment of non-controlling interests	–	–	–	–	–	–	–	–	–	–	–	–	**19**	**19**
Excess of acquisition cost of controlling interest over carrying value of additional minority interest	–	–	**202**	–	–	–	–	–	–	–	–	**202**	–	**202**
Dividends	–	–	–	–	–	–	–	–	–	–	**(20,541)**	**(20,541)**	**(40)**	**(20,581)**
At September 30, 2017	**₱11,273**	**₱4,111**	**(₱126)**	**₱1,049**	**(₱63)**	**₱3,934**	**(₱10)**	**₱1,033**	**(₱11)**	**₱–**	**₱49,524**	**₱70,714**	**₱800**	**₱71,514**
At January 1, 2016	₱11,273	₱4,111	(₱328)	₱1,049	₱102	₱935	(₱12)	(₱72)	(₱11)	₱11,000	₱52,229	₱80,276	₱585	₱80,861
Net income	–	–	–	–	–	–	–	–	–	–	15,676	15,676	144	15,820
Other comprehensive income (loss)	–	–	–	–	681	(17)	–	559	–	–	–	1,223	–	1,223
Total comprehensive income (loss)	–	–	–	–	681	(17)	–	559	–	–	15,676	16,899	144	17,043
Additional investment of non-controlling interests	–	–	–	–	–	–	–	–	–	–	–	–	35	35
Dividends	–	–	–	–	–	–	–	–	–	–	(28,268)	(28,268)	(28)	(28,296)
Reversal of appropriation	–	–	–	–	–	–	–	–	–	(11,000)	11,000	–	–	–
	–	–	–	–	–	–	–	–	–	(11,000)	(17,268)	(28,268)	(28)	(28,296)
At September 30, 2016	₱11,273	₱4,111	(₱328)	₱1,049	₱783	₱918	(₱12)	₱487	(₱11)	₱–	₱50,637	₱68,907	₱736	₱69,643

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	
	Note	**2017**	2016
		(Amounts in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax		**₱22,238**	₱21,991
Adjustments for:			
Provision for probable losses and expenses from claims – net	*18, 23 and 28*	**6,300**	6,793
Depreciation and amortization	*7, 9 and 10*	**5,231**	5,206
Interest and other financial income	*24*	**(1,633)**	(1,528)
Interest and other financial charges	*24*	**1,147**	984
Equity in net losses (earnings) of associates and joint ventures	*8*	**(322)**	133
Provision for doubtful accounts	*12*	**10**	199
Others		**(168)**	(221)
Operating income before working capital changes		**32,803**	33,557
Decrease (increase) in:			
Trade and other receivables		**(4,749)**	186
Inventories		**(591)**	(565)
Other current assets		**(490)**	669
Increase (decrease) in:			
Trade payables and other current liabilities		**2,343**	(2,589)
Customers' refund		**(362)**	(472)
Customers' deposits		**2,837**	2,979
Long-term employee benefits		**1,864**	(2,319)
Cash generated from operations		**33,655**	31,446
Income tax paid		**(7,250)**	(5,352)
Net cash flows provided by operating activities		**26,405**	26,094
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to:			
Available-for-sale financial assets	*10*	**(24,322)**	(73,847)
Utility plant and others	*7*	**(7,845)**	(7,397)
Held-to-maturity investments	*10*	**(963)**	(8,436)
Investments in associates and interests in joint ventures	*8 and 14*	**(616)**	(1,402)
Intangible assets	*10*	**(117)**	(112)
Proceeds from sale of:			
Available-for-sale financial assets		**29,041**	60,325
Held-to-maturity investments		**1,244**	1,742
Interest and other financial income received		**1,063**	822
Proceeds from disposal of utility plant and others		**125**	354
Dividends received from associates		**95**	82
Increase (decrease) in minority interest due to acquisition of a subsidiary		**(21)**	7
Proceeds from disposal of interest in an associate		**–**	3,151
Increase (decrease) in other noncurrent assets		**(4,204)**	396
Net cash used in investing activities		**(6,520)**	(24,315)

(Forward)

		Unaudited	
		For the Nine Months Ended September 30	
	Note	**2017**	**2016**
		(Amounts in millions)	
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from:			
Availment of notes payable	*20*	**₱4,271**	₱10,222
Availment of interest-bearing long-term financial liabilities	*16*	**603**	**–**
Investment of minority interest		**202**	**–**
Payments of:			
Dividends	*15*	**(20,586)**	(28,110)
Notes payable	*20*	**(2,276)**	(29)
Interest and other financial charges		**(1,094)**	(951)
Interest-bearing long-term financial liabilities		**(2,813)**	(405)
Increase in other noncurrent liabilities		**1,851**	3,235
Net cash used in financing activities		**(19,842)**	(16,038)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**43**	(14,259)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		**46,656**	50,840
CASH AND CASH EQUIVALENTS AT END OF PERIOD	*11*	**₱46,699**	₱36,581

See accompanying 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 directly through its local *RES* unit, *MPower* and indirectly through its affiliate *RES* entities. The *ERC* granted the following subsidiaries distinct *RES* licenses to operate as affiliate retail electricity suppliers in Luzon and Visayas, namely; Vantage Energy Solutions and Management, Inc. ("*Vantage*"), a wholly owned subsidiary of *MERALCO*; Solvre, Inc., a wholly owned subsidiary of MERALCO PowerGen Corporation ("*MGen*"); and MeridianX Inc. ("*MeridianX*"), a wholly owned subsidiary of Comstech Integration Alliance, Inc. ("*Comstech*"), on January 10, 2017, February 9, 2017 and February 9, 2017, respectively.

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 is developing power generation plants through its wholly owned subsidiary, *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 has 50% equity interest in Pure Meridian Hydropower Corporation ("*Pure Meridian*") which is focused on the development of various mini-hydroelectric power projects.

MERALCO manages the electric distribution facilities of Pampanga Electric Cooperative II ("*PELCO II*") through *Comstech* under an Investment Management Contract ("*IMC*"). *MERALCO* also manages the 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, Metro Pacific Investments Corporation ("*Metro Pacific*") and JG Summit Holdings, Inc. ("*JG Summit*"). *Metro Pacific* has direct equity interest in *MERALCO* and indirect ownership through its wholly owned subsidiary, Beacon Electric Asset Holdings, Inc. *Metro Pacific*'s direct and indirect ownership interest in *MERALCO* is 45.5% as at September 30, 2017 and 41.2% as at December 31, 2016. 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 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 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 (2) other private *DU*s.

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 ("*RAB*") of each *DU*, 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 4th *RP* for Group A *DU*s 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 October 27, 2017, 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 October 27, 2017, 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 October 27, 2017, 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 October 27, 2017, the application is pending final approval by the *ERC*.

4th RP Reset Application

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 on April 12, 2016, the *ERC* posted on its website the following draft issuance for comments:

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 *DU*s under the *RDWR*".

Under *ERC* Resolution No. 25, Series of 2016 dated July 12, 2016, the *ERC* promulgated a Resolution modifying the *RDWR* for Privately-Owned *DU*s Entering *PBR*. The *ERC* has directed

MERALCO and Private Electric Power Operators Association ("*PEPOA*") to publish the Resolution. However, *MERALCO* is seeking clarification from the *ERC* on certain issues regarding the Resolution, including the need to await the final decision of the *ERC* on the Petition for Rule Making filed by a consumer group to amend the *PBR*.

An initial hearing on the Petition for Rule Making was originally set by the *ERC* for January 9, 2017 and all interested parties were to file their comments on the Petition by December 26, 2016.

Subsequently, however, the *ERC* reset the hearing to January 23, 2017 with the deadline for filing of comments set on January 23, 2017. *MERALCO* filed its Comment to the Petition on January 9, 2017. Hearings were conducted on May 15 and June 21, 2017. The *ERC* will issue an Order on the date of the next public consultation.

In a Notice dated November 16, 2016, the *ERC* approved the draft "Regulatory Asset Base Roll Forward Handbook for Privately Owned Electricity Distribution Utilities" ("*RAB Handbook*") for posting in its website. All interested parties were given until December 19, 2016 to submit their respective comments to the draft *RAB Handbook*. Thereafter, during the public consultation on January 9, 2017, the parties were given until February 9, 2017 to file their comments to the draft *RAB Handbook*. In an Omnibus Motion filed on February 9, 2017, *MERALCO* submitted its initial comments to the draft *RAB Handbook* but moved for the deferment of the proceedings until the consumer group's Petition as referred in the foregoing has been resolved. As at October 27, 2017, the *ERC* has yet to resolve *MERALCO*'s Omnibus Motion.

Interim Average Rate for RY 2016

On June 11, 2015, *MERALCO* filed its application for the approval of a 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. *MERALCO* has completed the presentation of its evidence and is set to file its Formal Offer of Evidence ("*FOE*") after the *ERC* rules on pending motions. As at October 27, 2017, the *ERC* has yet to resolve the pending motions.

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, *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 Reconsideration. As at October 27, 2017, the *ERC* has yet to rule on the *MR*s.

CAPEX for RY 2017

On March 8, 2016, *MERALCO* again filed an application for approval of authority to implement its *CAPEX* program for *RY* 2017 (July 1, 2016 to June 30, 2017) pursuant to the Public Service Act. 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 constituting a substantial part of the *CAPEX* program, subject to certain conditions. On August 16, 2016, *MERALCO* filed a Motion for Partial Reconsideration on the requirement to submit an accounting of the depreciation fund. Hearings on the application have been completed. On September 14, 2016, *MERALCO* filed a Motion for Resolution. Subsequently, on April 25, 2017, *MERALCO* filed a Very Urgent Motion for Resolution of the Application. Thereafter, on October 18, 2017, *MERALCO* filed a Manifestation and Urgent Motion for Resolution. As at October 27, 2017, *MERALCO* is awaiting the final decision of the *ERC*.

CAPEX for RY 2018

On April 3, 2017, *MERALCO* filed an application for approval of authority to implement its *CAPEX* program for *RY* 2018 (July 1, 2017 to June 30, 2018) pursuant to the Public Service Act. On May 26, 2017, *MERALCO* received the Order dated May 15, 2017, granting *MERALCO* provisional authority to implement the 18 major projects and 36 residual projects constituting a substantial part of the *CAPEX* program, subject to certain conditions. Hearings were conducted on June 22 and August 1, 2017, August 25, 2017 and September 22, 2017. A conference was also conducted with the *ERC* technical staff and the intervenor on October 12, 2017. As at October 27, 2017, *MERALCO* shall be filing its *FOE* and submitting the case for resolution.

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*. A *RY* for *CEDC* begins on October 1 and ends on September 30. The 3*RP* for *CEDC* began on October 1, 2015 and shall end on September 30, 2019. *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 3rd *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* 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 an *MR* on 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*, *COA* and the *ERC* have filed their respective comments to the Petition. On June 22, 2017, *MERALCO* received the Motion for Leave to Intervene and Admit Comment-in-Intervention [Re: Petition dated September 2016] filed by other *DU*s that sought to intervene in the case. In a Resolution dated July 11, 2017, the *SC* required the parties to comment on the motion to intervene and comment in intervention. The intervenors filed their Comment [On Motion for Leave and Admit Comment-in-Intervention] dated September 19, 2017. *COA* filed a Motion for Extension of Time to File Comment dated September 28, 2017 asking for an additional period until October 29, 2017 to file its Comment. *MERALCO* filed its Comment on October 18, 2017. The parties are awaiting further action of the *SC* on the matter.

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 *DU*s 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 carrying charges, starting the next billing cycle until such time that the full amount has been collected. As at September 30, 2017, a total of ₱251 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 carrying charges, starting the next billing cycle until such time that the full amount has been collected. As at September 30, 2017, the amount has been fully recovered.

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. As at September 30, 2017, hearings are ongoing.

On January 29, 2016, *MERALCO* filed its application to confirm its under-recoveries of generation charge for special programs of ₱250.7 million, excluding carrying charge, covering the period March 2007 to December 2011. As at September 30, 2017, the application is pending approval by the *ERC*.

On March 31, 2017, *MERALCO* filed its application with the *ERC* to confirm its net generation charge over-recoveries of ₱4,919 million, net transmission charge over-recoveries of ₱632 million, net lifeline subsidy over-recoveries of ₱131 million, net *SL* over-recoveries of ₱1,243 million, net senior citizen discount over-recoveries of ₱2 million from January 2014 to December 2016 and real property tax ("*RPT*") payments under-recoveries of ₱1,090 million from June 2014 to December 2016. On May 11, 2017, the *ERC* approved *MERALCO*'s application to refund the over-recoveries of pass through charges (generation costs, transmission costs, system loss, life line subsidies and senior citizen discount subsidy) for the period January 2014 to December 2016 amounting to ₱6,927 million. The Order did not act on *MERALCO*'s application to recover the *RPT* payments, citing the absence of any rule or guideline providing for the process of confirmation, approval and recovery of *RPT*. The refund was included in the June 2017 billings to customers and until August 2017. On September 7, 2017, *MERALCO* filed a Manifestation and

Motion informing the *ERC* that the absolute amount of the remaining over/under recoveries were applied to the September 2017 billing in order to zero out the refund as directed by the *ERC*. As at October 27, 2017, hearings are ongoing.

Application for Approval of the Staggered Recovery and Payment of the Differential Generation Charge for February 2017 Supply

On January 31, 2017, *MERALCO* filed an Application seeking the *ERC*'s approval of the staggered recovery and payment scheme for the generation charge for the February 2017 supply month to mitigate the impact of scheduled outages and maintenance of certain generation power plants. On March 6, 2017, the *ERC* provisionally approved the recovery of the incremental fuel cost through a staggered scheme. The incremental fuel cost was included in the March 2017 billings to customers until May 2017. As at September 30, 2017, hearings are ongoing.

Application for the Recovery of Differential Generation Costs

On February 17, 2014, *MERALCO* filed for the recovery of the unbilled generation costs for December 2013 supply month amounting to ₱11,075 million. An amended application was filed on March 25, 2014 to adjust the unbilled generation costs 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 at the *SC* involving generation costs for the November and December 2013 supply months and the regulated *WESM* prices for the said period. As at October 27, 2017, the proceedings remain suspended.

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 ₱0.0207 per *kWh*, and carrying costs amounting to ₱198 million, or an equivalent ₱0.0013 per *kWh*. In July 2016, the amount has been fully recovered.

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 ₱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 October 27, 2017, 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, 2017, a total of ₱2,297 million of *LFT* and carrying charges have been billed to affected customers. The remaining unbilled amount is included in the "Trade and other receivables" account.

On June 13, 2013, *MERALCO* filed an application with the *ERC* for authority to collect *LFT* from customers of 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 had previously paid to the City of Trece Martires and the corresponding carrying cost**.** Hearings have been completed. 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.

On December 5, 2016, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Manila and Quezon City as well as for authority to refund the differential *LFT* for 2014 to 2016 under the *TRAC* formula. Hearings have been completed and *MERALCO* filed its

FOE on June 2, 2017. However, a consumer filed a motion to intervene after the termination of the proceedings. As at October 27, 2017, *MERALCO* has filed its opposition thereto and is awaiting the resolution of the *ERC* of the motion to intervene.

On October 25, 2017, *MERALCO* filed the application for authority to implement the new *LFT* rates in the City of Biñan as well as for authority to refund the differential *LFT* for 2017 under the *TRAC* formula.

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 19 – 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, held-to-maturity ("*HTM*") investments 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, 2017 and December 31, 2016.

Subsidiaries	Place of Incorporation	Principal Business Activity	2017 Percentage of Ownership Direct	2017 Indirect	2016 Direct	2016 Indirect
Corporate Information Solutions, Inc. ("*CIS*")	Philippines	e-Transactions	**100**	–	100	–
CIS Bayad Center, Inc. ("*Bayad Center*") [1]	Philippines	Bills payment collection	–	**95**	–	100
Customer Frontline Solutions, Inc. ("*CFSI*")	Philippines	Tellering services	–	**100**	–	100
Fieldtech Specialist, Inc. ("*Fieldtech*")	Philippines	Bills payment collection	–	**51**	–	51
Meralco Energy, Inc. ("*MServ*")	Philippines	Energy systems management	**100**	–	100	–
Aurora Managed Power Services, Inc. ("*AMPSI*")	Philippines	Energy systems management	–	**60**	–	60
eMeralco Ventures, Inc. ("*e-MVI*")	Philippines	e-Business development	**100**	–	100	–
Paragon Vertical Corporation ("*Paragon*")	Philippines	Information technology *("IT")* and multi-media services	–	**100**	–	100
Radius Telecoms, Inc. ("*Radius*")	Philippines	*IT* and multi-media services	–	**100**	–	100
MGen	Philippines	Development of power generation plants	**100**	–	100	–
Calamba Aero Power Corporation[2]	Philippines	Power generation	–	**100**	–	100
Atimonan Land Ventures Development Corporation	Philippines	Real estate	–	**100**	–	100
Atimonan One Energy, Inc. ("*A1E*") [3]	Philippines	Power generation	–	**100**	–	100
MPG Holdings Phils., Inc.	Philippines	Holding company	–	**100**	–	100
MPG Asia Limited ("*MPG Asia*")	British Virgin Islands	Holding company	–	**100**	–	100
Solvre, Inc. [4]	Philippines	Retail electricity supplier	–	**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 [5]	Nigeria	Management of power distribution	**100**	–	100	–
MSpectrum, Inc. ("*Spectrum*")	Philippines	Renewable energy	**100**	–	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	–
Clarion Energy Management Inc. ("*Clarion*") [6]	Philippines	Retail electricity supplier	–	**65**	–	65
Comstech	Philippines	Management of power distribution	**60**	–	60	–
MeridianX Inc.[7]	Philippines	Retail electricity supplier	–	**60**	–	60
Vantage[8]	Philippines	Retail electricity supplier	**100**	–	100	–

[1] *In 2017, Densan System Co. Ltd. (a Japanese company) subscribed to 5% equity of Bayad Center.*
[2] *Incorporated on February 15, 2011 and has not started commercial operations as at September 30, 2017.*
[3] *Incorporated on January 11, 2013 and has not started commercial operations as at September 30, 2017.*
[4] *Incorporated on November 14, 2016 and has not started commercial operations as at September 30, 2017.*
[5] *Incorporated on October 2, 2013 and has not started commercial operations as at September 30, 2017.*
[6] *Incorporated on November 11, 2016 and has not started commercial operations as at September 30, 2017.*
[7] *Incorporated on November 21, 2016 and has not started commercial operations as at September 30, 2017.*
[8] *Incorporated on November 10, 2016 and started commercial operations on January 10, 2017.*

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 (1) 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 period 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* and subsidiary, *Comstech*, *AMPSI, Fieldtech* and *Bayad Center* 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.

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 previous periods except with respect to the adoption of the following amendments and improvements to existing standards, which were effective beginning January 1, 2017.

Amendment to PFRS 12, Clarification of the Scope of the Standard (Part of Annual Improvements to PFRSs 2014 – 2016 Cycle)

The amendments clarify that the disclosure requirements in *PFRS 12*, other than those relating to summarized financial information, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale.

Amendments to PAS 7, Statement of Cash Flows, Disclosure Initiative

The amendments to *PAS 7* require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). On initial application of the amendments, entities are not required to provide comparative information for preceding periods.

Amendments to PAS 12, Income Taxes, Recognition of Deferred Tax Assets for Unrealized Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognized in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact.

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, 2017.

Effective beginning on or after January 1, 2018

Amendments to PFRS 2, Share-based Payment, Classification and Measurement of Share-based Payment Transactions

The amendments to *PFRS 2* address three (3) main areas: (i) the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; (ii) the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and (iii) the accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three (3) amendments and if other criteria are met. Early application of the amendments is permitted.

Amendments to PFRS 4, Insurance Contracts, Applying PFRS 9, Financial Instruments, with PFRS 4

The amendments address concerns arising from implementing *PFRS 9*, the new financial instruments standard before implementing the forthcoming insurance contracts standard. They allow entities to choose between the overlay approach and the deferral approach to deal with the transitional challenges. The overlay approach gives all entities that issue insurance contracts the option to recognize in other comprehensive income ("*OCI*"), rather than profit or loss, the volatility that could arise when *PFRS 9* is applied before the new insurance contracts standard is

issued. On the other hand, the deferral approach gives entities whose activities are predominantly connected with insurance an optional temporary exemption from applying *PFRS 9* until the earlier of application of the forth coming insurance contracts standard or January 1, 2021.

The overlay approach and the deferral approach will only be available to an entity if it has not previously applied *PFRS 9*.

PFRS 15, Revenue from Contracts with Customers

PFRS 15 establishes a new five (5)-step model that will apply to revenue arising from contracts with customers. Under *PFRS 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 principles in *PFRS 15* provide a more structured approach to measuring and recognizing revenue.

The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under *PFRSs*. Either a full or modified retrospective application is required for annual periods beginning on or after January 1, 2018. The *MERALCO Group* is currently assessing the potential effect of *PFRS 15* on its consolidated financial statements.

PFRS 9, Financial Instruments

PFRS 9 reflects all phases of the financial instruments project and replaces *PAS* 39, *Financial Instruments: Recognition and Measurement*, 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 providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions. The adoption of *PFRS 9* will have an effect on the classification and measurement of the *MERALCO Group*'s financial assets and impairment methodology for financial assets, but will have no impact on the classification and measurement of the *MERALCO Group*'s financial liabilities.

Amendments to PAS 28, Measuring an Associate or Joint Venture at Fair Value (Part of Annual Improvements to PFRSs 2014 – 2016 Cycle)

The amendments clarify that an entity that is a venture capital organization, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss ("*FVPL*"). They also clarify that if an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which (a) the investment entity associate or joint venture is initially recognized; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent. The amendments should be applied retrospectively, with earlier application permitted.

Amendments to PAS 40, Investment Property, Transfers of Investment Property

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. The amendments should be applied prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is only permitted if this is possible without the use of hindsight.

Philippine Interpretation IFRIC-22, Foreign Currency Transactions and Advance Consideration

The interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the nonmonetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. The interpretation may be applied on a fully retrospective basis. Entities may apply the interpretation prospectively to all assets, expenses and income in its scope that are initially recognized on or after the beginning of the reporting period in which the entity first applies the interpretation or the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

Effective Beginning on or after January 1, 2019

PFRS 16, Leases

Under the new standard, lessees will no longer classify their leases as either operating or finance leases in accordance with *PAS 17*, *Leases*. Rather, lessees will apply the single-asset model. Under this model, lessees will recognize the assets and related liabilities for most leases on their balance sheets, and subsequently, will depreciate the lease assets and recognize interest on the lease liabilities in their profit or loss. Leases with a term of 12 months or less or for which the underlying asset is of low value are exempted from these requirements.

The accounting by lessors is substantially unchanged as the new standard carries forward the principles of lessor accounting under *PAS 17*. Lessors, however, will be required to disclose more information in their financial statements, particularly on the risk exposure to residual value. Entities may early adopt *PFRS 16* but only if they have also adopted *PFRS 15*. When adopting *PFRS 16*, an entity is permitted to use either a full retrospective or a modified retrospective approach, with options to use certain transition reliefs.

Deferred Effectivity

Amendments to PFRS 10 and PAS 28, Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between *PFRS 10* and *PAS 28* in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that a full gain or loss is recognized when a transfer to an associate or joint venture

involves a business as defined in *PFRS 3*, *Business Combinations*. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture.

On January 13, 2016, the Financial Reporting Standards Council postponed the original effective date of January 1, 2016 of the said amendments until the International Accounting Standards Board has completed its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

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, amortization and 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 transition 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* in profit or loss. 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 transaction 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 date.

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, intangible assets, investment properties, investments in associates and interests in joint ventures, receivable from the Bureau of Internal Revenue *("BIR"),* 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 periods. 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 *FVPL*, loans and receivables, *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, advances to an associate, investments in Unit Investment Trust Funds ("*UITF*s"), 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 *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 to receive 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, 2017 and December 31, 2016.

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 26 – 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 there is a currently enforceable legal right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The *MERALCO Group* assesses that it has a currently enforceable right of offset if the right is not contingent on a future event, and is legally enforceable in the normal course of business, event of default, and event of insolvency or bankruptcy of the *MERALCO Group* and all of the counterparties.

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 ('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 (1) 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 reporting period is recognized for services rendered by employees up to the end of the reporting period.

Unused sick leaves are accumulated, up to a certain limit, and commuted to cash upon separation or retirement. An actuarial valuation of the obligations on the accumulated unused sick leaves is conducted periodically in accordance with the relevant accounting standards.

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.

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 statement 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* and subsidiary, *AMPSI*, *Comstech*, *Fieldtech* and *Bayad Center*, which are not held by *MERALCO*.

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, collectibility 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 date, 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 *OCI* 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 period 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 periods.

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 Power 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 *PPA*s and *PSA*s 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 ₱37,795 million and ₱36,848 million for the nine (9) months ended September 30, 2017 and 2016, respectively. These are recognized as "Purchased Power" in the consolidated statements of income.

See *Note 23 – 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.

Entity in which the MERALCO Group Holds less than 20% of the Voting Rights Accounted for as an Associate

MERALCO, through *MGen*, has a 14% interest in Global Business Power Corporation ("*GBPC").* *GBPC* is considered an associate and, thus, *MERALCO*'s interest in *GBPC* is accounted for using the equity method as *MERALCO* is deemed to have significant influence in *GBPC* as evidenced by its representation in the *BOD* and Executive Committee and the provision of essential technical information to *GBPC*. This representation guarantees *MGen*'s participation in the decision making acts and policy making process of *GBPC*.

MERALCO, through *Finserve*, has 10% interest in AF Payments, Inc. ("*AFPI*"). *AFPI* is considered an associate and, thus, *MERALCO/Finserve*'s interest in *AFPI* is accounted for using the equity method as *MERALCO/Finserve* is deemed to have significant influence as evidenced by its representation in the *BOD* which guarantees *MERALCO*'s participation in the decision making and policy making process of *AFPI*.

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 (1) 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 28 – 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 reporting date 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 ₱4,778 million and ₱4,859 million for the nine (9) months ended September 30, 2017 and 2016, respectively. Total carrying values of utility plant and others, net of accumulated depreciation and amortization, amounted to ₱132,022 million and ₱128,814 million as at September 30, 2017 and December 31, 2016, respectively.

Total depreciation of investment properties amounted ₱3 million and ₱4 million for the nine (9) months ended September 30, 2017 and 2016, respectively. Total carrying values of investment properties, net of accumulated depreciation, amounted to ₱1,510 million and ₱1,513 million as at September 30, 2017 and December 31, 2016, respectively.

Total amortization of intangible assets with finite lives amounted to ₱450 million and ₱343 million for the nine (9) months ended September 30, 2017 and 2016, respectively. Total carrying values of intangible assets with finite lives, net of accumulated amortization, amounted to ₱2,350 million and ₱2,713 million as at September 30, 2017 and December 31, 2016, 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, intangible assets with finite lives, 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, intangible assets with finite lives, 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 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 ₱4,061 million and ₱1,371 million as at September 30, 2017 and December 31, 2016, respectively.

The carrying values of nonfinancial assets subject to impairment review are as follows:

Account	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
	(Amounts in millions)	
Utility plant and others	**₱132,022**	₱128,814
Investments in associates and interest in joint ventures	**11,710**	10,924
Intangible assets	**2,350**	2,713
Investment properties	**1,510**	1,513
Receivable from the *BIR*	**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 acquire'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 involves 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 period 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, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Recognized deferred tax assets	**₱26,310**	₱23,816
Unrecognized deferred tax assets	**504**	489

See *Note 27 – 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 26 – 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, net of recoveries, recognized in the consolidated statements of income amounted to ₱10 million and ₱199 million for the nine (9) months ended September 30, 2017 and 2016, respectively. Trade and other receivables, net of asset impairment, amounted to ₱28,306 million and ₱25,341 million as at September 30, 2017 and December 31, 2016, respectively.

See *Note 12 – Trade and Other Receivables.*

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 no longer usable are written off and charged as expense in the consolidated statement of income.

The carrying values of inventories amounted to ₱3,383 million and ₱2,792 million as at September 30, 2017 and December 31, 2016, 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 ₱755 million and ₱1,093 million for the nine (9) months ended September 30, 2017 and 2016, respectively. The retirement and other post-employment benefit liabilities as at September 30, 2017 and December 31, 2016 amounted to ₱1,993 million and ₱1,875 million, respectively. The retirement surplus presented as part of other noncurrent assets amounted to ₱2,351 million and ₱1,860 million as at September 30, 2017 and December 31, 2016, 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 24 – Expenses and Income* and *Note 25 – 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 period 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, 2017 and December 31, 2016, gross carrying values of insurance liabilities arising from insurance contracts, included in "Other noncurrent liabilities" account, amounted to ₱332 million and ₱269 million, respectively.

Provisions

The *MERALCO Group* has various claims, assessments and cases as discussed in *Note 28 – 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 net provisions on various claims and assessments amounting to ₱7,541 million and ₱6,894 million for the nine (9) months ended September 30, 2017 and 2016, respectively.

See *Note 18 – Provisions* and *Note 21 – 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 *PPA*s and *PSA*s. 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 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 Luzon. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country. *CEDC*'s franchise area covers Clark Special Economic Zone and the sub-zone.

Power generation – The *MERALCO Group's* re-entry into power generation 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* owns a total of 859 MegaWatt ("*MW*") (gross) of coal and diesel-fired power plants.

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

MGen, through *SBPL*, is constructing a 455 *MW* (net) supercritical coal-fired power plant in Mauban, Quezon. The *PSA* with *MERALCO* was approved by the *ERC* on May 19, 2015.

MGen is developing a 2 x 600 *MW* (net) ultra-supercritical coal-fired power plant in Atimonan, Quezon through *A1E*. *A1E* is in the final stage of selection for an Engineering, Procurement and Construction ("*EPC*") contractor. The expected completion of the first unit in 2021 and the second 600 *MW* by early 2022. A *PSA* has been executed between *A1E* and *MERALCO* for the full capacity. The *PSA* was filed with the *ERC* for approval.

MGen is also developing (i) a 2 x 300 *MW* (net) Circulating Fluidized Bed ("*CFB*"), coal-fired power plant in the Subic Freeport Zone through Redondo Peninsula Energy, Inc. ("*RP Energy*"), and (ii) developing a 2 x 350 *MW* (net) sub-critical pulverized coal-fired power plant in Calaca, Batangas through St. Raphael Power Generation Corporation ("*St. Raphael*"), and among others.

In 2016, *MERALCO* also subscribed to a 50% equity interest in *Pure Meridian*" which is primarily engaged in the development of various mini-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 retail electricity supplier 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 elects to be among contestable customers may source their electricity supply from any retail electricity supplier, including *MPower*.

The *ERC* granted the following subsidiaries distinct *RES* licenses to operate as retail electricity suppliers within Luzon and Visayas: *Vantage*, a wholly-owned subsidiary of *MERALCO*; *Solvre*, a wholly-owned subsidiary of *MGen*; *MeridianX*, a wholly-owned subsidiary of *Comstech*, on January 10, 2017, February 9, 2017 and February 9, 2017, respectively. *Clarion*, a wholly-owned subsidiary of *CEDC*, has submitted the requirements for its *RES* licensing to *ERC*. The approval of the *RES* licensing is pending with the *ERC*.

- 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*"), *e-MVI*, *Paragon* and *Radius* (collectively referred to as "*e-MVI Group*"), *Comstech, MRail*, *RSIC*, *LOIL, Finserve*, *MServ* and *Spectrum*.

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 ("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.

Consolidated 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 (1) 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.

		Power		Other Services		Inter-segment Transactions		Total	
		For the Nine Months Ended September 30							
	Note	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016
		(*Amounts in millions*)							
Revenues		**₱208,848**	₱189,135	**₱6,845**	₱7,262	**(₱1,304)**	(₱1,233)	**₱214,389**	₱195,164
Segment results		**₱25,112**	₱25,017	**₱1,549**	₱1,769	**₱–**	₱–	**₱26,661**	₱26,786
Depreciation and amortization		**(4,943)**	(4,972)	**(288)**	(234)	**–**	–	**(5,231)**	(5,206)
Interest and other financial income	*24*	**1,612**	1,498	**21**	30	**–**	–	**1,633**	1,528
Equity in net earnings (losses) of associates and joint ventures	*8*	**380**	(40)	**(58)**	(93)	**–**	–	**322**	(133)
Interest and other financial charges	*24*	**(1,089)**	(949)	**(58)**	(35)	**–**	–	**(1,147)**	(984)
Provision for income tax – net		**(5,812)**	(5,742)	**(408)**	(429)	**–**	–	**(6,220)**	(6,171)
Net income attributable to non-controlling interests		**–**	–	**–**	–	**(90)**	(144)	**(90)**	(144)
Net income attributable to equity holders of the Parent		**₱15,260**	₱14,812	**₱758**	₱1,008	**(₱90)**	(₱144)	**₱15,928**	₱15,676

		Power		Other Services		Inter-segment Transactions		Total	
		For the Three Months Ended September 30							
	Note	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016
		(*Amounts in millions*)							
Revenues		**₱71,439**	₱64,366	**₱2,381**	₱2,445	**(₱463)**	(₱451)	**₱73,357**	₱66,360
Segment results		**₱8,653**	₱8,104	**₱512**	₱585	**₱**	₱–	**₱9,165**	₱8,689
Depreciation and amortization		**(1,672)**	(1,661)	**(97)**	(79)	**–**	–	**(1,769)**	(1,740)
Interest and other financial income	*24*	**551**	548	**7**	10	**–**	–	**558**	558
Equity in net earnings (losses) of associates and joint ventures	*8*	**111**	(65)	**(19)**	(93)	**–**	–	**92**	(158)
Interest and other financial charges	*24*	**(372)**	(357)	**(25)**	(12)	**–**	–	**(397)**	(369)
Provision for income tax – net		**(2,051)**	(1,870)	**(148)**	(165)	**–**	–	**(2,199)**	(2,035)
Net income attributable to non-controlling interests		**–**	–	**–**	–	**(23)**	(37)	**(23)**	(37)
Net income attributable to equity holders of the Parent		**₱5,220**	₱4,699	**₱230**	₱246	**(₱23)**	(₱37)	**₱5,427**	₱4,908

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 Ended September 30		**For the Three Months Ended September 30**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
EBITDA	**₱26,268**	₱26,309	**₱9,053**	₱8,265
Add (Deduct):				
Depreciation and amortization	**(5,231)**	(5,206)	**(1,769)**	(1,740)
Interest and other financial income	**1,633**	1,528	**558**	558
Interest and other financial charges	**(1,147)**	(984)	**(397)**	(369)
Equity in net earnings (losses) of associates and joint ventures	**322**	(133)	**92**	(158)
Foreign exchange gains	**393**	477	**112**	424
Income before income tax	**22,238**	21,991	**7,649**	6,980
Provision for income tax – net	**(6,220)**	(6,171)	**(2,199)**	(2,035)
Net income	**₱16,018**	₱15,820	**₱5,450**	₱4,945

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

	Unaudited			
	For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
CCNI	**₱15,370**	₱14,966	**₱5,252**	₱4,578
Add (Deduct) non-core items, net of tax:				
Foreign exchange gains	**312**	383	**89**	346
Non-core expenses	**246**	327	**86**	(16)
Net income for the period attributable to equity holders of the Parent	**15,928**	15,676	**5,427**	4,908
Net income for the period attributable to non-controlling interests	**90**	144	**23**	37
Net income	**₱16,018**	₱15,820	**₱5,450**	₱4,945

7. Utility Plant and Others

The movements in utility plant and others are as follows:

	Note	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment	Transportation Equipment	Others	Construction in Progress	Total
						(Amounts in millions)				
September 30, 2017 (Unaudited)										
Cost:										
Balance at January 1, 2017		**₱160,528**	**₱15,363**	**₱6,279**	**₱2,726**	**₱3,242**	**₱3,425**	**₱4,188**	**₱10,861**	**₱206,612**
Additions		**502**	**5**	**59**	**63**	**74**	**179**	**149**	**6,928**	**7,959**
Disposals/retirements		**(502)**	**–**	**(24)**	**–**	**283**	**(120)**	**(8)**	**–**	**(371)**
Transfers from construction in progress		**1,900**	**–**	**115**	**70**	**–**	**–**	**36**	**(2,121)**	**–**
Reclassifications	*10*	**–**	**–**	**(3)**	**25**	**5**	**–**	**3**	**–**	**30**
Balance at September 30, 2017		**162,428**	**15,368**	**6,426**	**2,884**	**3,604**	**3,484**	**4,368**	**15,668**	**214,230**
Less accumulated depreciation and amortization:										
Balance at January 1, 2017		**67,164**	**–**	**2,593**	**1,301**	**2,306**	**2,212**	**2,222**	**–**	**77,798**
Depreciation and amortization		**3,840**	**–**	**147**	**151**	**227**	**207**	**206**	**–**	**4,778**
Disposals/retirements		**(489)**	**–**	**(24)**	**–**	**271**	**(120)**	**(6)**	**–**	**(368)**
Balance at September 30, 2017		**70,515**	**–**	**2,716**	**1,452**	**2,804**	**2,299**	**2,422**	**–**	**82,208**
Net book value		**₱91,913**	**₱15,368**	**₱3,710**	**₱1,432**	**₱800**	**₱1,185**	**₱1,946**	**₱15,668**	**₱132,022**

	Note	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment	Transportation Equipment	Others	Construction in Progress	Total
						(Amounts in millions)				
December 31, 2016 (Audited)										
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		693	83	31	165	187	173	484	9,181	10,997
Disposals/retirements		(1,662)	–	(3)	–	(14)	(54)	(77)	–	(1,810)
Transfers from construction in progress		5,939	–	45	77	15	–	52	(6,128)	–
Reclassifications	*10*	(32)	–	(7)	2	(3)	–	16	–	(24)
Balance at December 31, 2016		160,528	15,363	6,279	2,726	3,242	3,425	4,188	10,861	206,612
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		5,629	–	169	210	286	258	276	–	6,828
Disposals/retirements		(1,444)	–	(3)	–	(12)	(29)	(74)	–	(1,562)
Reclassifications	*10*	(3)	–	(1)	(3)	(3)	–	6	–	(4)
Balance at December 31, 2016		67,164	–	2,593	1,301	2,306	2,212	2,222	–	77,798
Net book value		₱93,364	₱15,363	₱3,686	₱1,425	₱936	₱1,213	₱1,966	₱10,861	₱128,814

As at September 30, 2017 and December 31, 2016, the net book values of customer-funded assets included in "Utility plant and others" account amounted to ₱2,855 million and ₱2,657 million, respectively. The corresponding liabilities to customers in the same amounts as at September 30, 2017 and December 31, 2016 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 ("*ECP*s") and non-*ECP*s. *ECP*s 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 ₱113 million and ₱125 million for the nine (9) months ended September 30, 2017 and 2016, respectively.

The average annual interest rates used for capitalization for the nine (9) months ended September 30, 2017 and 2016 ranged from 4.45% to 4.70% and 4.40% to 4.50%, respectively.

8. Investments in Associates and Interests in Joint Ventures

This account consists of the following as at September 30, 2017 and December 31, 2016:

	Place of Incorporation	Principal Activity	**2017**	2016
			Percentage of Ownership	
Associates				
RP Energy	Philippines	Power generation	**47**	47
FPM Power Holdings Limited ("*FPM Power*")	British Virgin Islands	Investment and holding company	**40**	40
Bauang Private Power Corporation ("*BPPC*")	Philippines	Power generation	**38**	38
General Electric Philippines Meter and Instrument Company, Inc. ("*GEPMICI*")[1]	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	**14**	14
AFPI	Philipines	Electronic payment clearing and settlement system operator	**10**	10
Joint Ventures				
SBPL	Philippines	Power generation	**51**	51
MRail-DESCO Joint Venture ("*MDJV*")	Philippines	Maintenance of mass transit system	**50**	50
St. Raphael	Philippines	Power generation	**50**	50
Rockwell Business Center Joint Venture ("*RBC JV*")	Philippines	Real estate	**30**	30
Pure Meridian	Philippines	Renewable energy	**49**	49
Mariveles Power	Philippines	Power generation	**49**	49
Powersource First Bulacan Solar, Inc. ("*First Bulacan*")	Philippines	Renewable energy	**40**	–

[1] In August 2017, Aclara Technologies LLC, a U.S. based company and an affiliate of Sun Capital Partners Inc., acquired General Electric Company of U.S.A.'s 65% equity in GEPMICI.

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

	September 30, 2017 (Unaudited) (Nine Months)	December 31, 2016 (Audited) (One year)
	(Amounts in millions)	
Acquisition costs:		
Balance at beginning of period	**₱13,620**	₱15,214
Additions	**616**	1,398
Disposal	**–**	(2,992)
Balance at end of period	**14,236**	13,620

(Forward)

	September 30, 2017 (Unaudited) (Nine Months)	December 31, 2016 (Audited) (One year)
	(Amounts in millions)	
Accumulated equity in net losses:		
Balance at beginning of period	**(3,748)**	(1,513)
Equity in net earnings (losses)	**322**	(1,677)
Dividends	**(95)**	(491)
Disposal	**–**	(67)
Balance at end of period	**(3,521)**	(3,748)
Share in remeasurement adjustments on retirement liabilities		
Balance at beginning of period	**(₱12)**	(₱12)
Actuarial gain	**2**	–
Balance at end of period	**(10)**	(12)
Share in cumulative translation adjustments:		
Balance at beginning of period	**1,064**	(86)
Translation adjustments	**(59)**	1,150
Balance at end of period	**1,005**	1,064
	₱11,710	₱10,924

The carrying values of investments in associates and interests in joint ventures follow:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
GBPC	**₱5,450**	₱5,210
FPM Power	**1,865**	1,911
RP Energy	**1,377**	934
RBC JV	**1,073**	1,098
Mariveles Power	**954**	959
Indra Philippines	**265**	238
SBPL	**237**	213
AFPI	**184**	185
Pure Meridian	**119**	25
GEPMICI	**63**	54
St. Raphael	**49**	58
First Bulacan	**40**	–
MDJV	**23**	28
BPPC	**11**	11
	₱11,710	₱10,924

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* sold and assigned 153,921,676 shares representing 8% of its equity interest in *GBPC* to *JG Summit* for ₱3,151 million.

GBPC owns an aggregate of 859 *MW* (gross) of coal and diesel-fired power plants in operation in the Visayas which include Panay Energy Development Corporation's ("*PEDC*") 150 *MW CFB* coal-fired facility in Panay Island which started commercial operations in November 2016. A *PSA* for the 70 *MW* plant capacity has been filed with and is pending approval by the *ERC*.

In June 2017, *GBPC* acquired a 50% interest in Alsons Thermal Energy Corporation ("*ATEC*"). *ATEC* holds 75% interest in a 105 *MW* (net) *CFB* plant in Maasim, Sarangani that started commercial operations in 2016. Another 105 *MW CFB* unit is targeted to be completed by 2019.

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.

In December 2016, *FPM Power* recognized impairment charge on its investment in *PacificLight Power*. The impairment charge of ₱1.2 billion covers solely goodwill related to the acquisition and is included in the equity in net losses of associates in the 2016 annual consolidated statement of income.

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 (2) amendments, as well as the Lease and Development Agreement ("*LDA*") between *RP Energy* and Subic Bay Metropolitan Authority ("*SBMA*"). On February 23, 2016, the *LDA* and transmission line Right-of-Way ("*RoW*") lease agreement with *SBMA* were signed.

The development of the 2 x 300 *MW* project shall be implemented in two (2) phases. On October 13, 2016, the *EPC* for the first 300 *MW* was signed.

In April 2016, *RP Energy* signed separate *PSA*s with *MERALCO* and Aboitiz Energy Solutions, Inc. ("*Aboitiz Energy*"). *RP Energy* is awaiting the approval of its *PSA* with *MERALCO* by the *ERC*.

RP Energy's project has been issued a Certificate of Registration in June 2016 by the Board of Investments ("*BOI*") granting the project certain investment promotion incentives.

On December 22, 2016, *RP Energy* signed a loan agreement with three (3) local banks for the ₱31.5 billion project financing. The approval of the *PSA* between *RP Energy* and *Aboitiz Energy* by the *ERC* is a condition precedent to the first loan drawdown.

Site preparation of the first 300 *MW* unit has been completed, with expected commercial operations in 2020. The second phase shall follow within 12 months, subject to progress of *NGCP*'s *RoW* acquisition for the new transmission line that will connect the second phase to the grid.

RBC JV

RBC JV is a joint venture between Rockwell Land Corporation ("*Rockwell Land*") and *MERALCO* for a pre-agreed cooperation period, pursuant to which *Rockwell Land* built and managed three (3) Business Process Outsourcing-enabled buildings on a non-regulatory asset base property of *MERALCO*. Investment in *RBC JV* represents *MERALCO'*s 30% interest in the joint venture, *Rockwell Land* has 70% interest in *RBC JV*.

Mariveles Power

On June 16, 2016, *MERALCO* and *Mariveles Power* executed a joint venture agreement to develop, construct, finance, own, operate and maintain a 4 x 132 *MW* coal-fired power plant and associated facilities in Mariveles, Bataan.

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.

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) supercritical 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 ("*CSP*") 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 *PSA* was approved by the *ERC* in May 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. The initial drawdown was made on December 1, 2015. On December 11, 2015, *SBPL* entered into an Operation and Maintenance Agreement with Pearl Energy Phils Operating, Inc., a wholly owned subsidiary of *QPPL* , for the operations and maintenance of the power plant.

The expected commercial operations of *SBPL* is June 2019.

AFPI

MERALCO, through *Finserve*, has a 10% equity interest in *AFPI*. *AFPI* was incorporated in February 2014 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 operate and maintain the related hardware and software.

Pure Meridian

On January 7, 2016, *MERALCO* and Repower Energy Development Corporation ("*REDC*") entered into a joint venture through, *Pure Meridian*, which shall undertake the development of various mini-hydroelectric power projects.

GEPMICI

GEPMICI was established in 1979 together with General Electric Company of U.S.A., to serve the Philippine market for American National Standard Institute ("*ANSI*")-type Watt-hour meters. In August 2017, Aclara Technologies LLC, an affiliate of Sun Capital Partners Inc., acquired General Electric Company of U.S.A.'s 65% equity in *GEPMICI*.

St. Raphael

On April 27, 2016, *MGen* and Semirara Mining and Power Corporation entered a joint venture agreement to develop a 2 x 350 *MW* sub-critical pulverized coal-fired power plant in Calaca, Batangas. The development and operations shall be undertaken by *St. Raphael*, the joint venture entity. A *PSA* was signed by *St. Raphael* and *MERALCO* in April 2016 for the 400 *MW* of the plant's capacity. The *PSA* is pending approval by the *ERC*. Development activities for the project are ongoing and target commercial operations of the power plant is in 2021.

First Bulacan

On January 23, 2017, *Spectrum* entered into a shareholders agreement with Sunseap International Pte Ltd. and Powersource Philippines Development Corporation for the development of solar energy projects. The development and operations of the project will be undertaken by *First Bulacan*.

BPPC

BPPC was incorporated and registered with the *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 *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.

MDJV

On June 2, 2014, *MRail* and *DESCO* entered into a Joint Venture Agreement to participate in the bidding/negotiated procurement and undertake project for the general overhaul and rehabilitation of three (3) of diesel electric locomotives by the Philippine National Railways.

The condensed statements of financial position of material associates follow:

	September 30, 2017 (Unaudited)		
	GBPC	***FPM Power***	***RP Energy***
	(Amounts in millions)		
Current assets	**₱24,480**	**₱5,526**	**₱615**
Noncurrent assets	**68,141**	**53,277**	**2,227**
Current liabilities	**(13,996)**	**(19,085)**	**(13)**
Noncurrent liabilities	**(34,227)**	**(32,299)**	**(5)**
Non-controlling interests	**(13,258)**	**(2,756)**	**–**
Net assets	**₱31,140**	**₱4,663**	**₱2,824**

	December 31, 2016 (Audited)		
	GBPC	*FPM Power*	*RP Energy*
	(Amounts in millions)		
Current assets	₱23,680	₱7,192	₱373
Noncurrent assets	69,208	49,273	1,538
Current liabilities	(15,370)	(20,309)	(25)
Noncurrent liabilities	(35,520)	(29,616)	(5)
Non-controlling interests	(12,580)	(1,762)	–
Net assets	₱29,418	₱4,778	₱1,881

The condensed statements of comprehensive income of material associates are as follows:

	For the Nine Months Ended September 30 (Unaudited)					
	2017			2016		
	GBPC	***FPM Power***	***RP Energy***	*GBPC*	*FPM Power*	*RP Energy*
	(Amounts in millions)					
Revenues	**₱17,270**	**₱21,310**	**₱6**	₱13,017	₱19,853	₱2
Costs and expenses	**(14,791)**	**(21,833)**	**(38)**	(9,923)	(21,468)	(46)
Net income (loss)	**2,479**	**(523)**	**(32)**	3,094	(1,615)	(44)
Non-controlling interests	**(756)**	**557**	**–**	(987)	785	–
Net income (loss) attributable to equity holders of the parent	**1,723**	**34**	**(32)**	2,107	(830)	(44)
Other comprehensive income (loss)	**–**	**(148)**	**–**	–	1,388	–
Total comprehensive income (loss)	**₱1,723**	**(₱114)**	**(₱32)**	₱2,107	₱558	(₱44)
Dividends received	**₱–**	**₱–**	**₱–**	₱–	₱–	₱–

The reconciliation of the net assets of the foregoing material associates to the carrying amounts of investments in these associates recognized in the consolidated statements of financial position is as follows:

	September 30, 2017 (Unaudited)		
	GBPC	***FPM Power***	***RP Energy***
	(Amounts in millions, except % of ownership)		
Net assets of associates	**₱31,140**	**₱4,663**	**₱2,824**
Proportionate ownership in associates (%)	**14**	**40**	**47**
	4,359	**1,865**	**1,327**
Goodwill	**1,091**	**–**	**50**
	₱5,450	**₱1,865**	**₱1,377**

	December 31, 2016 (Audited)		
	GBPC	*FPM Power*	*RP Energy*
	(Amounts in millions, except % of ownership)		
Net assets of associates	₱29,418	₱4,778	₱1,881
Proportionate ownership in associates (%)	14	40	47
	4,119	1,911	884
Goodwill	1,091	–	50
	₱5,210	₱1,911	₱934

The following is the aggregate information of associates that are considered as not individually material:

	For the Nine Months Ended September 30 (Unaudited)	
	2017	2016
	(Amounts in millions)	
Share in net loss	**(₱8)**	(₱13)
Share in other comprehensive income	**2**	–
Share in total comprehensive loss	**(₱6)**	(₱13)
Dividends received	**₱10**	₱–

Joint Ventures

The condensed statements of financial position of material joint ventures follow:

	September 30, 2017 (Unaudited)		
	RBC JV	***SBPL***	***Mariveles Power***
	(Amounts in millions)		
Current assets	**₱826**	**₱991**	**₱17**
Noncurrent assets	**3,176**	**24,918**	**1,931**
Current liabilities	**(425)**	**(492)**	**(1)**
Noncurrent liabilities	**–**	**(24,952)**	**–**
Net assets	**₱3,577**	**₱465**	**₱1,947**

	December 31, 2016 (Audited)		
	RBC JV	*SBPL*	*Mariveles Power*
	(Amounts in millions)		
Current assets	₱734	₱527	₱123
Noncurrent assets	3,301	16,141	1,834
Current liabilities	(374)	(300)	–
Noncurrent liabilities	–	(15,950)	–
Net assets	₱3,661	₱418	₱1,957

The foregoing condensed statements of financial position include the following:

	September 30, 2017 (Unaudited)		
	RBC JV	***SBPL***	***Mariveles Power***
	(Amounts in millions)		
Cash and cash equivalents	**₱633**	**₱756**	**₱17**
Current financial liabilities (excluding trade payables)	**(28)**	**(464)**	**–**

	December 31, 2016 (Audited)		
	RBC JV	*SBPL*	*Mariveles Power*
	(Amounts in millions)		
Cash and cash equivalents	₱553	₱391	₱19
Current financial liabilities (excluding trade payables)	(27)	(298)	–

The condensed statements of comprehensive income of material joint ventures are as follows:

	For the Nine Months Ended September 30 (Unaudited)					
	2017			2016		
	RBC JV	***SBPL***	***Mariveles Power***	*RBC JV*	*SBPL*	*Mariveles Power*
	(Amounts in millions)					
Revenues	**₱523**	**₱144**	**₱–**	₱507	₱1	₱–
Costs and expenses	**(151)**	**(75)**	**(10)**	(174)	(99)	(2)
Provision for income tax - net	**(88)**	**(21)**	**–**	(89)	(31)	–
Net income (loss)	**₱284**	**₱48**	**(₱10)**	₱244	(₱129)	(₱2)
Dividends received	**₱85**	**₱–**	**₱–**	₱73	₱–	₱–

The foregoing condensed statements of comprehensive income include the following:

	For the Nine Months Ended September 30 (Unaudited)					
	2017			2016		
	RBC JV	***SBPL***	***Mariveles Power***	*RBC JV*	*SBPL*	*Mariveles Power*
	(Amounts in millions)					
Depreciation	**₱154**	**₱3**	**₱–**	₱150	₱3	₱–
Interest income	**(7)**	**(1)**	**–**	(8)	(1)	(2)
Provision for income tax - net	**88**	**21**	**–**	89	31	–

The reconciliation of the net assets of the foregoing material joint ventures to the carrying amounts of investments in these associates recognized in the consolidated statements of financial position is as follows:

	September 30, 2017 (Unaudited)		
	RBC JV	***SBPL***	***Mariveles Power***
	(Amounts in millions, except % of ownership)		
Net assets of associates	**₱3,577**	**₱465**	**₱1,947**
Proportionate ownership in associates (%)	**30**	**51**	**49**
	₱1,073	**₱237**	**₱954**

	December 31, 2016 (Audited)		
	RBC JV	*SBPL*	*Mariveles Power*
	(Amounts in millions, except % of ownership)		
Net assets of associates	₱3,661	₱418	₱1,957
Proportionate ownership in associates (%)	30	51	49
	₱1,098	₱213	₱959

The following is the condensed financial information of joint ventures which are considered as not material:

	For the Nine Months Ended September 30 (Unaudited)	
	2017	2016
	(Amounts in millions)	
Share in net loss	**(₱14)**	(₱41)
Share in other comprehensive loss	**–**	–
Share in total comprehensive loss	**(₱14)**	(₱41)
Dividends received	**₱–**	₱9

9. Investment Properties

The movements in investment properties are as follows:

	September 30, 2017 (Unaudited)		
	Land	**Buildings and Improvements**	**Total**
	(Amounts in millions)		
Cost	**₱1,427**	**₱204**	**₱1,631**
Less accumulated depreciation:			
Balance at January 1, 2017	**–**	**118**	**118**
Depreciation	**–**	**3**	**3**
Balance at September 30, 2017	**–**	**121**	**121**
	₱1,427	**₱83**	**₱1,510**

	December 31, 2016 (Audited)		
	Land	Buildings and Improvements	Total
	(Amounts in millions)		
Cost:			
Balance at January 1, 2016	₱1,427	₱224	₱1,651
Disposals and others	–	(20)	(20)
Balance at December 31, 2016	1,427	204	1,631
Less accumulated depreciation:			
Balance at January 1, 2016	–	113	113
Depreciation	–	5	5
Balance at December 31, 2016	–	118	118
	₱1,427	₱86	₱1,513

Investment properties consist of real properties held for capital appreciation, former substation sites and other non-regulatory asset base real properties. Some of these investment properties are being leased out.

The aggregate fair values of the investment properties as at September 30, 2017 and December 31, 2016 are as follows:

	Amount
	(in millions)
Land	₱1,863
Buildings and improvements	150

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 one (1) 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 following: 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, 2017 (Unaudited)**	December 31, 2016 (Audited)
		(Amounts in millions)	
Financial Assets:			
HTM investments	*14 and 26*	**₱27,444**	₱34,997
AFS financial assets	*26*	**5,664**	10,186
Advance payments to a supplier	*26 and 29*	**1,497**	1,277
Nonfinancial Assets:			
Intangible assets	*7*	**2,350**	2,713
Retirement surplus	*25*	**2,351**	1,860
Deferred input *VAT*		**1,406**	1,733
Receivable from *BIR*	*28*	**181**	181
Deferred reinsurance premium		**131**	168
Goodwill		**36**	36
Unbilled receivables and others	*2*	**4,743**	608
		₱45,803	₱53,759

HTM Investments

The details of *HTM* investments are as follows:

	September 30, 2017 (Unaudited)			December 31, 2016 (Audited)		
	Current Portion (see *Note 14*)	**Noncurrent Portion**	**Total**	Current Portion (see *Note 14*)	Noncurrent Portion	Total
			(Amounts in millions)			
Government securities	**₱8,587**	**₱26,374**	**₱34,961**	₱1,350	₱33,914	₱35,264
Private debt securities	**–**	**1,070**	**1,070**	–	1,083	1,083
	₱8,587	**₱27,444**	**₱36,031**	₱1,350	₱34,997	₱36,347

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, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Investments in government securities	**₱3,829**	₱5,470
Investments in *UITF*s	**914**	3,825
Investments in ordinary shares of stock and club shares:		
Quoted	**882**	852
Unquoted	**39**	39
	₱5,664	₱10,186

The rollforward of unrealized gains (losses) on quoted *AFS* financial assets, net of tax, included in the consolidated statements of financial position follows:

	September 30, 2017 (Unaudited) (Nine Months)	December 31, 2016 (Audited) (One year)
	(Amounts in millions)	
Balance at beginning of period	**(₱271)**	₱102
Unrealized gains (losses) on change in fair value	**208**	(373)
Balance at end of period	**(₱63)**	(₱271)

Intangible Assets

The movements of intangible assets are as follows:

		September 30, 2017 (Unaudited)			
	Note	**Software**	**Franchise**	**Land and Leasehold Rights**	**Total**
			(Amounts in millions)		
Cost:					
Balance at January 1, 2017		**₱4,755**	**₱49**	**₱431**	**₱5,235**
Additions		**117**	**–**	**–**	**117**
Reclassifications	*7*	**(30)**	**–**	**–**	**(30)**
Balance at September 30, 2017		**4,842**	**49**	**431**	**5,322**
Less accumulated amortization:					
Balance at January 1, 2017		**2,264**	**–**	**258**	**2,522**
Amortization		**437**	**–**	**13**	**450**
Balance at September 30, 2017		**2,701**	**–**	**271**	**2,972**
		₱2,141	**₱49**	**₱160**	**₱2,350**

		December 31, 2016 (Audited)			
	Note	Software	Franchise	Land and Leasehold Rights	Total
			(Amounts in millions)		
Cost:					
Balance at January 1, 2016		₱4,144	₱49	₱431	₱4,624
Additions		587	–	–	587
Reclassifications	*7*	24	–	–	24
Balance at December 31, 2016		4,755	49	431	5,235
Less accumulated amortization:					
Balance at January 1, 2016		1,799	–	240	2,039
Amortization		461	–	18	479
Reclassifications		4	–	–	4
Balance at December 31, 2016		2,264	–	258	2,522
		₱2,491	₱49	₱173	₱2,713

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 under *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 *DU*s and which are still to be billed, covered by the approved recovery mechanism of the *ERC* . The balance also includes other unbilled generation and pass-through charges of current and prior periods, which are the subject of various applications for recovery and approval by the *ERC*.

Provision for impairment loss on unbilled receivables amounted to ₱4,061 million and ₱1,371 million as at September 30, 2017 and December 31, 2016, respectively.

11. Cash and Cash Equivalents

This account consists of:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
		(Amounts in millions)
Cash on hand and in banks	**₱6,375**	₱5,746
Cash equivalents	**40,324**	40,910
	₱46,699	₱46,656

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:

	Note	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
		(Amounts in millions)	
Trade:			
Electricity:			
Billed	*22 and 26*	**₱21,201**	₱18,920
Unbilled	*2 and 10*	**3,548**	3,632
Service contracts		**4,104**	3,659
Cost and estimated earnings in excess of billings on uncompleted contracts		**943**	605
Insurance receivable		**148**	104
Nontrade	*22 and 26*	**1,343**	1,635
		31,287	28,555
Less allowance for doubtful accounts		**2,981**	3,214
		₱28,306	₱25,341

Billed receivables from sale of electricity of *MERALCO*, *CEDC* and *Vantage* consist of the following:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Residential	**₱9,878**	₱8,834
Commercial	**7,930**	7,167
Industrial	**3,125**	2,665
Streetlights	**268**	254
	21,201	18,920
Less allowance for doubtful accounts	**2,753**	2,991
	₱18,448	₱15,929

Movements in allowance for doubtful accounts for trade and other receivables are as follows:

	September 30, 2017 (Unaudited)			
	Balance at January 1, 2017	**Provisions (Reversals)**	**Write-offs**	**Balance at September 30, 2017**
	(Amounts in millions)			
Billed trade receivables:				
Residential	**₱1,712**	**₱278**	**(₱189)**	**₱1,801**
Commercial	**899**	**(132)**	**(43)**	**724**
Industrial	**291**	**(146)**	**(4)**	**141**
Streetlights	**89**	**–**	**(2)**	**87**
	2,991	**–**	**(238)**	**2,753**
Other trade receivables	**219**	**12**	**(5)**	**226**
Nontrade receivables	**4**	**(2)**	**–**	**2**
	₱3,214	**₱10**	**(₱243)**	**₱2,981**

	September 30, 2017 (Unaudited)						
	Residential	**Commercial**	**Industrial**	**Streetlights**	**Other Trade Receivables**	**Nontrade Receivables**	**Total**
	(Amounts in millions)						
Individually impaired	**₱470**	**₱174**	**₱84**	**₱19**	**₱226**	**₱2**	**₱975**
Collectively impaired	**1,331**	**550**	**57**	**68**	–	–	**2,006**
	₱1,801	**₱724**	**₱141**	**₱87**	**₱226**	**₱2**	**₱2,981**

	December 31, 2016 (Audited)			
	Balance at January 1, 2016	Provisions (Reversals)	Write-offs	Balance at December 31, 2016
	(Amounts in millions)			
Billed trade receivables:				
Residential	₱2,175	₱139	(₱602)	₱1,712
Commercial	909	87	(97)	899
Industrial	249	70	(28)	291
Streetlights	126	(32)	(5)	89
	3,459	264	(732)	2,991
Other trade receivables	203	16	–	219
Nontrade receivables	3	1	–	4
	₱3,665	₱281	(₱732)	₱3,214

	December 31, 2016 (Audited)						
	Residential	Commercial	Industrial	Streetlights	Other Trade Receivables	Nontrade Receivables	Total
	(Amounts in millions)						
Individually impaired	₱665	₱359	₱148	₱29	₱219	₱4	₱1,424
Collectively impaired	1,047	540	143	60	–	–	1,790
	₱1,712	₱899	₱291	₱89	₱219	₱4	₱3,214

Trade Receivables – Electricity

Trade receivables of *MERALCO* and *CEDC* include charges for pass-through costs. Pass-through costs consist of generation, transmission and *SL* charges, which represent 54%, 10% and 4%, respectively, of the total billed amount in 2017 and 51%, 12% and 4%, respectively, of the total billed amount in 2016. 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 26 – Financial Assets and Financial Liabilities.*

Trade Receivables – Service Contracts

Service contracts receivable arise from contracts entered into by the *MIESCOR Group*, *e-MVI Group*, *CIS Group*, *MRail*, *MServ*, *Comstech* and *Spectrum* for construction, engineering, related manpower, consulting, light rail maintenance, data transport, bills collection, tellering and e-business development, energy management services, energy systems management and harnessing renewable energy 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, 2017 (Unaudited)	December 31, 2016 (Audited)
		(Amounts in millions)
Materials and supplies:		
At cost	**₱3,363**	₱2,772
At net realizable value ("*NRV*")	**20**	20
	₱3,383	₱2,792

The cost of materials at *NRV* amounted to ₱212 million as at September 30, 2017 and December 31, 2016.

14. **Other Current Assets**

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
			(Amounts in millions)
Financial assets:			
Advances to an associate	*22 and 26*	**₱5,769**	₱5,644
HTM investments	*10 and 26*	**8,587**	1,350
Nonfinancial assets:			
Prepayments and advances to suppliers		**2,407**	2,418
Pass-through *VAT* – net		**1,000**	1,833
Prepaid tax		**1,291**	1,342
Input *VAT*		**679**	551
Others		**42**	81
		₱19,775	₱13,219

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, 2017 (Unaudited)	December 31, 2016 (Audited)
		(In millions, except par value)
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 43,671 and 44,110 shareholders of *MERALCO*'s common shares as at September 30, 2017 and December 31, 2016, 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 and unrealized foreign exchange gains totaling to ₱44,348 million and ₱41,698 million as at September 30, 2017 and December 31, 2016, respectively. These amounts are restricted for dividend declaration purposes as of the close of the respective reporting year.

The following are the cash dividends declared during the nine (9) months ended September 30, 2017 and 2016:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
August 3, 2017	August 30, 2017	September 22, 2017	₱8.93	₱10,059
February 27, 2017	March 27, 2017	April 21, 2017	9.30	10,482
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

The *BOD*-approved dividend policy of *MERALCO* consists of (i) regular cash dividends equivalent to 50% of *CCNI* for the period, and (ii) 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*.

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 172,412 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.

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 previously set aside a total of 55 million common shares for *ESPP* awards. As at September 30, 2017, 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.

16. Interest-bearing Long-term Financial Liabilities

This account consists of the following:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Long-term portion of interest-bearing financial liabilities – long-term debt	**₱24,836**	₱26,999
Current portion of interest-bearing financial liabilities:		
Long-term debt	**347**	371
Redeemable preferred stock	**1,498**	1,502
	1,845	1,873
	₱26,681	₱28,872

All of the redeemable preferred shares have been called 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, 2017 and December 31, 2016. Interest is no longer accrued when the preferred shares are called for redemption.

The details of interest-bearing long-term financial liabilities are as follows:

Description	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
	(Amounts in millions)	
Fixed Rate Loans		
₱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	**6,120**	6,480
₱600 Million Term Loan Facilities	**600**	–
₱130 Million Term Loan Facility	**94**	106
Floating Rate Loan		
₱2.5 Billion Term Loan Facility	**–**	2,437
Others	**3**	–
Total long-term debt	**25,317**	27,523
Less unamortized debt issuance costs	**134**	153
	25,183	27,370
Redeemable Preferred Stock	**1,498**	1,502
	26,681	28,872
Less current portion	**1,845**	1,873
Long-term portion of interest-bearing financial liabilities	**₱24,836**	₱26,999

All of *MERALCO*'s interest-bearing long-term financial liabilities as at September 30, 2017 and December 31, 2016 are denominated in Philippine peso. The scheduled maturities of *MERALCO*'s outstanding long-term debt at nominal values as at September 30, 2017 are as follows:

	Amount
	(In millions)
Less than one (1) year	₱414
One (1) year up to two (2) years	414
More than two (2) years up to three (3) years	413
More than three (3) years up to four (4) years	11,913
More than four (4) years up to five (5) years	390
More than five (5) years	11,773
	₱25,317

₱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 and with an overallotment option of up to ₱5.0 billion. The 12-year corporate bonds also include a call option, whereby *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.

₱600 Million Term Loan Facilities

In 2017, *MServ* obtained a total of ₱600 million, 10-year fixed rate term loans. The principal amount is payable over 10 years until January 2027.

₱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. In July 2017, the loan was pre-terminated.

The annual interest rates for the interest-bearing financial liabilities are as follows:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
Fixed Rate Loans	**4.38% to 5.50%**	4.38% to 5.50%
Floating Rate Loan	**2.29% to 2.70%**	2.29% to 2.71%

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, 2017 and December 31, 2016, *MERALCO* is in compliance with all of the covenants of the loan agreements.

Unamortized Debt Issuance Costs

The following presents the changes to the unamortized debt issuance costs:

	Note	**September 30, 2017 (Unaudited) (Nine Months)**	December 31, 2016 (Audited) (One Year)
		(Amounts in millions)	
Balance at beginning of period		**₱153**	₱177
Amortization charged to interest and other financial charges	*24*	**(19)**	(24)
Balance at end of period		**₱134**	₱153

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, 2017 (Unaudited)	December 31, 2016 (Audited)
Balance at beginning of period	**150,157,797**	152,231,414
Redemptions	**(364,507)**	(2,073,617)
Balance at end of period	**149,793,290**	150,157,797

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.

17. Customers' Deposits

This account consists of:

	September 30, 2017 (Unaudited)			December 31, 2016 (Audited)		
	Current Portion (see *Note 21*)	**Noncurrent Portion**	**Total**	Current Portion (see *Note 21*)	Noncurrent Portion	Total
			(Amounts in millions)			
Bill deposits	**₱2,664**	**₱23,548**	**₱26,212**	₱2,594	₱23,501	₱26,095
Meter deposits	**424**	–	**424**	416	–	416
	₱3,088	**₱23,548**	**₱26,636**	₱3,010	₱23,501	₱26,511

Bill Deposits

Bill deposits serve to guarantee payment of bills by a customer.

As provided for under the *Magna Carta* and *DSOAR*, all captive customers are required to pay a deposit to the *DU,* 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 (1) 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:

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
		(Amounts in millions)	
Balance at beginning of period		**₱26,095**	₱26,054
Additions		**3,275**	4,453
Refunds		**(3,158)**	(4,412)
Balance at end of period		**26,212**	26,095
Less portion maturing within one year	*21*	**2,664**	2,594
Noncurrent portion of bill deposits and related interests		**₱23,548**	₱23,501

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 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, 2017 and December 31, 2016, total meter deposits refunded by *MERALCO* amounted to ₱2,639 million (inclusive of interest amounting to ₱1,362 million).

18. Provisions

Provisions consist of amounts recognized for probable losses and expenses relating to claims against the *MERALCO Group*, among others. The movements follow:

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
		(Amounts in millions)	
Balance at beginning of period		**₱38,224**	₱37,402
Additions (reversals) for the period - net		**(2,025)**	1,504
Settlements		**(850)**	(682)
Balance at end of period		**35,349**	38,224
Less current portion	*21*	**17,294**	19,054
Noncurrent portion of provisions		**₱18,055**	₱19,170

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 28 – Contingencies and Legal Proceedings*, consistent with the limited disclosure as allowed in *PFRS*.

19. 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 ₱0.17 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 to continue refunding to eligible accounts or customers under Phases I to IV, for three (3) years from January 1, 2016 or until December 31, 2018.

20. Notes Payable

Notes payable represent unsecured interest-bearing working capital loans obtained from local banks. Annual interest rates range from 2.8% to 4.25% and 2.5% to 4.25% as at September 30, 2017 and December 31, 2016, respectively.

Interest expense on notes payable amounted to ₱249 million and ₱14 million for the nine (9) months ended September 30, 2017 and 2016, respectively.

See *Note 24 – Expenses and Income*.

21. Trade Payables and Other Current Liabilities

This account consists of the following:

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
		(Amounts in millions)	
Trade accounts payable	*22 and 23*	**₱35,777**	₱31,319
Provisions	*18 and 28*	**17,294**	19,054
Output *VAT* - net		**7,917**	7,081
Accrued expenses:			
Employee benefits		**2,201**	1,940
Taxes		**1,647**	1,553
Interest	*16*	**189**	115
Others		**1,328**	989

(Forward)

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
		(Amounts in millions)	
Current portions of:			
Bill deposits and related interests	*17*	**₱2,664**	₱2,594
Meter deposits and related interests	*17*	**424**	416
Deferred income		**1,077**	1,005
Refundable service extension costs		**2,502**	2,502
Dividends payable on:			
Common stock	*15*	**723**	604
Redeemable preferred stock	*17*	**250**	250
Payable to customers		**8,411**	8,279
Universal charges payable		**2,830**	2,365
FiT-All	*31*	**943**	631
Reinsurance liability		**189**	131
Regulatory fees payable		**139**	181
Other current liabilities		**4,011**	2,911
		₱90,516	₱83,920

Trade Accounts Payable

Trade accounts payable mainly represent obligations to power generating companies, National Grid Corporation of the Philippines ("*NGCP*") and Philippine Electricity Market Corporation ("*PEMC*"), for cost of power purchased and transmission charge. In addition, this account includes liabilities due to local and foreign suppliers for purchases of goods and services, which include of transformers, poles, materials and supplies, and contracted services.

Trade payables are non-interest-bearing and are generally settled within 15 to 60 days from the receipt of invoice. Other payables are non-interest-bearing and due within one (1) year from incurrence.

See *Note 22 – Related Party Transactions* and *Note 29 – 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 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, 2017 and December 31, 2016, the noncurrent portion of refundable service extension costs of ₱5,590 million and ₱4,927 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 amounts passed on and collected from customers on a monthly basis by *DU*s. These are charges imposed to recover the stranded debts, stranded contract costs of *NPC* and stranded contract costs of eligible contracts of distribution. *DU*s remit collections monthly to *PSALM* who administers the fund generated from universal charges and disburses the said funds in accordance with the intended purposes.

22. 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 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 all 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 and renders services to such affiliates.

PSAs with Joint Ventures and Associates

As discussed in Note 29, *MERALCO* signed long-term *PSA*s with the following related parties: *SBPL*, *RP Energy*, *St. Raphael*, *Mariveles Power* and *PEDC*.

Following is a summary of related party transactions for the nine (9) months ended September 30, 2017 and 2016 and the outstanding balances as at September 30, 2017 and December 31, 2016:

	Amount of Transactions For the Nine Months Ended September 30		Outstanding Receivable (Liability)			
Category	**2017**	2016	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)	Terms	Conditions
	(Amounts in millions)					
Sale of electricity:						
JG Summit Group	**₱1,426**	₱2,182	**₱118**	**₱201**	10-day; noninterest-bearing	Unsecured, no impairment
PLDT Group	**1,128**	930	**69**	**45**	10-day; noninterest-bearing	Unsecured, no impairment
Metro Pacific Group	**116**	106	**3**	**3**	10-day; noninterest-bearing	Unsecured, no impairment
Purchases of IT services - *Indra Philippines*	**755**	533	**(150)**	**(1)**	30-day; noninterest-bearing	Unsecured
Purchases of meters and devices - *GEPMICI*	**296**	185	**(65)**	**(13)**	30-day; noninterest-bearing	Unsecured
Revenue from pole attachment - *PLDT*	**370**	302	**158**	**25**	Advance payment	Unsecured, no impairment
Purchases of wireline and wireless services - *PLDT Group*	**68**	59	**(12)**	**(9)**	30-day; noninterest-bearing	Unsecured
Purchases of power:						
Panay Power Corportation ("*PPC*")	**191**	196	**(39)**	**(61)**	30-day; noninterest-bearing	Unsecured
Toledo Power Corporation ("*TPC*")	**269**	107	**(66)**	**(37)**	30-day; noninterest-bearing	Unsecured

Advances to FPM Power

FPM Power has a non-interest-bearing loan from *MPG Asia* amounting to US$110 million, which is due and demandable. The loan is outstanding as at September 30, 2017 and December 31, 2016.

See *Note 14 – Other Current Assets.*

Transaction with MERALCO Retirement Benefits Fund ("*Fund*")

MERALCO'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, 2017 and December 31, 2016, the fair value of the total assets being managed by the Fund amounted to ₱37.7 billion and ₱36.5 billion, respectively.

See *Note 25 – 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**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
Short-term employee benefits	**₱560**	₱488	**₱108**	₱113
Long-term employee incentives and retirement benefits	**203**	214	**68**	72
Total compensation to key management personnel	**₱763**	₱702	**₱176**	₱185

Each of the directors is entitled to a per diem of ₱120,000 for every *BOD* meeting attended. Each member of the Audit, 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. The increase in compensation shall be through a stock grant based on a pre-approved number of shares for each director which was implemented beginning May 2013 as approved by the stockholders.

As at September 30, 2017, 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.

23. Purchased Power

The details of purchased power are as follow:

	Unaudited			
	For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
Generation costs	**₱135,867**	₱116,263	**₱46,518**	₱39,841
Transmission costs	**26,910**	28,160	**8,576**	9,144
	₱162,777	₱144,423	**₱55,094**	₱48,985

Purchased power costs for the captive customers are pass-through costs and are revenue-neutral to *MERALCO* and *CEDC,* as *DU*s.

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 ₱37,795 million and ₱36,848 million for the nine (9) months ended September 30, 2017 and 2016, 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 6.05% and 6.40% for the nine (9) months ended September 30, 2017 and 2016, respectively.

The details of purchased power follow:

	Unaudited			
	For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
First Gas Power Corporation ("*FGPC*") and FGP Corp. ("*FGP*")	**₱34,944**	₱29,942	**₱12,577**	₱9,074
NGCP	**26,783**	27,955	**8,552**	9,084
South Premiere Power Corporation ("*SPPC*")	**23,137**	21,578	**7,855**	6,335
PEMC/WESM	**18,075**	12,351	**4,648**	5,518
San Miguel Energy Corporation ("*SMEC*")	**12,095**	11,949	**3,996**	4,086
Masinloc Power Partners Co. Ltd. ("*MPPCL*")	**10,499**	9,225	**3,664**	3,208
QPPL	**10,853**	10,244	**4,137**	3,415
Therma Luzon, Inc. ("*TLI*")	**8,479**	7,687	**3,282**	2,835
Sem-Calaca Power Corporation ("*Sem-Calaca*")	**7,937**	6,882	**3,184**	2,840
Therma Mobile, Inc. ("*TMO*")	**2,386**	2,350	**707**	816
Southwest Luzon Power Generation Corporation	**2,378**	1,513	**931**	613
Trans-Asia Oil and Energy Development Corporation ("*Trans-Asia*")	**1,786**	1,618	**665**	577
1590 Energy Corporation	**1,135**	679	**211**	326
PEDC	**1,216**	–	**486**	–
Others	**1,074**	450	**199**	258
	₱162,777	₱144,423	**₱55,094**	₱48,985

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, 2017 and December 31, 2016, the total transmission costs and *SL* charge over-recoveries included in "Other noncurrent liabilities" account in the consolidated statements of financial position amounted to ₱943 million and ₱6,592 million, respectively.

24. Expenses and Income

Salaries, Wages and Employee Benefits

	Note	Unaudited			
		For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
		2017	2016	**2017**	2016
			(Amounts in millions)		
Salaries, wages and related employee benefits		**₱8,648**	₱8,300	**₱2,791**	₱2,734
Retirement benefits	*25*	**672**	1,012	**201**	340
Other long-term post-employment benefits	*25*	**83**	81	**28**	27
		₱9,403	₱9,393	**₱3,020**	₱3,101

Other Expenses

	Note	Unaudited			
		For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
		2017	2016	**2017**	2016
			(Amounts in millions)		
Materials used	*13*	**₱1,335**	₱1,767	**₱445**	₱623
Rent and utilities		**638**	547	**225**	175
Transportation and travel		**296**	278	**109**	82
Advertising		**270**	197	**104**	77
Insurance		**265**	263	**83**	88
Communication	*2*	**106**	96	**38**	34
Others		**831**	1,077	**356**	236
		₱3,741	₱4,225	**₱1,360**	₱1,315

Interest and Other Financial Charges

	Note	**Unaudited**			
		For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
		2017	2016	**2017**	2016
			(Amounts in millions)		
Interest expense on interest-bearing long-term financial liabilities, net of interest capitalized	*7 and 16*	**₱806**	₱876	**₱267**	₱336
Interest expense on notes payable	*20*	**249**	14	**96**	4
Interest expense on bill deposits	*17*	**48**	49	**16**	16
Amortization of debt issuance costs	*16*	**19**	18	**7**	6
Others		**25**	27	**11**	7
		₱1,147	₱984	**₱397**	₱369

Interest and Other Financial Income

	Note	**Unaudited**			
		For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
		2017	2016	**2017**	2016
			(Amounts in millions)		
Interest income on cash in banks and cash equivalents	*11*	**₱583**	₱484	**₱204**	₱141
Income from *HTM* and *AFS* investments		**979**	612	**328**	202
Others		**71**	432	**26**	215
		₱1,633	₱1,528	**₱558**	₱558

25. Long-term Employee Benefits

Liabilities for long-term employee benefits consist of the following:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Long-term incentives	**₱2,172**	₱1,244
Retirement benefits liability	**342**	307
Other long-term post-employment benefits	**1,651**	1,568
	₱4,165	₱3,119

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**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
Current service costs	**₱705**	₱919	**₱216**	₱311
Net interest costs (income)	**(65)**	78	**(20)**	24
Net retirement benefits expense	**₱640**	₱997	**₱196**	₱335

Retirement Benefits Asset

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Defined benefit obligation	**₱35,646**	₱34,957
Fair value of plan assets	**(37,655)**	(36,510)
Retirement benefits asset	**(₱2,009)**	(₱1,553)

Retirement benefit asset are presented in the consolidated statements of financial position as follows:

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
		(Amounts in millions)	
Retirement surplus under other noncurrent assets	*10*	**(₱2,351)**	(₱1,860)
Retirement benefits liability		**342**	307
Retirement benefits asset		**(₱2,009)**	(₱1,553)

Changes in the net retirement benefits asset are as follows:

	September 30, 2017 (Unaudited) (Nine Months)	December 31, 2016 (Audited) (One year)
	(Amounts in millions)	
Retirement benefits liability (asset) at beginning of period	**(₱1,553)**	₱2,021
Net retirement benefits expense	**640**	1,139
Contributions by employer	**(311)**	(1,283)
Amounts recognized in *OCI*	**(785)**	(3,430)
Retirement benefits asset at end of period	**(₱2,009)**	(₱1,553)

Changes in the present value of the defined benefits obligation are as follows:

	September 30, 2017 (Unaudited) (Nine Months)	December 31, 2016 (Audited) (One year)
	(Amounts in millions)	
Defined benefit obligation at beginning of period	**₱34,957**	₱38,220
Interest costs	**1,420**	1,843
Current service costs	**705**	1,085
Benefits paid	**(1,462)**	(1,936)
Actuarial losses (gains) due to:		
Changes in financial assumptions	**26**	(2,372)
Experience adjustments	**–**	(1,867)
Past service costs	**–**	(16)
Defined benefit obligation at end of period	**₱35,646**	₱34,957

Changes in the fair value of plan assets are as follows:

	September 30, 2017 (Unaudited) (Nine Months)	December 31, 2016 (Audited) (One year)
	(Amounts in millions)	
Fair value of plan assets at beginning of period	**₱36,510**	₱36,199
Benefits paid	**(1,462)**	(1,936)
Interest income	**1,485**	1,773
Return on plan assets, excluding amount included in net interest on the net defined benefit obligation and interest income	**811**	(809)
Contributions by employer	**311**	1,283
Fair value of plan assets at end of period	**₱37,655**	₱36,510

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 executive member of the *BOD*; (ii) two (2) senior executives ; (iii) an independent member of the *BOD*; (iv) a member of the *BOD* who represents the largest shareholder group; and (v) a non-executive, non-*BOD* member who represents another shareholder group, all of whom are non-beneficiaries of the plan.

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, 2017 and December 31, 2016 amounted to ₱37,655 million and ₱36,510 million, respectively. The major categories of plan assets are as follows:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
		(Amount in millions)
Cash and cash equivalents	**₱2,781**	₱1,922
Investments quoted in active markets:		
Quoted equity investments		
Holding firms	**3,564**	3,161
Electricity, energy, power and water	**982**	1,048
Banks	**872**	532
Telecommunication	**857**	676
Property	**835**	611
Food, beverages and tobacco	**613**	650
Retail	**302**	161
Mining	**238**	137
Construction, infrastructure and allied services	**226**	103
Transportation services	**173**	87
Others	**1,381**	902
Quoted debt investments		
"AAA" rated securities	**14,038**	15,294
Government securities	**8,169**	8,754
Unquoted investments		
Receivables	**1,669**	1,517
Property	**954**	954
Others	**1**	1
Fair value of plan assets	**₱37,655**	₱36,510

Marketable equity securities, government securities, bonds and commercial notes are investments held by the trustee banks.

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**	
	2017	2016	**2017**	2016
		(Amounts in millions)		
Interest costs	**₱64**	₱60	**₱22**	₱20
Current service costs	**19**	21	**6**	7
	₱83	₱81	**₱28**	₱27

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, 2017 (Unaudited) (Nine Months)	December 31, 2016 (Audited) (One Year)
		(Amounts in millions)
Balance at beginning of period	**₱1,568**	₱1,599
Interest costs	**64**	80
Current service costs	**19**	28
Benefits paid	**–**	(70)
Actuarial gains due to change in assumptions	**–**	(69)
Balance at end of period	**₱1,651**	₱1,568

Actuarial Assumptions

The principal assumptions used as at September 30, 2017 and December 31, 2016 in determining retirement benefits and other long-term post-employment benefits obligations are shown below:

Annual discount rate	**4.78% to 5.62%**
Future range of annual salary increases	**4.0% - 10.0%**

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	**2017**	2016
		(Amounts in millions)	
Annual discount rate	+1.0%	**(₱4,838)**	(₱4,838)
	-1.0%	**4,543**	4,543
Future range of annual salary increases	+1.0%	**4,333**	4,333
	-1.0%	**(4,549)**	(4,549)

Funding

MERALCO 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 an independent actuary.

The following is the maturity profile of the undiscounted benefit obligation as at September 30, 2017:

	Amounts in millions
Less than one (1) year	₱1,241
One (1) year up to five (5) years	5,850
More than five (5) years up to 10 years	12,183
More than 10 years up to 15 years	13,118
More than 15 years up to 20 years	2,655
More than 20 years	4,514

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 of cash and cash equivalents, investments and rentals 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 are 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 as 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 voluntary. 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 ₱32 million and ₱15 million for the nine (9) months ended September 30, 2017 and 2016, 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**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
Expense recognized for defined benefit plans	**₱640**	₱997	**₱196**	₱335
Expense recognized for defined contribution plan	**32**	15	**5**	5
Retirement benefits expense	**₱672**	₱1,012	**₱201**	₱340

Long-term Incentive Plan ("*LTIP*")

MERALCO's *LTIP* covers qualified employees 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 (3)-year period as well as employees' attainment of a minimum level of performance rating. Employees 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.

26. Financial Assets and Financial Liabilities

Financial assets consist of cash and cash equivalents and trade and nontrade receivables, which are generated directly from operations, advances to an associate, *AFS* financial assets 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, 2017 and December 31, 2016:

	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**
			(Amounts in millions)				
Assets as at September 30, 2017							
Noncurrent							
Other noncurrent assets	**₱1,497**	**₱27,444**	**₱–**	**₱–**	**₱5,664**	**₱–**	**₱34,605**
Current							
Cash and cash equivalents	**46,699**	**–**	**–**	**–**	**–**	**–**	**46,699**
Trade and other receivables	**24,758**	**–**	**–**	**–**	**–**	**–**	**24,758**
Other current assets	**5,769**	**8,587**	**–**	**–**	**–**	**–**	**14,356**
Total assets	**₱78,723**	**₱36,031**	**₱–**	**₱–**	**₱5,664**	**₱–**	**₱120,418**
Liabilities as at September 30, 2017							
Noncurrent							
Interest-bearing long-term financial liabilities - net of current portion	**₱–**	**₱–**	**₱–**	**₱–**	**₱–**	**₱24,836**	**₱24,836**
Customers' deposits - net of current portion	**–**	**–**	**–**	**–**	**–**	**23,548**	**23,548**
Refundable service extension costs - net of current portion	**–**	**–**	**–**	**–**	**–**	**5,590**	**5,590**
Current							
Notes payable	**–**	**–**	**–**	**–**	**–**	**13,469**	**13,469**
Trade payables and other current liabilities	**–**	**–**	**–**	**–**	**–**	**54,464**	**54,464**
Customers' refund	**–**	**–**	**–**	**–**	**–**	**4,626**	**4,626**
Current portion of interest-bearing long-term financial liabilities	**–**	**–**	**–**	**–**	**–**	**1,845**	**1,845**
Total liabilities	**₱–**	**₱–**	**₱–**	**₱–**	**₱–**	**₱128,378**	**₱128,378**

	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
			(Amounts in millions)				
Assets as at December 31, 2016							
Noncurrent							
Other noncurrent assets	₱1,277	₱34,997	₱–	₱–	₱10,186	₱–	₱46,460
Current							
Cash and cash equivalents	46,656	–	–	–	–	–	46,656
Trade and other receivables	21,709	–	–	–	–	–	21,709
Other current assets	5,644	1,350	–	–	–	–	6,994
Total assets	₱75,286	₱36,347	₱–	₱–	₱10,186	₱–	₱121,819
Liabilities as at December 31, 2016							
Noncurrent							
Interest-bearing long-term financial liabilities - net of current portion	₱–	₱–	₱–	₱–	₱–	₱26,999	₱26,999
Customers' deposits - net of current portion	–	–	–	–	–	23,501	23,501
Refundable service extension costs - net of current portion	–	–	–	–	–	4,927	4,927
Current							
Notes payable	–	–	–	–	–	11,475	11,475
Trade payables and other current liabilities	–	–	–	–	–	49,146	49,146
Customers' refund	–	–	–	–	–	4,988	4,988
Current portion of interest-bearing long-term financial liabilities	–	–	–	–	–	1,873	1,873
Total liabilities	₱–	₱–	₱–	₱–	₱–	₱122,909	₱122,909

Fair Values

The fair values of the financial assets and financial liabilities are amounts 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:

	September 30, 2017 (Unaudited)		December 31, 2016 (Audited)	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
	(Amounts in millions)			
Financial assets				
Loans and receivables -				
Advance payments to a supplier	**₱1,497**	**₱1,222**	₱1,277	₱1,083
AFS financial assets	**5,664**	**5,664**	10,186	10,186
HTM investments	**36,031**	**35,625**	36,347	35,663
	₱43,192	**₱42,511**	₱47,810	₱46,932
Financial liabilities				
Financial liabilities carried at amortized cost -				
Interest-bearing-long-term financial liabilities	**₱26,681**	**₱30,269**	₱28,872	₱30,129

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 4.64% and 4.74% as at September 30, 2017 and December 31, 2016, respectively.

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 since there are no available market price for such securities.

HTM Investments

The fair values were determined by discounting the expected future cash flows using the interest rate as at reporting 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 amounts of bill deposits approximate 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 0.12% to 4.12% as at September 30, 2017 and 0.47% to 4.16% as at December 31, 2016.

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, 2017 (Unaudited)				December 31, 2016 (Audited)			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
				(Amounts in millions)				
Financial assets								
Advance payments to a supplier	**₱–**	**₱1,222**	**₱–**	**₱1,222**	₱–	₱1,083	₱–	₱1,083
AFS financial assets	**5,625**	**39**	**–**	**5,664**	10,147	39	–	10,186
HTM investments	**35,495**	**130**	**–**	**35,625**	35,521	142	–	35,663
	₱41,120	**₱1,391**	**₱–**	**₱42,511**	₱45,668	₱1,264	₱–	₱46,932
Financial liabilities								
Interest-bearing long-term financial liabilities	**₱–**	**₱30,269**	**₱–**	**₱30,269**	₱–	₱30,129	₱–	₱30,129

For the nine (9) months ended September 30, 2017 and 2016, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into or 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. All borrowings bear fixed rate of interest as at September 30, 2017 and approximately 91% of the borrowings bear fixed rate of interest as at December 31, 2016.

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
				(Amounts in millions)			
December 31, 2016 (Audited)	12	2,425	–	–	–	–	2,437

Floating interest rate of bank loans is repriced at intervals of less than one (1) 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 (9) months ended September 30, 2016. *MERALCO Group* has no floating rate loan as at September 30, 2017. There is no other impact on the *MERALCO Group*'s equity other than those already affecting the consolidated statement of income.

	2016	
	Increase (Decrease) in Basis Points	Effect on Income before Income Tax
	(Amounts in millions)	
Floating rate loans from various banks	+100	(₱18)
	(100)	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, 2017 and December 31, 2016, translated to Philippine peso at ₱50.82 and ₱49.72 to US$1, respectively.

	September 30, 2017 (Unaudited)		December 31, 2016 (Audited)	
	U.S. Dollar	**Peso Equivalent**	U.S. Dollar	Peso Equivalent
		(Amounts in millions)		
Financial assets:				
Cash and cash equivalents	**$215**	**₱10,927**	$289	₱14,382
Trade and other receivables	**2**	**95**	2	113
AFS financial assets	**5**	**254**	5	249
Advances to an associate	**110**	**5,590**	110	5,469
Advance payments to suppliers	**55**	**2,807**	52	2,605
	387	**19,673**	458	22,818
Financial liabilities -				
Trade payables and other liabilities	**(5)**	**(278)**	(7)	(357)
	$382	**₱19,395**	$451	₱22,461

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 (9) months ended September 30, 2017 and 2016 (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 statements of income.

	2017		2016	
	Appreciation (Depreciation) of U.S. Dollar	**Effect on Income before Income Tax**	Appreciation (Depreciation) of U.S. Dollar	Effect on Income before Income Tax
	(In %)	*(In millions)*	*(In %)*	*(In millions)*
U.S. dollar-denominated financial assets	**+5**	**₱971**	+5	₱1,123
and financial liabilities	**–5**	**(971)**	–5	(1,123)

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 balances as at financial reporting date 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 world prices or index of the commodity. 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 (1) month's consumption to secure credit. Also, as a policy, disconnection notices are sent three (3) 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, 2017 and December 31, 2016. The maximum exposure is equivalent to the nominal amount of the accounts.

	Gross Maximum Exposure	
	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Cash and cash equivalents:		
Cash in banks	**₱6,297**	₱5,627
Cash equivalents	**40,324**	40,910
Trade and other receivables:		
Billed electricity	**18,448**	15,929
Service contracts	**3,884**	3,446
Insurance receivable	**148**	104
Cost and estimated earnings in excess of billings on uncompleted contracts	**937**	599
Nontrade receivables	**1,341**	1,631
Other current assets:		
Advances to an associate	**5,769**	5,644
HTM investments	**8,587**	1,350

(Forward)

	Gross Maximum Exposure	
	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
Other noncurrent assets:		
HTM investments	**27,444**	34,997
AFS financial assets	**5,664**	10,186
Advance payments to a supplier	**1,497**	1,277
	₱120,340	₱121,700

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 using internal credit rating policies. The following tables show the credit quality by asset class:

	September 30, 2017 (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	**₱46,621**	**₱–**	**₱–**	**₱–**	**₱–**	**₱46,621**
Trade and other receivables:						
Billed electricity	**4,090**	**2,379**	**10,562**	**1,417**	**2,753**	**21,201**
Service contracts	**1,433**	**–**	**205**	**2,246**	**220**	**4,104**
Insurance receivable	**–**	**–**	**88**	**60**	**–**	**148**
Cost and estimated earnings in excess of billings on uncompleted contracts	**–**	**–**	**584**	**353**	**6**	**943**
Nontrade receivables	**696**	**24**	**282**	**339**	**2**	**1,343**
Other current assets:						
Advances to an associate	**–**	**5,769**	**–**	**–**	**–**	**5,769**
HTM investments	**8,587**	**–**	**–**	**–**	**–**	**8,587**
Other noncurrent assets:						
HTM investments	**27,444**	**–**	**–**	**–**	**–**	**27,444**
AFS financial assets	**5,664**	**–**	**–**	**–**	**–**	**5,664**
Advance payments to a supplier	**–**	**–**	**1,497**	**–**	**–**	**1,497**
	₱94,535	**₱8,172**	**₱13,218**	**₱4,415**	**₱2,981**	**₱124,631**

	December 31, 2016 (Audited)					
	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	₱46,537	₱–	₱–	₱–	₱–	₱46,537
Trade and other receivables:						
Billed electricity	3,176	1,844	8,285	2,624	2,991	18,920
Service contracts	1,005	–	163	2,278	213	3,659
Insurance receivable	1	–	68	35	–	104
Cost and estimated earnings in excess of billings on uncompleted contracts	–	–	373	226	6	605
Nontrade receivables	945	8	294	384	4	1,635
Other current assets:						
Advances to an associate	–	5,644	–	–	–	5,644
HTM investments	1,350	–	–	–	–	1,350
Other noncurrent assets:						
HTM investments	34,997	–	–	–	–	34,997
AFS financial assets	10,186	–	–	–	–	10,186
Advance payments to a supplier	–	–	1,277	–	–	1,277
	₱98,197	₱7,496	₱10,460	₱5,547	₱3,214	₱124,914

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, 2017 and December 31, 2016:

	September 30, 2017 (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	**₱6,297**	**₱–**	**₱–**	**₱–**	**₱–**	**₱6,297**
Cash in banks	**40,324**	–	–	–	–	**40,324**
Trade and other receivables:						
Trade:						
Billed electricity	**17,031**	**731**	**229**	**457**	**2,753**	**21,201**
Service contracts	**1,638**	**183**	**28**	**2,035**	**220**	**4,104**
Insurance receivable	**88**	**4**	**6**	**50**	–	**148**
Cost and estimated earnings in excess of billings on uncompleted contracts	**584**	**66**	**47**	**240**	**6**	**943**
Nontrade receivables	**1,002**	**33**	**72**	**234**	**2**	**1,343**
Other current assets:						
Advances to an associate	**5,769**	–	–	–	–	**5,769**
HTM investments	**8,587**	–	–	–	–	**8,587**
Other noncurrent assets:						
HTM investments	**27,444**	–	–	–	–	**27,444**
AFS financial assets	**5,664**	–	–	–	–	**5,664**
Advance payments to a supplier	**1,497**	–	–	–	–	**1,497**
	₱115,925	**₱1,017**	**₱382**	**₱3,016**	**₱2,981**	**₱123,321**

	December 31, 2016 (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	₱5,627	₱–	₱–	₱–	₱–	₱5,627
Cash in banks	40,910	–	–	–	–	40,910
Trade and other receivables:						
Trade:						
Billed electricity	13,305	690	244	1,690	2,991	18,920
Service contracts	1,168	146	22	2,110	213	3,659
Insurance receivable	69	2	2	31	–	104
Cost and estimated earnings in excess of billings on uncompleted contracts	373	43	30	153	6	605
Nontrade receivables	1,247	57	76	251	4	1,635
Other current assets:						
Advances to an associate	5,644	–	–	–	–	5,644
HTM investments	1,350	–	–	–	–	1,350
Other noncurrent assets:						
HTM investments	34,997	–	–	–	–	34,997
AFS financial assets	10,186	–	–	–	–	10,186
Advance payments to a supplier	1,277	–	–	–	–	1,277
	₱116,153	₱938	₱374	₱4,235	₱3,214	₱124,914

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 (1) institution.

The following table sets out the maturity profile of the financial liabilities based on contractual undiscounted payments plus future interest:

	September 30, 2017 (Unaudited)				
	Less than 3 Months	**Over 3–12 Months**	**Over 1–5 Years**	**More than 5 Years**	**Total**
	(Amounts in millions)				
Notes payable	**₱1,194**	**₱12,634**	**₱–**	**₱–**	**₱13,828**
Trade payables and other current liabilities	**48,874**	**–**	**–**	**–**	**48,874**
Customers' refund	**4,626**	**–**	**–**	**–**	**4,626**
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	**–**	**–**	**–**	**–**	**–**
Fixed rate borrowings	**305**	**1,235**	**16,938**	**12,805**	**31,283**
Redeemable preferred stock	**1,498**	**–**	**–**	**–**	**1,498**
Customers' deposits	**1,094**	**1,994**	**4,990**	**18,558**	**26,636**
Refundable service extension costs	**275**	**2,227**	**4,405**	**1,185**	**8,092**
Total undiscounted financial liabilities	**₱57,866**	**₱18,090**	**₱26,333**	**₱32,548**	**₱134,837**

	December 31, 2016 (Audited)				
	Less than 3 Months	Over 3–12 Months	Over 1–5 Years	More than 5 Years	Total
	(Amounts in millions)				
Notes payable	₱11,618	₱–	₱–	₱–	₱11,618
Trade payables and other current liabilities	43,634	–	–	–	43,634
Customers' refund	4,988	–	–	–	4,988
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	27	39	2,452	–	2,518
Fixed rate borrowings	283	1,202	16,789	13,408	31,682
Redeemable preferred stock	1,502	–	–	–	1,502
Customers' deposits	350	2,660	4,993	18,508	26,511
Refundable service extension costs	424	2,078	4,161	766	7,429
Total undiscounted financial liabilities	₱62,826	₱5,979	₱28,395	₱32,682	₱129,882

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 interests) of ₱2,664 million and ₱2,594 million will be refunded within a year. This is shown as part of "Trade payables and other current liabilities" account in the consolidated statements of financial position as at September 30, 2017 and December 31, 2016, 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, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions, except debt to equity ratio)	
Long-term debt	**₱25,183**	₱27,370
Redeemable preferred stock	**1,498**	1,502
Notes payable	**13,469**	11,475
Debt (a)	**40,150**	40,347
Equity attributable to the holders of the parent (b)	**70,714**	74,417
Debt to equity ratio(a)/(b)	**0.57**	0.54

27. Income Taxes and Local Franchise Taxes

Income Taxes

The components of net deferred tax assets and liabilities as at September 30, 2017 and December 31, 2016 are as follows:

	Note	**September 30, 2017 (Unaudited)**	December 31, 2016 (Audited)
			(Amounts in millions)
Deferred tax assets:			
Provisions for various claims	*18 and 21*	**₱23,100**	₱21,027
Accrued employee benefits	*25*	**1,151**	846
Unfunded retirement benefits cost and unamortized past service cost	*25*	**1,022**	932
Allowance for doubtful accounts	*12*	**825**	898
Allowance for excess of cost over net realizable value of inventories	*13*	**58**	58
Others		**154**	55
		26,310	23,816
Deferred tax liabilities:			
Revaluation increment in utility plant and others	*15*	**7,077**	7,160
Actuarial gains	*25*	**1,726**	1,482
Capitalized interest		**759**	763
Capitalized duties and taxes deducted in advance		**645**	617
Depreciation method differential		**542**	666
Others		**265**	145
		11,014	10,833
		₱15,296	₱12,983

The deferred tax assets and liabilities are presented in the consolidated statements of financial position as follows:

	September 30, 2017 (Unaudited)	December 31, 2016 (Audited)
	(Amounts in millions)	
Deferred tax assets - net	**₱15,345**	₱13,019
Deferred tax liabilities - net	**(49)**	(36)
	₱15,296	₱12,983

Provision for (benefit from) income tax consists of:

	Unaudited			
	For the Nine Months Ended September 30		**For the Three Months Ended September 30**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
Current	**₱8,799**	₱8,008	**₱3,410**	₱2,972
Deferred	**(2,579)**	(1,837)	**(1,211)**	(937)
	₱6,220	₱6,171	**₱2,199**	₱2,035

A reconciliation between the provision for income tax computed at statutory income tax rate of 30% for the nine (9) months ended September 30, 2017 and 2016, 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**	
	2017	2016	**2017**	2016
	(Amounts in millions)			
Income tax computed at statutory tax rate	**₱6,671**	₱6,598	**₱2,294**	₱2,095
Income tax effects of:				
Interest income subjected to lower final tax rate	**(487)**	(445)	**(166)**	(163)
Nondeductible interest expense	**201**	184	**69**	68
Nontaxable income	**(65)**	(64)	**(20)**	(2)
Equity in net earnings (losses) of associates and joint ventures	**(97)**	40	**(28)**	48
Others	**(3)**	(142)	**50**	(11)
	₱6,220	₱6,171	**₱2,199**	₱2,035

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 2017 and 2016, *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 ₱1,680 million and ₱1,629 million as at September 30, 2017 and December 31, 2016, respectively.

NOLCO totaling to ₱1,680 million may be claimed as deduction against taxable income as follows:

Date Incurred	Expiry Date	Amount
		(In millions)
December 31, 2014	December 31, 2017	₱500
December 31, 2015	December 31, 2018	322
December 31, 2016	December 31, 2019	467
September 30, 2017	September 30, 2020	391
		₱1,680

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.

28. 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, on November 27, 2003, *MERALCO* filed a claim 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 ("*TCC*s"), proportionate to the actual refund of claims to utility customers. The *BIR* initially issued *TCC*s amounting to ₱317 million corresponding to actual refund to customers as at August 31, 2005. In May 2014, the *BIR* issued additional *TCC*s amounting to ₱396 million corresponding to actual refund to customers as at December 31, 2012.

As at September 30, 2017 and December 31, 2016, the amount of unissued *TCC*s 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, "Overpayment of Income Tax related to *SC* Refund"). 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 October 27, 2017, 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.

RPT Assessments

Several Local Government Units ("*LGU*s") assessed *MERALCO* for deficiency *RPT*s on certain assets of *MERALCO.* The assets include electric transformers, distribution wires, insulators, and poles, collectively referred to as *TWIP*. Of these *LGU*s, one (1) 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 *LGC*. *MERALCO* did not appeal the *SC* Decision. The cases of the other *LGU*s are pending with their respective administrative bodies or government offices.

MERALCO will file for the recovery of any resulting *RPT* payments from customers through a separate application with the *ERC*. In 2016, *MERALCO* began the process of settlement with the affected *LGU*s.

On January 30, 2017, *PEPOA* filed a Petition for rule-making proposing that Real Properly Tax be allowed as a pass-through cost in the light of the *SC* Decision. In an Order dated June 7, 2017, the case was set for hearings on August 7, 9 and 11, 2017, respectively. *MERALCO* filed its intervention and submitted its comments. As at October 27, 2017, the Petition is pending before the *ERC*.

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 *MERALCO* to enter into a long-term power 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 *BOD*s 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. The parties have filed their respective memoranda. As at October 27, 2017, *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 (2) 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 ("*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 of 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. As at October 27, 2017, *MERALCO* is awaiting further action of the *SC* on the matter.

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 ("*SGC*s") is ₱4.7 billion. Additionally, *MERALCO* was directed to file a petition against the following *SGC*s: *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 *SGC*s.

In an Order dated July 1, 2013, the *ERC* issued the following clarifications/resolutions: 1) *SPPC* should be included as one of the *SGC*s 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 *SGC*s 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 *SGC*s: *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 October 27, 2017, *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*. The Petition has been given due course and the parties have filed their respective memoranda. As at October 27, 2017, *MERALCO* is still 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 *SGC*s; 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 *SGC*s, 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 *SGC*s' 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 October 27, 2017, 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 October 27, 2017, *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 October 27, 2017, 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 *DU*s 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 October 27, 2017, 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 (2) 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 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. In an Order dated June 13, 2017, the *ERC* denied the motion to consolidate but upheld the authority of private counsel to represent the Complainants. *MERALCO* filed a Motion for Partial Reconsideration to question such authority.

In an Order dated February 2, 2017, the *ERC* denied the motion to dismiss. *MERALCO* filed its Motion for Reconsideration of the Order on February 23, 2017. In an Order dated June 20, 2017, the *ERC* denied the Motion for Reconsideration. On September 19, 2017, *MERALCO* filed a Petition for Certiorari with the *CA*. In a Resolution dated October 2, 2017, the *CA* required respondents to file their Comment on the Petition within 10 days and held in abeyance its resolution on the prayer for injunctive relief until the comments have been filed. *MERALCO* was likewise given a period of five (5) days to file its reply. *MERALCO* is awaiting the comment of the

respondents. In the meantime, *TMO* also filed a separate Petition for Review on Certiorari with the *CA*.

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 court issued an Order dated June 27, 2016 denying the motions for reconsideration. *PSALM* has elevated these orders to the *CA* through a Petition for Certiorari. In an Order dated May 25, 2017, the *CA* denied *PSALM*'s prayer for the issuance of a *TRO* and/or writ of preliminary injunction. On July 17, 2017, *MERALCO* received a copy of *PSALM*'s Motion for Reconsideration. As at October 27, 2017, *MERALCO* is awaiting further action by the *CA*.

Others

Liabilities for certain local taxes amounting to ₱2,972 million as at September 30, 2017 and December 31, 2016, 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.

29. 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 *PSA*s are for a period of seven (7) years, extendable for three (3) years upon agreement of the parties. Thereafter, applications for approval of the *PSA*s were filed with the *ERC*.

MPower likewise signed separate *PSA*s 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 *PSA*s of *MERALCO* with *SPPC*, *Sem-Calaca*, *MPPCL*, *TLI* and *SMEC*.

*MR*s were filed regarding the *ERC* decisions on the *PSA*s with *SPPC*, *Sem-Calaca* and *SMEC*. *MERALCO* is awaiting the decision of the *ERC* on the *SPPC* and *Sem-Calaca MR*s. 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 *PSA*s for an additional period of three (3) years up to December 25, 2022. Thereafter, relevant Manifestations with Motion for Approval of the Supplemental Agreements were filed with the *ERC*.

Under the *PSA*s approved by the *ERC*, 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
	(In Megawatt)	*(In millions)*
2018	3,150	₱42,526
2019	2,530	34,620
2020	1,305	22,321
2021	525	9,210
2022-2036	525	144,695
2037-2039	455	27,085

FGPC and *FGP*

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

Accordingly, *MERALCO* entered into separate 25-year *PPA*s 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 *PPA*s. 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 *PPA*s of *FGP* and *FGPC* were approved by the *ERC* on May 31, 2006.

Under the respective *PPA*s 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* 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
	(In million kwh)	*(In Millions)*
2018	14,980	₱21,113
2019	14,980	20,745
2020	14,980	20,882
2021 to 2025	14,980	106,587
2026 to 2027	7,203	34,378

Philippine Power and Development Company ("*Philpodeco*")

On May 15, 2014, *MERALCO* and *Philpodeco* executed a *PSA*. *Philpodeco* operates three (3) run-of-river hydro power plants, namely: (i) Palakpakin, a 448 *kW* hydro power plant located at Barangay Prinza, Calauan, Laguna; (ii) Calibato, a 75 *kW* Calibato hydro power plant located at Barangay Sto. Angel, San Pablo City, Laguna; and (iii) 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 *Philpodeco.* This *PSA* provides that *MERALCO* shall accept all the energy deliveries of *Philpodeco* as measured by the latter's billing meter. Hearings on this case have been completed and *MERALCO* has submitted its *FOE*. As at October 27, 2017, 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.

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*. As at October 27, 2017, *MERALCO* is awaiting the *ERC*'s decision on its Manifestation with Motion.

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 October 27, 2017, the case is pending decision by the *ERC*. However, the contract term has expired while the decision is pending with 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. Said motions are still pending decision by the *ERC*. On January 3, 2017, *MERALCO* filed a Manifestation with Motion informing the *ERC* of the extension of the term of the *PSA* from June 26, 2017 to June 25, 2018. In an Order dated June 6, 2017, the *ERC* noted *MERALCO*'s Manifestation and Motion and confirmed the one (1) year extension of the *PSA*. *MERALCO* and *TMO* were further directed to strictly comply with the provisions of *ERC* Resolution No. 1, Series of 2016, in particular the one (1) time limit for renewal of the *PSA*.

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* expires 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 October 27, 2017, the case is submitted for decision.

RP Energy

On April 20, 2016, *MERALCO* signed a 20-year *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*. Hearings have been completed. *MERALCO* and *RPE* have both filed their respective *FOE*. The case is submitted for decision. Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *RPE* and *MERALCO* filed their oppositions. *MERALCO* and *RPE* likewise filed motions for the resolution of the pending case. As at October 27, 2017, the motions are still pending before the *ERC*.

A1E

On April 26, 2016, *MERALCO* signed a 20-year *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*. Hearings have been completed. *MERALCO* and *A1E* have both filed their respective *FOE* on March 8, 2017. Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* files its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *A1E* and *MERALCO* filed their oppositions. *MERALCO* and *A1E* likewise filed motions for the resolution of the pending case. As at October 27, 2017, the motions are still pending before the *ERC*.

St. Raphael

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *St. Raphael* for the purchase of up to 400 *MW* of electrical output from the 2 x 350 *MW* coal-fired power generating facility that *St. Raphael* 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*. Hearings have been completed and *MERALCO* has filed its *FOE.* Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* files its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *St. Raphael* and *MERALCO* filed their oppositions. *MERALCO* and *St. Raphael* likewise filed motions for the resolution of the pending case. As at October 27, 2017, the motions are still pending before the *ERC*.

Central Luzon Premiere Power Corp. ("*Central Luzon Power*")

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Central Luzon Power* 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 *Central Luzon Power* 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*. In its Order dated January 25, 2017, the *ERC* held the processing of the application in abeyance. On February 9, 2017, *Central Luzon Power* filed a *MR* of the said *ERC* Order.

Several other consumer groups subsequently filed their petitions to intervene. On July 22, 2017, *MERALCO* filed its consolidated comment to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. As at October 27, 2017, the case is still awaiting further action from *ERC*.

Mariveles Power

On April 26, 2016, *MERALCO* signed a 20-year *PSA* with *Mariveles Power* 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 *Mariveles Power* 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*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On September 30, 2016, *Mariveles Power* filed a Motion for Reconsideration of the August 9, 2016 Order of the *ERC*. On October 3, 2016, *MERALCO* filed a Manifestation alleging that *ERC* can validly proceed with the hearing and evaluation of the Joint Application. The said *MR* is pending resolution by the *ERC*. Several other consumer groups subsequently filed their petitions to intervene. On July 22, 2017, *MERALCO* filed its consolidated comment to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. As at October 27, 2017, the case is still awaiting further action from the *ERC*.

PEDC

On April 26, 2016, *MERALCO* signed a 20-year *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. In its letter dated November 23, 2016, the *ERC* informed *MERALCO* that *ERC* has provisionally approved the *PSA* between *MERALCO* and *PEDC* in its order dated July 11, 2016. Hearings have been completed. On October 4, 2016, *MERALCO* received a Petition from a consumer group seeking to intervene in the case. On October 11, 2016, *MERALCO* filed an Opposition to the consumer group's Petition for Intervention on the ground that the same was defective and filed out of time. On January 10, 2017, *MERALCO* and *PEDC* filed their Joint Motion to Admit *FOE* with Joint Urgent Motion for Early Resolution of the Application, seeking to, among other things, already source 70 *MW* from *PEDC* beginning January 28, 2017 in order to temper the anticipated additional burden that the *SPEX*-Malampaya Outage may bring to end-users. On January 16, 2017, *MERALC*O filed a Manifestation with the *ERC*. On January 17, 2017, *MERALCO* received a letter dated November 23, 2016, informing *MERALCO* that *ERC* provisionally approved the *PSA*. On January 23, 2017, *MERALCO* received two (2) Orders from the *ERC*, both dated December 8, 2016: (i) treating the consumer group's Petition for Intervention as an Opposition; and (ii) setting another hearing for the continuation of the presentation of *MERALCO* and *PEDC*'s evidence. During the hearing on February 23, 2017, *PEDC* presented its evidence and *MERALCO* was directed to answer additional clarificatory questions from, and submit additional documents to, the *ERC*. *MERALCO* filed its Compliance with said *ERC* directive on April 17, 2017. Several other consumer groups subsequently filed their petitions to intervene. On July 19, 2017, *MERALCO* filed its consolidated opposition to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations to which both *PEDC* and *MERALCO* filed their oppositions. As at October 27, 2017, the motions are still pending before the *ERC*.

Global Luzon Energy Development Corporation ("*GLEDC*")

On April 27, 2016, *MERALCO* signed a 20-year *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*. In its Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On October 4, 2016, *MERALCO* received a Petition from a consumer group seeking to intervene in the case. On October 21, 2016, *MERALCO* received *GLEDC*'s Motion for Reconsideration of the August 9, 2016 *ERC* Order. Several other consumer groups subsequently filed their petitions to intervene. On July 21, 2017, *MERALCO* filed its consolidated comment to these petitions. On August 30, 2017, the *ERC* issued an order denying the request for intervenor status but treated such parties as oppositors. The parties have filed their respective motions for reconsiderations. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. As at October 27, 2017, the case is still awaiting further action from *ERC*.

First Bulacan

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *First Bulacan* for the purchase of 50 *MW* of electrical output from its solar plant in San Miguel, Bulacan. The *PSA*'s effectivity is subject to a *CSP*, and if *First Bulacan* will be declared as the winning power supplier, upon approval of the *ERC*. The Application for approval of the *PSA* with *First Bulacan* was filed on February 23, 2017. The application is set for hearing on June 23, 2017. *MERALCO* filed its *FOE* on July 12, 2017. *First Bulacan* has filed urgent motions for the resolution of the Application. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. *MERALCO* and *First Bulacan* filed their oppositions to the petition. As at October 27, 2017, the case is pending decision with the *ERC*.

Solar Philippines Tanauan Corporation ("*Solar Philippines Tanauan*")

On September 16, 2016, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tanauan* for the purchase of 50 *MW* of electrical output from its solar plant in Tanauan, Batangas. The *PSA*'s effectivity is subject to a *CSP*, and if *Solar Philippines Tanauan* will be declared as the winning power supplier, upon approval of the *ERC*. The Application for approval of the *PSA* with *Solar Philippines Tanauan* was filed on February 27, 2017. Hearings have been completed and *MERALCO* filed its *FOE* on July 12, 2017. On October 3, 2017, *MERALCO* received a consumer group's petition for intervention. *MERALCO* and *Solar Philippines Tanauan* filed their oppositions to the petition. As at October 27, 2017, the case is pending decision with the *ERC*.

Solar Philippines Tarlac Corporation ("*Solar Philippines Tarlac*")

After being declared the winner bidder in a *CSP*, on October 6, 2017, *MERALCO* signed a 20-year *PSA* with *Solar Philippines Tarlac* for the purchase of up to 85 *MW* of electrical output from its solar plant in Tarlac. The Application for approval of the *PSA* with *Solar Philippines Tarlac* was filed on October 19, 2017. As at October 27, 2017, the *ERC* has yet to schedule the Application for initial hearing.

*Interim Power Supply Agreements ("IPSA*s")

On January 19, 2016, after the conduct of a price challenge in compliance with *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 (1) year up to two (2) 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 (2) separate *IPSA*s with the following wholly-owned subsidiaries of *GBPC*, namely; (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 (1) year up to four (4) times, unless terminated by either party prior to the expiration of its term. Both *IPSA*s 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 *IPSA*s.

On January 26, 2017, considering the imminent Malampaya shutdown from January 28 until February 16, 2017, *MERALCO* agreed to extend the *IPSAs* with *TPC* and *PPC* until February 25, 2018, provided that beginning January 28, 2017, (i) supply from *TPC* and *PPC* will be through replacement energy at a price lower than the Contract Price and (ii) supply from *PPC* will be on a firm basis until August 25, 2017, and on a non-firm basis from August 26, 2017 until end of the term thereof. All other terms and conditions under the *IPSAs*, as may be approved by the *ERC*, remain the same.

On January 24, 2017, in view of the Malampaya shutdown that was to coincide with the scheduled outage of other plants, *MERALCO* signed an *IPSA* with Strategic Power Development Corporation ("*SPDC*") for the supply of 100 *MW* per hour of electric power from 0901H to 1000H and from 2001H to 2100H, and 150 *MW* per hour of electric power from 1001H to 2000H, from January 28 until February 16, 2017. An application for approval of such *IPSA* was filed before the *ERC* on February 9, 2017. The said *IPSA* was effective immediately, on the condition that disallowances and penalties that the *ERC* may impose as a result thereof shall be for the account of *SPDC*. *MERALCO* and *SPDC*, in a letter-agreement dated February 15, 2017, agreed to extend the term of the *IPSA* until March 25, 2017 under the same terms and conditions of the *IPSA*. On February 16, 2017, *MERALCO* and *SPDC* filed a Joint Manifestation with Motion with the *ERC* apprising the Honorable Commision of the extended Term and praying that the same be duly considered and approved accordingly. The hearings on this case have been completed and *MERALCO* filed its *FOE* on July 21, 2017.

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. *Altenergy* 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 with respect to 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. In its Decision dated June 8, 2015, the *ERC* approved *ATN's* application for authority to develop, own and operate a dedicated point-to-point lines and facilities.

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 *TSA*.

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.

In 2016, the *TSA* was terminated.

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 for 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 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 *CEZ*.

30. 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**	
	2017	2016	**2017**	2016
	(In millions, except per share data)			
Net income attributable to equity holders of the Parent (a)	**₱15,928**	₱15,676	**₱5,428**	₱4,908
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)	**₱14.13**	₱13.91	**₱4.82**	₱4.35

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 2017 and 2016.

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.

31. **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 with the January 2010 billing. The said cap is one (1) 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) recognized as 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 October 4, 2016, a legislator proposed a bill to lower the current cap of system loss rate from 8.5% to 5% for private *DU*s and from 13% to 10% for electric cooperatives and to exclude non-technical system losses and electricity used by the private *DU*s and electrical cooperatives from what may be passed on to consumers as system loss charges. As at October 27, 2017, this proposed bill is still subject for deliberation of the Senate.

On May 9, 2017, the *ERC* posted on its website the draft rules on the *Proposed Rules for Setting the Distribution System Loss Cap and Establishing Performance Incentive Scheme for Distribution Efficiency. ERC* engaged a third party consultant to conduct the study on the system losses of *DU*s and propose new caps. Said rules proposed different system loss caps according to four (4) clusters. Electric cooperatives were grouped in Clusters 1 to 3 and private *DU*s in Cluster 4. *DU*s in clusters 1 to 4 have proposed system loss caps of 11.5%, 10%, 7.75%, and 4%, respectively. These caps, which include feeder technical loss and nontechnical loss but exclude sub-transmission and substation technical losses are proposed to be implemented based on the *DU*'s next regulatory reset schedule. For *MERALCO*, the proposed implementation date is July 2019. A series of public consultations and focus grouped discussions followed, the latest of which was a public consultation for Mindanao stakeholders held in Pasig City last August 9, 2017. In said public consultation, the third party consultant proposed a graduated reduction in system loss caps per cluster. Beginning 2018, *DU*s in clusters 1 to 3 shall have a cap of 12% and *DU*s in cluster 4 shall have a cap of 8%, all of which exclude sub-transmission and substation system losses. The caps of cluster 1 to 3 will remain/be lowered to 12%, 10.25%, 8.25% by 2022, respectively. For private *DU*s, the cap will be reviewed based on their submission of annual feeder data to the *ERC*. If private *DU*s fail to submit one (1) year's data (from 2018-2020), its cap in 2022, shall be set at 4.75% excluding subtransmission and substation system losses. The latest proposal of the third party consultant also includes a 1% cap on subtransmission and substation system losses which was not previously capped in the original draft rules. The final recommendations are being planned for presentation to *ERC* in September or October 2017.

Benefit-Sharing Scheme to Lower System Loss

On January 26, 2011, *MERALCO*, together with *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 *DU*s 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 October 27, 2017, 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 operations 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, mandating all *DU*s to submit to the *ERC* and *CRB* information on end-users with (i) monthly average peak demand of at least 1 *MW* for the preceding 12 months; and (ii) monthly average peak demand of 750 *kW* but not greater than 999 *kW*. The *ERC* shall use this information as basis for 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 Circular essentially provided for mandatory contestability.

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 Supplier of last resort ("*SOLR*"), or, if applicable, procures power from the *WESM*;

2. Prohibits *DU*s from engaging in the supply of electricity to the contestable market except in its capacity as a *SOLR*;

3. Mandates Local *RES*s to wind down their supply businesses within a period of three (3) years;

4. Imposes upon all *RES*s, including *DU*-affiliate *RES*s, 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 *RES*s 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.

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*. A similar petition was subsequently filed by the *DOE* before the *SC*.

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. In a Resolution dated November 9, 2016, the *SC* denied *MERALCO*'s *MR* of the October 10, 2016 Resolution.

On November 2, 2016, in relation to the Petition filed by the *ERC*, the *SC* issued a Resolution dated September 26, 2016, which partially granted the *ERC* Petition. While the *SC* allowed the *RTC*-Pasig to proceed with the principal case of declaratory relief, it nonetheless issued a Preliminary Mandatory Injunction ("*PMI*") against *RTC*-Pasig to vacate the preliminary injunction it previously issued, and Preliminary Injunction ("*PI*") ordering the *RTC*-Pasig to refrain issuing further orders and resolutions tending to enjoin the implementation of *EPIRA*. On November 14, 2016, *MERALCO* filed a Motion for Partial Reconsideration with Very Urgent Motion to lift *PMI*/*PI*.

On November 24, 2016, the *ERC* promulgated a resolution moving the contestability date of end users with an average monthly peak demand of at least one (1) *MW* from December 31, 2016 to February 26, 2017. On January 17, 2017, *MERALCO,* through counsel, received an *SC* Resolution dated December 5, 2016, which consolidated the *SC DOE* Petition with the *SC ERC* Petition. The same resolution also denied the Motion for Partial Reconsideration filed by *MERALCO*.

In relation to the *ERC* and *DOE* Petitions, a separate Petition for Certiorari, Prohibition and Injuction was filed by several institutional customers. In said Petition, said customers sought to declare as null and void, as well as to enjoin the *DOE* and *ERC* from implementing *DOE* Circular No. 2015-06- 0010, Series of 2015*, ERC* Resolution Nos. 5, 10, 11 and 28, Series of 2016. Acting on the Petition, the *SC en banc* through a Resolution dated February 21, 2017, issued a *TRO* enjoining the *DOE* and the *ERC* from implementing *DOE* Circular No. 2015-06- 0010 Series of 2015, *ERC* Resolution Nos. 5, 10, 11 and 28 Series of 2016. Pursuant to the foregoing, *PEMC* has taken the position that the *TRO* enjoined the voluntary contestability of 750 *kW* to 999 *kW* customers and has not allowed them to switch to the contestable market. The *DOE*, in a press release, has advised that it is in the process, together with *PEMC* and *ERC*, of drafting a general advisory for the guidance of *RCOA* stakeholders. The *PCCI* petition was consolidated with two (2) other separate petitions filed by an educational institution and several distribution utilities. The *DOE* and *ERC* have also filed a consolidated comment on these petitions.

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 (i) adopt a permanent pre-emptive mitigating measure that will be applied in the *WESM*; (ii) direct all interested stakeholders to submit their proposed measures within 20 days from effectivity of such Resolution; and (iii) 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 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 which shall be applied 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 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* 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*-Pasig denied the Motion for Leave to File and Admit Supplemental Petition. *PIPPA* filed a Motion for Partial Reconsideration which was denied by the *RTC*-Pasig in its Resolution dated September 10, 2015. *PIPPA* filed a Petition for Certiorari with the *CA*. The *CA* denied the Petition for Certiorari in it Decision dated June 9, 2017. *PIPPA* filed a Motion for Reconsideration dated

July 19, 2017. In a Resolution dated August 16, 2017, the parties were directed to file their comments to the *PIPPA*'s motion for reconsideration. *MERALCO* has filed its comment on the Motion for Reconsideration. As at October 27, 2017, *MERALCO* is awaiting the further action of the *CA* on the motion.

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.

On December 7, 2015, the *RTC*-Pasig 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. *PIPPA* appealed the *RTC*-Pasig Decision with the *SC*. *MERALCO* has filed its comment thereto. *PIPPA* filed a Consolidated Reply on July 17, 2017.

On May 9, 2017, the *ERC* issued Resolution No. 4, Series of 2017, entitled, "A Resolution Adopting Amendments to the Pre-emptive Mitigating Measure in the *WESM*". They adopted a recalculated cumulative price threshold level of ₱1,080,000 and a shorter 5-day (120-hour) rolling average period. This is equivalent to ₱9,000 per *MWh* over said period.

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" ("*Guidelines*"). Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *DU*s which are under the legislatively-authorized regulatory jurisdiction of the *ERC*. The Guidelines are the subject of an injunction case filed by the *DU*s at the *RTC*-Pasig.

On February 4, 2015, the *RTC*-Pasig 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 *RTC*-Pasig. *MERALCO* submitted the Tripartite Agreement among *PEZA*, *PEPOA* and *MERALCO* for approval of the *RTC*-Pasig. In a Decision dated July 3, 2015, the *RTC*-Pasig approved the Compromise Agreement between *PEZA*, *PEPOA* and *MERALCO*. In the hearing on February 10, 2016, the *RTC*-Pasig dismissed the petition upon motion by *PEZA*. The *ERC* filed a motion for reconsideration which is pending resolution by the *RTC*-Pasig.

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 Decision dated August 12, 2016, the *CA* dismissed the Petition. On September 17, 2016, *MERALCO* filed a *MR*. In an Amended Decision dated September 15, 2017, the *CA* granted *MERALCO*'s *MR* and approved the sale of the Dasmarinas-Abubot-Rosario 115 *kV* line and Rosario substation equipment in favor of *MERALCO*. *NGCP* filed a *MR* (of the Amended Decision) dated October 4, 2017.

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*-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 *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 (2) 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* were submitted for resolution of the *ERC*.

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-All* charge shall 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-All* isbursement 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 *TRO* and/or *WPI*, 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. The parties have been directed to submit their respective memoranda.

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. As at October 27, 2017, the motion for reconsideration is pending.

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*- All 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.

On December 1, 2016, *TransCo* filed its Application for Approval of the *FiT-All* for calendar year 2017. In an Order dated April 26, 2017, the *ERC* set the case for initial hearing on May 15, 19 and June 2 and 9, respectively. Hearings on this case are have been completed and the parties are set to file their respective memoranda.

On August 30, 2017, *TransCo* filed its Application for Approval of the *FiT*-All for calendar year 2018. The initial hearing of this case is set on December 6, 2017.

On September 29, 2016, Alternergy Wind One Corporation, Petrowind Energy, Inc. and Trans-Asia Renewable Energy Corporation filed a Petition to Initiate Rule-Making to adjust the Wind *FIT* rate of ₱7.40 per *kWh* to ₱7.93 per *kWh*. *MERALCO* filed an intervention in the case. The hearing on the Petition was set on January 6, 2017. *MERALCO*'s motion on the propriety of the petition has been submitted for the resolution of the *ERC*.

In May 2017, *TransCo* filed for an application with the *ERC* seeking to collect a *FiT-All* rate of ₱0.2291 per *kWh* for 2017. As at October 27, 2017, hearings are ongoing.

Net Metering Program

The *RE* Act mandates the *DU*s 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 *DU*s.

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 *DU*s' 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, 2017, *MERALCO* has already installed 1,069 meters and energized 982 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 *ILP*. *ILP* protocols, compensation and recovery mechanism are governed by *ERC* Resolution No. 5, Series of 2015 "A Resolution Adopting the Amended Rules to Govern the Interruptible Load Program" and *DOE* Circular No. DC2015-06-0003 "Providing the Interim Manner for Declaring Bilateral Contract Quantities in the Wholesale Electricity Spot Market and Directing the Philippine Electricity Market Corporation to Establish Necessary Protocols to Complement the Interruptible Load Program".

To prepare for the scheduled maintenance of the Malampaya gas facility, *MERALCO*, as directed by the *DOE*, conducted a forum for its customers participating in the *ILP* on January 19, 2017.

Under the *ILP*, a customer may voluntarily reduce its load requirement from the grid usually by shifting its requirement to its generator set.

As at September 30, 2017, there are 169 companies with a total committed de-loading capacity of 657 *MW* that have signed up with *MERALCO*, *MPower* and with other retail electricity suppliers 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, 2017, 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, 2017, there are 76,763 customers availing of *PRES*.

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 *DU*s 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 *DU*s to procure all its uncontracted demand through *CSP*, through the participation of a Third Party and which may be done by *DU*s 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 the same date, *ERC* promulgated Resolution No. 13, Series of 2015.

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

- All *DU*s are required to undergo *CSP*. Pending the *ERC's* issuance of a prescribed process, *DU*s 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 *PSA*s 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 (2) qualified bids for the *CSP* to be considered successful.

In reference to *PSA*s with provisions allowing the automatic renewal or extension of their term, *PSA*s 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 *PSA*s shall no longer be permitted.

On November 18, 2016, *MERALCO* received a copy of the Petition dated April 28, 2016 filed by a consumer group in the *SC* against *ERC*, *DOE*, *MERALCO*, *Central Luzon Power*, *St. Raphael*, *PEDC*, *Mariveles Power*, *A1E*, *RPE* and the Philippine Competition Commission which sought to declare as void Resolution No. 1, Series of 2016 and to mandate the *ERC* to disapprove all *PSA* applications for failing to comply with the *CSP* requirement. In a Resolution dated November 16, 2016, the *SC* directed all parties to comment on the Petition. *MERALCO* has filed its comments to the Petition. In a Resolution dated June 17, 2017, the petitioners were directed to file their replies to the comments filed by respondents.