COVER SHEET

PW-102

S.E.C Registration Number

MANILA ELECTRIC COMPANY

(Company's Full Name)

LOPEZ BUILDING, ORTIGAS AVENUE,

BRGY UGONG, PASIG CITY

(Business Address: No. Street City / Town / Province)

ATTY. WILLIAM S. PAMINTUAN

Contact Person

632-8014

Company Telephone Number

12-31

Month Day

Fiscal Year

17-C

FORM TYPE

05 31

Month Day

Annual Meeting

Secondary License Type, if Applicable

Dept. Requiring this Doc.

Amended Articles Number/Section

Total Amount of Borrowings

Total No. of Stockholders

Domestic

Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document I.D.

Cashier

STAMPS

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SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-C

CURRENT REPORT UNDER SECTION 17 OF THE SECURITIES REGULATION CODE AND SRC RULE 17.2(c) THEREUNDER

1. **Date of Report:** *March 1, 2017*
2. **SEC Identification Number:** *PW-102*
3. **BIR Tax Identification Code:** *000-101-528-000*
4. **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 principal office:** *Lopez Building, Ortigas Avenue, Barangay Ugong, Pasig City*
8. **Issuer's telephone numbers:** *6328014* **Area Code:** *1605*
9. **Former name or former address:** *Not Applicable*
10. **Securities registered pursuant to Sections 18 and 12 of the SRC or Sections 4 and 8 of the RSA:**

Number of Shares of
Common Stock Outstanding

1,127,098,705
(As of December 31, 2016)

Debt Securities: Php 18.5 Billion Bonds

11. **Item Number reported:** ***Item 9 (Other Events)***

Please find attached 2016 Audited Consolidated Financial Results of the Company. (Please refer to attached document)

SIGNATURE

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

MANILA ELECTRIC COMPANY
Issuer

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

Date: March 1, 2017

Cc: Disclosure Department
Listings and Disclosure Group
Philippine Stock Exchange

Issuer Compliance and Disclosure Department
Philippine Dealing & Exchange Corp.

SGV
Building a better working world

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City
Philippines

Tel: (632) 891 0307
Fax: (632) 819 0872
ey.com/ph

BOA/PRC Reg. No. 0001,
December 14, 2015, valid until December 31, 2018
SEC Accreditation No. 0012-FR-4 (Group A),
November 10, 2015, valid until November 9, 2018

INDEPENDENT AUDITOR'S REPORT

The Board of Directors and Stockholders
Manila Electric Company and Subsidiaries
Lopez Building, Ortigas Avenue
Barangay Ugong, Pasig City, Metro Manila

Opinion

We have audited the consolidated financial statements of Manila Electric Company and its subsidiaries (the Group), which comprise the consolidated statements of financial position as at December 31, 2016 and 2015, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2016, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2016 and 2015, and its consolidated financial performance and its consolidated cash flows for each of the three years in the period ended December 31, 2016 in accordance with Philippine Financial Reporting Standards (PFRSs).

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the Code of Ethics for Professional Accountants in the Philippines (Code of Ethics) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report, including those in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Revenue recognition

The Group's revenues from the sale of electricity represent 97% of its consolidated revenues and arise from its service contracts with a large number of customers that are classified as either commercial, industrial or residential, located within the Group's franchise area. Notes 2, 4, 22, 23, 29 and 31 provide the relevant disclosures related to the rate-making regulations and regulatory policies of the Energy Regulatory Commission (ERC). This matter is significant to our audit because the revenue recognized depends on (a) the complete capture of electric consumption based on the meter readings over the franchise area taken on various dates; (b) the propriety of rates computed and applied across customer classes; and (c) the reliability of the IT systems involved in processing the billing transactions.

Audit response

We obtained an understanding and evaluated the design of, as well as tested the controls over, the customer master file maintenance, accumulation and processing of meter data, and interface of data from the billing system to the financial reporting system. In addition, we performed a test recalculation of the bill amounts using the ERC-approved rates and formulae, as well as actual costs incurred, and compared them with the amounts reflected in the billing statements. We involved our internal specialist in understanding the IT processes and in understanding and testing the IT general controls over the IT systems supporting the revenue process.

Retirement and other long-term employee benefits

The Group has defined benefit retirement and other long-term post-employment benefits plans for all regular employees. We consider this as a key audit matter because the valuation of the benefits obligation involves a significant level of management judgment. The valuation also requires an actuary whose calculations involve the use of certain assumptions, such as prospective salary increase, discount rate, mortality rates, and employee turnover rates that could have a material impact on the calculation of the benefits expense and liability. Notes 10 and 25 to the consolidated financial statements provide the relevant disclosures related to this matter.

Audit response

We obtained an understanding of the Group's defined benefit retirement and other long-term post-employment benefits plans as well as the processes included in estimating the amounts of the related asset, liability and expense. We also involved an internal specialist to assist us with our review of the scope, bases of assumptions, methodology and results of the work by the Group's actuary, whose professional qualifications and objectivity were also evaluated. We compared the key inputs used, such as the attrition rates, discount rate, and future salary increase rate against the Group's internal data and external references. We also inquired about the basis of the salary rate increase and compared it against the Group's forecast. Moreover, we reviewed the required disclosures in the consolidated financial statements.

Provisions and contingencies

The Group is involved in certain proceedings for which the Group has recognized provisions for probable costs and/or expenses, which may be incurred, and/or has disclosed relevant information about such contingencies. This matter is important to our audit because the assessment of the potential outcome or liability involves significant management judgment and estimation. Notes 18, 21 and 28 to the consolidated financial statements provide the relevant disclosures related to this matter.

Audit response

We examined the bases of management's assessment of the possible outcomes and the related estimates of the probable costs and/or expenses that are recognized and/or disclosed in the Group's consolidated financial statements. In addition, we evaluated the input data supporting the assumptions used, such as tariffs, tax rates, historical experience, regulatory rulings and other developments, against the Group's internal and external data and performed recalculations and inspection of relevant supporting documents. We also reviewed the disclosures on provisions and contingencies in the Group's consolidated financial statements.

Other Information

Management is responsible for the other information. The other information comprises the information included in the SEC Form 17-A and Annual Report for the year ended December 31, 2016, but does not include the consolidated financial statements and our auditor's report thereon. The SEC Form 17-A and Annual Report for the year ended December 31, 2016 are expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audits of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audits, or otherwise appears to be materially misstated.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with PFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with PSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with PSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Martin C. Guantes.

SYCIP GORRES VELAYO & CO.

Martin C. Guantes
Martin C. Guantes
Partner
CPA Certificate No. 88494
SEC Accreditation No. 0325-AR-3 (Group A),
August 25, 2015, valid until August 24, 2018
Tax Identification No. 152-884-272
BIR Accreditation No. 08-001998-52-2015,
February 27, 2015, valid until February 26, 2018
PTR No. 5908704, January 3, 2017, Makati City

February 27, 2017

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

		December 31	
	Note	**2016**	2015
		(Amounts in millions)	
ASSETS			
Noncurrent Assets			
Utility plant and others	*7,10 and 15*	**₱128,814**	₱124,913
Investments in associates and interests in joint ventures	*8 and 22*	**10,924**	13,603
Investment properties	*9 and 15*	**1,513**	1,538
Deferred tax assets - net	*27*	**13,019**	11,296
Other noncurrent assets	*2, 7, 10, 12, 25, 26, 28 and 29*	**53,759**	35,594
Total Noncurrent Assets		**208,029**	186,944
Current Assets			
Cash and cash equivalents	*11 and 26*	**46,656**	50,840
Trade and other receivables	*10, 12, 17 and 26*	**25,341**	26,761
Inventories	*13 and 24*	**2,792**	2,273
Other current assets	*10, 14, 22 and 26*	**13,219**	15,421
Total Current Assets		**88,008**	95,295
Total Assets		**₱296,037**	₱282,239
EQUITY AND LIABILITIES			
Equity Attributable to Equity Holders of the Parent			
Common stock	*15*	**11,273**	11,273
Additional paid-in capital		**4,111**	4,111
Excess of acquisition cost over carrying value of non-controlling interest acquired		**(328)**	(328)
Employee stock purchase plan	*15*	**1,049**	1,049
Unrealized fair value gains (losses) on available-for-sale (*AFS*) financial assets	*10*	**(271)**	102
Remeasurement adjustments on retirement and other post-employment liabilities	*25*	**3,384**	935
Share in remeasurement adjustments on associates' retirement liabilities	*8*	**(12)**	(12)
Cumulative translation adjustments of subsidiaries and associates	*8*	**1,085**	(72)
Treasury shares	*15*	**(11)**	(11)
Retained earnings:	*15*		
Appropriated		**–**	11,000
Unappropriated		**54,137**	52,229
Equity Attributable to Equity Holders of the Parent		**74,417**	80,276
Non-controlling Interests		**729**	585
Total Equity		**75,146**	80,861

(Forward)

	Note	December 31 2016	2015
		(Amounts in millions)	
Noncurrent Liabilities			
Interest-bearing long-term financial liabilities - net of current portion	*16, 24 and 26*	**₱26,999**	₱27,370
Customers' deposits - net of current portion	*17, 21 and 26*	**23,501**	23,584
Long-term employee benefits	*25*	**3,119**	3,620
Provisions	*18, 21 and 28*	**19,170**	21,014
Refundable service extension costs - net of current portion	*21 and 26*	**4,927**	4,234
Deferred tax liabilities - net	*27*	**36**	17
Other noncurrent liabilities	*2, 5, 7, 23 and 28*	**38,537**	28,324
Total Noncurrent Liabilities		**116,289**	108,163
Current Liabilities			
Notes payable	*20, 24 and 26*	**11,475**	1,043
Trade payables and other current liabilities	*15, 16, 17, 18, 21, 22, 23, 26and 28*	**83,920**	79,557
Customers' refund	*2, 19 and 26*	**4,988**	5,550
Income tax payable		**2,346**	1,883
Current portion of interest-bearing long-term financial liabilities	*16, 24 and 26*	**1,873**	1,895
Current portion of long-term employee benefits	*25*	**–**	3,287
Total Current Liabilities		**104,602**	93,215
Total Liabilities		**220,891**	201,378
Total Liabilities and Equity		**₱296,037**	₱282,239

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

		Years Ended December 31		
	Note	**2016**	2015	2014
		(Amounts in millions, except per share data)		
REVENUES				
Sale of electricity	*22, 23, 29 and 31*	**₱249,206**	₱249,773	₱261,740
Sale of other services	*9 and 22*	**7,975**	8,626	4,596
		257,181	258,399	266,336
COSTS AND EXPENSES				
Purchased power	*23 and 29*	**189,853**	192,117	203,242
Salaries, wages and employee benefits	*24 and 25*	**12,841**	12,420	11,008
Provision for probable losses and expenses from claims	*18, 23 and 28*	**9,373**	11,628	10,720
Depreciation and amortization	*7, 9 and 10*	**7,312**	6,910	6,093
Contracted services		**5,618**	4,668	4,292
Taxes, fees and permits		**854**	595	662
Provision for doubtful accounts - net	*12*	**171**	502	460
Other expenses	*22 and 24*	**5,451**	6,151	3,765
		231,473	234,991	240,242
OTHER INCOME (EXPENSES)				
Interest and other financial income	*2 and 24*	**2,080**	1,538	770
Interest and other financial charges	*7, 16, 17, 20 and 24*	**(1,343)**	(1,216)	(1,439)
Foreign exchange gains		**896**	367	8
Equity in net losses (earnings) of associates and joint ventures	*8*	**(1,677)**	(27)	295
Others	*2, 22 and 29*	**1,029**	806	740
		985	1,468	374
INCOME BEFORE INCOME TAX		**26,693**	24,876	26,468
PROVISION FOR (BENEFIT FROM) INCOME TAX	*27*			
Current		**10,099**	9,732	9,961
Deferred		**(2,746)**	(4,045)	(1,624)
		7,353	5,687	8,337
NET INCOME		**₱19,340**	₱19,189	₱18,131
Attributable To				
Equity holders of the Parent	*30*	**₱19,176**	₱19,098	₱18,053
Non-controlling interests		**164**	91	78
		₱19,340	₱19,189	₱18,131
Earnings Per Share Attributable to Equity Holders of the Parent	*30*			
Basic		**₱17.01**	₱16.94	₱16.02
Diluted		**17.01**	16.94	16.02

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Note	2016	2015	2014
		Years Ended December 31		
		(Amounts in millions)		
NET INCOME		**₱19,340**	₱19,189	₱18,131
OTHER COMPREHENSIVE INCOME (LOSS)				
Items that will be reclassified to profit or loss in subsequent period:				
Unrealized fair value gain (loss) on available-for-sale financial assets	*10*	**(414)**	(11)	8
Income tax effect		**41**	1	(1)
		(373)	(10)	7
Cumulative translation adjustments of subsidiaries and associates	*8*	**1,157**	(427)	(34)
Items that will not be reclassified to profit or loss in subsequent period:				
Remeasurement adjustments on retirement and other post-employment liabilities	*25*	**3,499**	(524)	(215)
Income tax effect		**(1,050)**	157	71
		2,449	(367)	(144)
Share in remeasurement adjustments on associates' retirement liabilities		**–**	(1)	(20)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAX		**3,233**	(805)	(191)
TOTAL COMPREHENSIVE INCOME, NET OF INCOME TAX		**₱22,573**	₱18,384	₱17,940
Total Comprehensive Income Attributable To				
Equity holders of the Parent		**₱22,409**	₱18,293	₱17,862
Non-controlling interests		**164**	91	78
		₱22,573	₱18,384	₱17,940

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014

	Equity Attributable to Equity Holders of the Parent														
	Common Stock (Note 15)	Subscription Receivable	Additional Paid-in Capital	Excess of Acquisition Cost Over Carrying Value of Non-controlling Interest Acquired	Employee Stock Purchase Plan (Note 15)	Unrealized Fair Value Gains (Losses) on AFS Financial Assets (Note 10)	Remeasurement Adjustments on Retirement and Other Post-Employment Liabilities (Note 25)	Share in Remeasurement Adjustments on Associates' Retirement Liabilities	Cumulative Translation Adjustments of Subsidiaries and Associates (Note 8)	Treasury Shares (Note 15)	Appropriated Retained Earnings (Note 15)	Unappropriated Retained Earnings (Note 15)	Equity Attributable to Equity Holders of the Parent	Non-controlling Interests (Note 6)	Total Equity
	(Amounts in millions)														
At January 1, 2016	**₱11,273**	**₱–**	**₱4,111**	**(₱328)**	**₱1,049**	**₱102**	**₱935**	**(₱12)**	**(₱72)**	**(₱11)**	**₱11,000**	**₱52,229**	**₱80,276**	**₱585**	**₱80,861**
Net income	–	–	–	–	–	–	–	–	–	–	–	**19,176**	**19,176**	**164**	**19,340**
Other comprehensive income (loss)	–	–	–	–	–	**(373)**	**2,449**	–	**1,157**	–	–	–	**3,233**	–	**3,233**
Total comprehensive income (loss)	–	–	–	–	–	**(373)**	**2,449**	–	**1,157**	–	–	**19,176**	**22,409**	**164**	**22,573**
Dividends	–	–	–	–	–	–	–	–	–	–	–	**(28,268)**	**(28,268)**	**(20)**	**(28,288)**
Reversal of appropriation	–	–	–	–	–	–	–	–	–	–	**(11,000)**	**11,000**	–	–	–
	–	–	–	–	–	–	–	–	–	–	**(11,000)**	**(17,268)**	**(28,268)**	**(20)**	**(28,288)**
At December 31, 2016	**₱11,273**	**₱–**	**₱4,111**	**(₱328)**	**₱1,049**	**(₱271)**	**₱3,384**	**(₱12)**	**₱1,085**	**(₱11)**	**₱–**	**₱54,137**	**₱74,417**	**₱729**	**₱75,146**
At January 1, 2015	₱11,273	(₱8)	₱4,111	(₱328)	₱1,049	₱112	₱1,302	(₱20)	₱355	(₱11)	₱11,000	₱50,319	₱79,154	₱320	₱79,474
Net income	–	–	–	–	–	–	–	–	–	–	–	19,098	19,098	91	19,189
Other comprehensive income (loss)	–	–	–	–	–	(10)	(367)	(1)	(427)	–	–	–	(805)	–	(805)
Total comprehensive income (loss)	–	–	–	–	–	(10)	(367)	(1)	(427)	–	–	19,098	18,293	91	18,384
Effect of partial disposal of a joint venture	–	–	–	–	–	–	–	9	–	–	–	–	9	–	9
Collection of subscriptions receivable	–	8	–	–	–	–	–	–	–	–	–	–	8	–	8
Dividends	–	–	–	–	–	–	–	–	–	–	–	(17,188)	(17,188)	174	(17,014)
	–	8	–	–	–	–	–	9	–	–	–	(17,188)	(17,171)	174	(16,997)
At December 31, 2015	₱11,273	₱–	₱4,111	(₱328)	₱1,049	₱102	₱935	(₱12)	(₱72)	(₱11)	₱11,000	₱52,229	₱80,276	₱585	₱80,861

(Forward)

	Equity Attributable to Equity Holders of the Parent														
	Common Stock (Note 15)	**Subscriptions Receivable**	**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 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**	**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, 2014	₱11,273	(₱69)	₱4,111	(₱328)	₱1,049	₱105	₱1,446	₱–	₱389	(₱11)	₱11,000	₱46,197	₱75,162	₱173	₱75,335
Net income	–	–	–	–	–	–	–	–	–	–	–	18,053	18,053	78	18,131
Other comprehensive loss	–	–	–	–	–	7	(144)	(20)	(34)	–	–	–	(191)	–	(191)
Total comprehensive income (loss)	–	–	–	–	–	7	(144)	(20)	(34)	–	–	18,053	17,862	78	17,940
Collection of subscriptions receivable	–	61	–	–	–	–	–	–	–	–	–	–	61	–	61
Dividends	–	–	–	–	–	–	–	–	–	–	–	(13,931)	(13,931)	69	(13,862)
	–	61	–	–	–	–	–	–	–	–	–	(13,931)	(13,870)	69	(13,801)
At December 31, 2014	₱11,273	(₱8)	₱4,111	(₱328)	₱1,049	₱112	₱1,302	(₱20)	₱355	(₱11)	₱11,000	₱50,319	₱79,154	₱320	₱79,474

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Note	Years Ended December 31		
		2016	2015	2014
		(Amounts in millions)		
CASH FLOWS FROM OPERATING ACTIVITIES				
Income before income tax		**₱26,693**	₱24,876	₱26,468
Adjustments for:				
Depreciation and amortization	*7, 9 and 10*	**7,312**	6,910	6,093
Provision for probable losses and expenses from claims - net	*18, 23 and 28*	**8,691**	11,611	10,720
Interest and other financial income	*24*	**(2,080)**	(1,538)	(770)
Interest and other financial charges	*24*	**1,343**	1,216	1,439
Provision for doubtful accounts	*12*	**171**	502	460
Equity in net losses (gains) of associates and joint ventures	*8*	**1,677**	27	(295)
Others		**(477)**	(568)	(194)
Operating income before working capital changes		**43,330**	43,036	43,921
Decrease (increase) in:				
Trade and other receivables		**(2,212)**	5,496	10,075
Inventories		**(519)**	(59)	(750)
Other current assets		**(326)**	(754)	2,290
Increase (decrease) in:				
Trade payables and other current liabilities		**1,423**	887	(10,199)
Customers' refund		**(562)**	(387)	(76)
Customers' deposits		**3,786**	(1,342)	(1,079)
Long-term employee benefits		**(2,153)**	1,496	480
Cash generated from operations		**42,767**	48,373	44,662
Income tax paid		**(7,416)**	(6,690)	(7,167)
Net cash provided by operating activities		**35,351**	41,683	37,495
CASH FLOWS FROM INVESTING ACTIVITIES				
Additions to:				
Utility plant and others	*7*	**(10,807)**	(10,383)	(12,062)
Available-for-sale investments	*10*	**(8,954)**	(10,799)	–
Held-to-maturity investments	*10*	**(5,752)**	(21,118)	–
Investments in associates and interests in joint ventures	*8 and 14*	**(1,398)**	(80)	(1,422)
Intangible assets	*10*	**(587)**	(707)	(514)
Investment properties		**–**	(33)	(6)
Proceeds from disposal of interests in joint ventures	*8*	**3,151**	330	–
Interest and other financial income received		**831**	698	659
Dividends received from associates		**491**	605	554
Proceeds from disposal of utility plant and others		**456**	148	166
Increase (decrease) in minority interest due to acquisition of a subsidiary		**(20)**	174	–
Decrease (increase) in other noncurrent assets		**(372)**	(1,243)	9
Proceeds from disposal of investment properties		**–**	20	–
Net cash used in investing activities		**(22,961)**	(42,388)	(12,616)

(Forward)

		Years Ended December 31		
	Note	**2016**	2015	2014
		(Amounts in millions)		
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from:				
Availment of notes payable	*20*	**₱10,432**	₱929	₱432
Collection of subscriptions receivable		**–**	8	61
Availment of interest-bearing long-term financial liabilities	*16*	**–**	–	7,330
Payments of:				
Dividends	*15*	**(28,114)**	(16,926)	(13,834)
Interest and other financial charges		**(1,256)**	(1,882)	(1,996)
Interest-bearing long-term financial liabilities		**(417)**	(400)	(9,508)
Notes payable	*20*	**–**	(286)	(1,846)
Increase in non-controlling interest		**–**	–	69
Increase in other noncurrent liabilities		**2,781**	633	4,031
Net cash used in financing activities		**(16,574)**	(17,924)	(15,261)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**(4,184)**	(18,629)	9,618
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		**50,840**	69,469	59,851
CASH AND CASH EQUIVALENTS AT END OF YEAR	*11*	**₱46,656**	₱50,840	₱69,469

See accompanying Notes to Consolidated Financial Statements

1. Corporate Information

Manila Electric Company *("MERALCO")* holds a congressional franchise under Republic Act *("RA")* No. 9209 effective June 28, 2003. *RA* No. 9209 grants *MERALCO* a 25-year franchise valid through June 28, 2028 to construct, operate, and maintain the electric distribution system in the cities and municipalities of Bulacan, Cavite, Metro Manila, and Rizal and certain cities, municipalities and barangays in the provinces of Batangas, Laguna, Pampanga, and Quezon. On October 20, 2008, the Energy Regulatory Commission *("ERC")* granted *MERALCO* a consolidated Certificate of Public Convenience and Necessity for the operation of electric service within its franchise coverage, effective until the expiration of *MERALCO*'s congressional franchise. *MERALCO*'s participation in retail electricity supply *("RES")* is through its local *RES* unit, *MPower*. As of February 27, 2017, the *ERC* granted *MERALCO*'s wholly owned subsidiary, Vantage Energy Solutions and Management, Inc. ("*VESM*"), and Solvre, Inc., a wholly owned subsidiary of MERALCO PowerGen Corporation *("MGen"),* and Meridian Exchage, Inc., a wholly owned subsidiary of Comstech Integration Alliance, Inc. *("Comstech")*, distinct *RES* licenses to operate as retail electricity suppliers in Luzon and Visayas.

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

MERALCO has an equity interest in a power generating company, Global Business Power Corporation *("GBPC")*. Separately, it 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 manages electric distribution facilities of Pampanga Electric Cooperative II *("PELCO II")* through *Comstech* under an Investment Management Agreement ("*IMC*"). *MERALCO* also manages electric distribution facilities in the Cavite Economic Zone *("CEZ")* under a 25-year concession agreement with Philippine Economic Zone Authority *("PEZA")*.

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

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

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

The consolidated financial statements were approved and authorized for issue by the Board of Directors (*"BOD"*) on February 27, 2017.

2. Rate Regulations

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

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

Performance-Based Regulations ("PBR")

MERALCO

MERALCO is among the Group A entrants to the *PBR*, together with two other private *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 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) 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 February 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 February 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 February 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 February 27, 2017, the application is pending final approval by the *ERC*.

4th RP Reset Application

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

a. Draft "Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Operating under Performance Based Regulation, First Entry Group: Fourth Regulatory Period";

b. Draft "Position Paper: Regulatory Reset for the July 1, 2015 to June 30, 2019 Fourth Regulatory Period for the First Entry Group of Privately Owned Distribution Utilities subject to Performance Based Regulation"; and

c. Draft "Commission Resolution on the Issues on the Implementation of *PBR* for Privately Owned *DU*s under the *RDWR*".

Under *ERC* Resolution No. 25, Series of 2016 dated July 12, 2016, the *ERC* promulgated a Resolution modifying the Rules for Setting Distribution Rates ("*RDWR*") for Privately-Owned Distribution Utilities Entering Performance Based Regulation ("*PBR*").

On December 2, 2016, the *ERC* released a Notice of Proposed Rule-Making setting the petition filed by a consumer group for initial hearing on January 9, 2017. All interested parties were given until December 26, 2016 to file their comments on said Petition.

In the Petition, the consumer group seeks a repeal of the *PBR* rate-setting methodology for setting distribution wheeling rates. In a subsequent Order and Notice of Public Hearing, the *ERC* reset the hearing to January 23, 2017 and gave interested parties until January 9, 2017 to file their respective comments to the Petition. *MERALCO* filed its Comment to the Petition on January 9, 2017. The consumer group moved for a resetting of the January 23, 2017 hearing. The next hearing is set on March 17, 2017.

In a Notice dated November 16, 2016, the *ERC* approved the draft "Regulatory Asset Base ("*RAB*") Roll Forward Handbook for Privately Owned Electricity Distribution Utilities (*DUs*)" (*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 Petition has been resolved.

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. As at February 27, 2017, intervenors are set to present their own evidence after the *ERC* rules on pending motions. As at February 27, 2017, the intervenors are set to present their own evidence after the *ERC* rules on 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 of February 27, 2017, the *ERC* has yet to rule on the Motion for Reconsideration.

CAPEX for RY 2017

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

CEDC

CEDC is among the four (4) Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. The 2nd *RP* of *CEDC* began on October 1, 2011 and ended on September 30, 2015. *CEDC* is to undergo the reset process and is awaiting the release by the *ERC* of the final rules to govern the filing of its 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. As at February 27, 2017, *MERALCO* is awaiting further action of the *SC* on the Petition.

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

On July 13, 2009, the *ERC* issued Resolution No. 16, Series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities." These rules govern the recovery of pass-through costs, including under- or over-recoveries with respect to the following bill components: generation charge, transmission charge, *SL* charge, lifeline and inter-class rate subsidies, *LFT* and business tax. On October 18, 2010, the *ERC* promulgated *ERC* Resolution No. 21, Series of 2010, amending the *SL* true-up formula contained in Resolution No. 16, Series of 2009, and setting March 31, 2011 (covering adjustments implemented until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) as the new deadlines for *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 December 31, 2016, a total of ₱168 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 December 31, 2016, a total of ₱1,208 million has been billed to the customers.

On March 31, 2014, *MERALCO* filed its application with the *ERC* to confirm its under- or over- recoveries of net generation charge under-recoveries of ₱559 million, transmission charge over-recoveries of ₱639 million, net lifeline subsidy over-recoveries of ₱75 million, *SL* over-recoveries of ₱502 million from January 2012 to October 2013, and net senior citizen discount over-recoveries of ₱0.4 million from February 2011 to October 2013, excluding proposed carrying charges. Under- or over-recoveries from November and December 2013 supply months were excluded in the meantime, in view of the pending *SC* and *ERC* cases involving pass-through costs for these months. As of February 27, 2017, hearings are ongoing and the next scheduled hearing is on March 16, 2017.

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. Hearings are ongoing and the next scheduled hearing is on March 16, 2017.

Application for the Recovery of Differential Generation Costs

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

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

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

On November 12, 2010, *MERALCO* filed its application with the *ERC* for the recovery of the total generation costs refunded under the *2nd GRAM*, plus any additional amount that it will still refund to its customers pursuant to the *SC* Resolution dated August 16, 2006, and the corresponding carrying charges. In a Decision dated June 1, 2015, the *ERC* approved the application with modification and directed *MERALCO* to recover its generation costs incurred for the period from November 2003 to January 2004 amounting to ₱746 million, or an equivalent ₱0.0207 per *kWh*, and carrying costs amounting to ₱198 million, or an equivalent ₱0.0013 per *kWh*. As at December 31, 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 of ₱0.0169 per *kWh*. *MERALCO* implemented the refund beginning November 2009 until September 2010. However, the *ERC* has yet to rule on *MERALCO*'s *deferred PPA* under-recoveries of ₱106 million, which is not a transmission line fee. On November 4, 2009, *MERALCO* filed an *MR* with the *ERC*. As at February 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 December 31, 2016, a total of ₱2,247 million of *LFT* and carrying charges have been billed to affected customers. The amount recoverable within 12 months is included in the "Trade and other receivables" account while the long-term portion is included in the "Other noncurrent assets" account.

On June 13, 2013, *MERALCO* filed an application with the *ERC* for authority to collect the new *LFT* ordered by 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 concluded and on September 29, 2015, *MERALCO* filed its *FOE* with Manifestation and Compliance and thereby submitted the case for resolution. In a decision dated May 10, 2016, the *ERC* approved the application with modification.

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. As of February 27, 2017, *MERALCO* is awaiting further action of the *ERC* on the matter.

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 December 31, 2016 and 2015.

			2016		2015	
	Place of		Percentage of Ownership			
Subsidiaries	Incorporation	Principal Business Activity	Direct	Indirect	Direct	Indirect
Corporate Information Solutions, Inc. ("*CIS*")	Philippines	e-Transactions	**100**	**–**	100	–
CIS Bayad Center, Inc. *("Bayad Center")*	Philippines	Bills payment collection	**–**	**100**	–	100
Customer Frontline Solutions, Inc. *("CFSI")*	Philippines	Tellering services	**–**	**100**	–	100
Fieldtech Specialist, Inc. *("Fieldtech")*	Philippines	Bills payment collection	**–**	**51**	–	51
Meralco Energy, Inc. *("MEI")*	Philippines	Energy systems management	**100**	**–**	100	–
Aurora Managed Power Services, Inc. *("AMPSI")*	Philippines	Energy systems management	**60**	**–**	–	–
eMERALCO Ventures, Inc. *("e-MVI")*	Philippines	e-Business development	**100**	**–**	100	–
Paragon Vertical Corporation	Philippines	Information technology *("IT")* and multi-media services	**–**	**100**	–	100
Radius Telecoms, Inc.	Philippines	*IT* and multi-media services	**–**	**100**	–	100
MGen	Philippines	Development of power generation plants	**100**	**–**	100	–
Calamba Aero Power Corporation[1]	Philippines	Power generation	**–**	**100**	–	100
Atimonan Land Ventures Development Corporation	Philippines	Real estate	**–**	**100**	–	100
Atimonan One Energy, Inc. *("A1E")* [2]	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. [3]	Philippines	Retail electricity supplier	**–**	**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 [4]	Nigeria	Management of power distribution	**100**	**–**	100	–
MSpectrum, Inc. ("*MSpectrum*") [5]	Philippines	Renewable energy	**100**	**–**	–	–
MIESCOR	Philippines	Engineering, construction and consulting services	**99**	**–**	99	–
Miescor Builders Inc. *("MBI")*	Philippines	Electric transmission and distribution operation and maintenance services	**–**	**99**	–	99
Miescor Logistics Inc. *("MLI")*	Philippines	General services, manpower/maintenance	**–**	**99**	–	99
CEDC	Philippines	Power distribution	**65**	**–**	65	–
Clarion Energy Management Inc.	Philippines	Retail electricity supplier	**–**	**65**	–	–
Comstech	Philippines	Management of power distribution	**60**	**–**	60	–
Meridian Exchage, Inc.	Philippines	Retail electricity supplier	**–**	**60**	–	–
VESM [6]	Philippines	Retail electricity supplier	**100**	**–**	–	–

[1] *Incorporated on February 15, 2011 and has not started commercial operations as at December 31, 2016.*
[2] *Incorporated on January 11, 2013 and has not started commercial operations as at December 31, 2016.*
[3] *Incorporated on November 25, 2016 and has not started commercial operations as at December 31, 2016.*
[4] *Incorporated on October 2, 2013 and has not started commercial operations as at December 31, 2016.*
[5] *Incorporated on January 21, 2016 and has not started commercial operations as at December 31, 2016.*
[6] *Incorporated on November 10, 2016 and has not started commercial operations as at December 31, 2016.*

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

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

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

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

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

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

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

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

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 years except with respect to the adoption of the following amendments and improvements to existing standards. The adoption of these pronouncements did not have a significant impact on the *MERALCO*'s Group's financial position or performance unless otherwise indicated.

Amendments to PFRS 10, Consolidated Financial Statements, PFRS 12, Disclosure of Interests in Other Entities, and PAS 28, Investments in Associates and Joint Ventures, Investment Entities: Applying the Consolidation Exception

These amendments clarify that the exemption in *PFRS 10* from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity that measures all of its subsidiaries at fair value. They also clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity parent is consolidated. The amendments also allow an investor (that is not an investment entity and has an investment entity associate or joint venture) to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries when applying the equity method.

These amendments are not applicable to the Group since none of the entities within the Group is an investment entity.

Amendments to PFRS 11, Joint Arrangements, Accounting for Acquisitions of Interests in Joint Operations

The amendments to *PFRS 11* require a joint operator that is accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business (as defined by *PFRS 3*), to apply the relevant *PFRS 3* principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to *PFRS 11* to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation.

These amendments do not have any impact on the *MERALCO* Group as there has been no interest acquired in a joint operation during the year.

PFRS 14, Regulatory Deferral Accounts

PFRS 14 is an optional standard that allows an entity, whose activities are subject to rate-regulation, to continue applying most of its existing accounting policies for regulatory deferral account balances upon its first-time adoption of *PFRS*. Entities that adopt *PFRS 14* must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of income and other comprehensive income. The standard requires disclosures on the nature of, and risks associated with, the entity's rate-regulation and the effects of that rate-regulation on its financial statements.

Since the *MERALCO* Group is an existing PFRS preparer, this standard would not apply.

Amendments to PAS 1, Presentation of Financial Statements, Disclosure Initiative

The amendments are intended to assist entities in applying judgment when meeting the presentation and disclosure requirements in *PFRS*s. They clarify the following:

- that entities shall not reduce the understandability of their financial statements by either obscuring material information with immaterial information; or aggregating material items that have different natures or functions;
- that specific line items in the statement of income and other comprehensive income and the statement of financial position may be disaggregated;
- that entities have flexibility as to the order in which they present the notes to financial statements; and
- that the share of other comprehensive income of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

These amendments do not have any impact to the *MERALCO* Group.

Amendments to PAS 16, Property, Plant and Equipment and PAS 38, Intangible Assets, Clarification of Acceptable Methods of Depreciation and Amortization

The amendments clarify the principle in *PAS 16* and *PAS 38* that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortize intangible assets.

These amendments are applied prospectively and do not have any impact to the *MERALCO* Group, given that the *MERALCO* Group has not used a revenue-based method to depreciate or amortize its property, plant and equipment and intangible assets

Amendments to PAS 16 and PAS 41, Agriculture: Bearer Plants

The amendments change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of *PAS 41*. Instead, *PAS 16* will apply. After initial recognition, bearer plants will be measured under *PAS 16* at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce, which grows on bearer plants will remain in the scope of *PAS 41* measured at fair value less costs to sell. For government grants related to bearer plants, PAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, will apply.

The amendments are applied retrospectively and do not have any impact on the *MERALCO* Group as the *MERALCO* Group does not have any bearer plants.

Amendments to PAS 27, Separate Financial Statements, Equity Method in Separate Financial Statements

The amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying *PFRS* and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively.

These amendments do not have any impact on the *MERALCO* Group's consolidated financial statements. *MERALCO* will continue to account for its investment in subsidiaries, joint ventures and associates using cost method in its separate financial statements.

Annual Improvements to PFRSs 2012 - 2014 Cycle

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

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

Amendment to PFRS 7, Financial Instruments: Disclosures, Servicing Contracts

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

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

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

Amendment to PAS 19, Employee Benefits, Discount Rate: Regional Market Issue

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

Amendment to PAS 34, Interim Financial Reporting, Disclosure of Information 'Elsewhere in the Interim Financial Report'

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

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

Standards issued but not yet effective

Pronouncements issued but not yet effective are listed below. Unless otherwise indicated, the *MERALCO* Group does not expect that the future adoption of the said pronouncements to have a significant impact on its consolidated financial statements. The *MERALCO* Group intends to adopt the following pronouncements when they become effective.

Effective beginning on or after 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. Early application of the amendments is permitted.

Application of amendments will result in additional disclosures in the 2017 consolidated financial statements of the *MERALCO* Group.

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. Early application of the amendments is permitted.

These amendments are not expected to have any impact on the *MERALCO* Group.

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 main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and 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 amendments and if other criteria are met. Early application of the amendments is permitted.

The *MERALCO* Group is assessing the potential effect of the amendments on its consolidated financial statements.

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, 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 forthcoming 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-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.

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.

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. 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.

The *MERALCO* Group is currently assessing the impact of adopting PFRS 16.

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

Land is stated at cost less any impairment in value.

The *MERALCO Group*'s utility plant and others are stated at deemed cost. The revalued amount recorded as at January 1, 2004 was adopted as deemed cost as allowed by the transitional provisions of *PFRS 1*. The balance of revaluation increment was closed to retained earnings.

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

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

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

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

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

Construction in Progress

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

Borrowing Costs

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

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

All other borrowing costs are expensed as incurred.

Asset Retirement Obligations

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

Assets Funded by Customers

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

Investments in Associates and Interests in Joint Ventures

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

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

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

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

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

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

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

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

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

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

Business Combinations and Goodwill

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

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

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

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

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred, any non-controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the previously held equity interest in the acquiree, over the fair value of net identifiable assets acquired. If the difference is negative, such difference is recognized as gain in the consolidated statement of income.

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

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

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

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

Investment Properties

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

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

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

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

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

Investment properties are derecognized either when they have been disposed of or when these are permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss from the derecognition of the investment properties is recognized in the consolidated statement of income in the year 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 year 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 years. Such reversal is recognized in the consolidated statement of income. After such reversal, the depreciation and amortization expense are adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

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

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 years.

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

Financial Assets

Initial Recognition

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

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

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

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

Subsequent Measurement

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

Financial Assets at FVPL

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

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

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

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

Loans and Receivables

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

HTM Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as *HTM* when the *MERALCO Group* has the positive intention and ability to hold these assets to maturity. After initial measurement, *HTM* investments are measured at amortized cost using the effective interest method. Gains or losses are recognized in the consolidated statement of income. Assets in this category are included in the current assets except for maturities beyond 12 months from the reporting date, which are classified as noncurrent assets.

AFS Financial Assets

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

Financial Liabilities

Initial Recognition

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

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

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

Subsequent Measurement

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

Financial Liabilities at FVPL

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

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

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

Other Financial Liabilities

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

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

Derivative Financial Instruments

Initial Recognition and Subsequent Measurement

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

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

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

See *Note 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, and only if, there is currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

Amortized Cost of Financial Instruments

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

'Day 1' Profit or Loss

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

Impairment of Financial Assets

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

Financial Assets Carried at Amortized Cost

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

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

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

AFS Financial Assets

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

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

Assets Carried at Cost

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

Derecognition of Financial Instruments

Financial Assets

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

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

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

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

Financial Liabilities

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

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

Redeemable Preferred Stock

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

Inventories

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

VAT

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

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

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

Provisions

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

Retirement Benefits

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

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

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

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

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

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

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

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

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

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

Termination Benefits

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

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

Employee Leave Entitlements

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

Long-term Incentive Plan

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

Equity

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

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

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

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

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

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

Employee Stock Purchase Plan

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

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

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

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

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

Revenue Recognition

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

Sale of Electricity

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

Sale of Services

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

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

Service and consulting fees are recognized when services are rendered.

Interest Income

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

Dividends

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

Lease Income

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

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

Expense Recognition

Expenses are decreases in economic benefits during the financial reporting year 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 year in which they are earned.

Foreign Currency-Denominated Transactions and Translations

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

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

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

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

Income Taxes

Current Income Tax

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

Deferred Income Tax

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

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

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

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

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

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

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

Earnings per Share

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

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

Contingencies

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

Events After the Reporting Date

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

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

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

Judgments

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

Determination of Functional Currency

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

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

Operating Lease Commitments

As Lessor

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

As Lessee

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

Arrangement that Contains a Lease

MERALCO's Purchased Power Agreements *("PPAs")* and Purchase Supply Agreements *("PSAs")* with certain power generating companies qualify as leases on the basis that *MERALCO* and these power generating companies have 'take or pay' *("ToP")* arrangements where payments for purchased power or for contracted capacity are made on the basis of the availability of the power plant and not based solely on actual consumption. In determining the lease classification, it is judged that substantially all the risks and rewards incident to the ownership of the power plants are with these power generating companies. Thus, the *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 ₱49,522 million, ₱45,702 million and ₱44,204 million for the years ended December 31, 2016, 2015 and 2014, 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 the 20% of the Voting Rights Accounted for as an Associate

MERALCO, through *MGen*, has a 14% interest in *GBPC. MERALCO's* investment in *GBPC* is accounted for as an associate as *MERALCO* has significant influence in *GBPC* as evidenced by its representation in the *BOD* and Executive Committee. This representation guarantees *MGen*'s participation in the decision making acts and policy making process of *GBPC*.

Contingencies

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

See *Note 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 period are discussed as follows:

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

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

The total depreciation and amortization expense of utility plant and others amounted to ₱6,828 million, ₱6,475 million and ₱5,778 million for the years ended December 31, 2016, 2015 and 2014, respectively. Total carrying values of utility plant and others, net of accumulated depreciation and amortization, amounted to ₱128,814 million and ₱124,913 million as at December 31, 2016 and 2015, respectively.

Total depreciation of investment properties amounted ₱5 million, ₱7 million and ₱6 million for the years ended December 31, 2016, 2015 and 2014, respectively. Total carrying values of investment properties, net of accumulated depreciation, amounted to ₱1,513 million and ₱1,538 million as at December 31, 2016 and 2015, respectively.

Total amortization of intangible assets with finite lives amounted to ₱479 million, ₱428 million and ₱309 million for the years ended December 31, 2016, 2015 and 2014, respectively. Total carrying values of intangible assets with finite lives, net of accumulated amortization, amounted to ₱2,713 million and ₱2,585 million as at December 31, 2016 and 2015, respectively.

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

Impairment of Nonfinancial Assets

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

Determining the recoverable amount of utility plant and others, 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 a material adverse impact on the *MERALCO Group*'s consolidated financial position and results of operations.

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

Provision for impairment loss on unbilled receivables amounted to ₱1,371 million and ₱2,134 million as at December 31, 2016 and 2015, respectively.

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

Account	**2016**	2015
	(Amounts in millions)	
Utility plant and others	**₱128,814**	₱124,913
Investments in associates and joint ventures	**10,924**	13,603
Intangible assets	**2,713**	2,585
Investment properties	**1,513**	1,538
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 acquiree's identifiable assets and liabilities and contingent liabilities, if any, at the acquisition date. Any excess in the purchase price over the estimated fair market values of the net assets acquired is recorded as goodwill in the consolidated statement of financial position. Thus, the number of items, which 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 year 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 year. 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:

	2016	2015
	(Amounts in millions)	
Recognized deferred tax assets	**₱23,816**	₱21,275
Unrecognized deferred tax assets	**489**	372

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 ₱171 million, ₱502 million and ₱460 million for the years ended December 31, 2016, 2015 and 2014, respectively. Trade and other receivables, net of asset impairment, amounted to ₱25,341 million and ₱26,761 million as at December 31, 2016 and 2015, respectively.

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

Estimating Net Realizable Value of Inventories

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

The carrying values of inventories amounted to ₱2,792 million and ₱2,273 million as at December 31, 2016 and 2015, respectively.

See *Note 13 – Inventories*.

Estimation of Retirement Benefit Costs

The cost of defined benefit retirement plans and other post-employment benefits as well as the present value of the retirement obligation are determined using actuarial valuations. The actuarial valuation involves making various assumptions. These include the determination of the discount rates, future salary increases, mortality rates and future retirement benefits increases. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, defined benefit obligations are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date. The retirement and other post-employment benefits expense amounted to ₱1,443 million, ₱1,364 million and ₱1,304 million for the years ended December 31, 2016, 2015 and 2014, respectively. The retirement and other post-employment benefit liabilities as at December 31, 2016 and 2015 amounted to ₱1,875 million and ₱3,620 million, respectively.

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

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

See *Note 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 year claims are reassessed for adequacy and any changes are charged to provisions. Insurance contract liabilities are not discounted for the time value of money.

As at December 31, 2016 and 2015, gross carrying values of insurance liabilities arising from insurance contracts, included in "Other noncurrent liabilities" account, amounted to ₱269 million and ₱242 million, respectively.

Provision for Asset Retirement Obligations

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

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

Provisions

The *MERALCO Group* has various claims, assessments and cases as discussed in *Note 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 ₱9,373 million, ₱11,628 million and ₱10,720 million for the years ended December 31, 2016, 2015 and 2014, 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 years.

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

6. **Segment Information**

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

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

- Power

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

  Electricity distribution – This is principally electricity distribution and supply of power on a pass-through basis covering all captive customers in the *MERALCO* and the *CEDC* franchise areas in the Luzon Grid. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country. *CEDC*'s franchise area covers the Clark Freeport Zone and the sub-zone.

  Power generation – The *MERALCO Group*'s re-entry in the power generation business is through investments in operating companies or participation in the development of power generation projects. *MGen*, the power generation arm of the *MERALCO Group,* has a 14% equity interest in *GBPC* effective June 30, 2016. *GBPC* currently operates a total of 859 MegaWatt *("MW")* - gross of coal and diesel-fired power plants, which include a 150 *MW*-gross coal-fired power plants in the Panay Island which was commissioned in November 2016.

MGen owns an effective 28% equity in PacificLight Power Pte Ltd. *("PacificLight Power")* in Jurong Island, Singapore. *PacificLight Power*, which owns and operates a 2x400 MW liquefied natural gas ("*LNG*") power plant, began commercial operations in February 2014.

Atimonan One Energy Inc. ("*A1E*") is currently developing a 2x600 *MW* ultra supercritical pulverized coal fired power plant in Atimonan, Quezon.

A *PSA* have been executed between *A1E* and *MERALCO* for the full capacity. The *PSA* was submitted to the *ERC* for approval.

A1E is in the process of selecting the Engineering, Procurement and Construction (*"EPC"*) contractor for the project. Site preparation works are targeted to start in 2017, with expected completion of the first unit in 2021 and the second 600 *MW* by early 2022.

Aside from *A1E*, *MGen* is currently (i) constructing a 455 *MW* net capacity supercritical coal-fired power plant in Mauban, Quezon through *SBPL*, (ii) developing a 2x300 *MW* Circulating Fluidized Bed *("CFB"),* coal-fired power plant in the Subic Freeport Zone through Redondo Peninsula Energy, Inc. *("RP Energy")*, (iii) developing 2 x 350 *MW* coal plant in Calaca, Batangas through St. Raphael Power Generation Corporation ("*SRPGC*"), and (iv) developing a 4x150 *MW* coal-fired power plant in Mariveles Bataan through Mariveles Power Generation Corporation ("*MPGC*").

MERALCO has also subscribed 50% equity interest in Pure Meridian Hydropower Corporation which shall undertake the development of 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 ("*RES")* within its franchise area under a separate business unit, *MPower*. Under Retail Competition and Open Access *("RCOA"*), qualified contestable customers who opt to switch to contestability and become contestable customers may source their electricity supply from competing *RES*s, including *MPower*.

- Other Services

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

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

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

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

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

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

		Power			Other Services			Inter-segment Transactions			Total		
	Note	**2016**	2015	2014	**2016**	2015	2014	**2016**	2015	2014	**2016**	2015	2014
							(Amounts in Millions)						
Revenues		**₱249,206**	₱249,773	₱261,740	**₱9,866**	₱10,422	₱6,894	**(₱1,891)**	(₱1,796)	(₱2,298)	**₱257,181**	₱258,399	₱266,336
Segment results		**₱32,495**	₱29,304	₱31,984	**₱2,450**	₱2,187	₱951	**–**	–	₱–	**₱34,945**	₱31,491	₱32,935
Depreciation and amortization		**(6,948)**	(6,607)	(5,863)	**(364)**	(303)	(230)	**–**	–	–	**(7,312)**	(6,910)	(6,093)
Interest and other financial income	*24*	**2,027**	1,506	742	**53**	32	28	**–**	–	–	**2,080**	1,538	770
Equity in net earnings (losses) of associates and joint ventures	*8*	**(1,567)**	(27)	295	**(110)**	–	–	**–**	–	–	**(1,677)**	(27)	295
Interest and other financial charges	*24*	**(1,293)**	(1,187)	(1,426)	**(50)**	(29)	(13)	**–**	–	–	**(1,343)**	(1,216)	(1,439)
Provision for income tax - net		**(6,749)**	(5,146)	(8,085)	**(604)**	(541)	(252)	**–**	–	–	**(7,353)**	(5,687)	(8,337)
Net income attributable to non-controlling interests		**–**	–	–	**–**	–	–	**(164)**	(91)	(78)	**(164)**	(91)	(78)
Net income attributable to equity holders of the Parent		**₱17,965**	₱17,843	₱17,647	**₱1,375**	₱1,346	₱484	**(₱164)**	(₱91)	(₱78)	**₱19,176**	₱19,098	₱18,053

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:

	2016	2015	2014
		(Amounts in millions)	
EBITDA	**₱34,049**	₱31,124	₱32,927
Add (Deduct):			
Depreciation and amortization	**(7,312)**	(6,910)	(6,093)
Interest and other financial income	**2,080**	1,538	770
Interest and other financial charges	**(1,343)**	(1,216)	(1,439)
Equity in net earnings (losses) of associates and joint ventures	**(1,677)**	(27)	295
Foreign exchange gains	**896**	367	8
Income before income tax	**26,693**	24,876	26,468
Provision for income tax	**(7,353)**	(5,687)	(8,337)
Net income	**₱19,340**	₱19,189	₱18,131

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

	2016	2015	2014
		(Amounts in millions)	
CCNI	**₱19,583**	₱18,887	₱18,128
Add (Deduct) non-core items, net of tax:			
Foreign exchange gains	**718**	337	17
Non-core expenses	**(1,125)**	(126)	(92)
Net income for the year attributable to equity holders of the Parent	**19,176**	19,098	18,053
Net income for the year attributable to non-controlling interests	**164**	91	78
Net income	**₱19,340**	₱19,189	₱18,131

7. Utility Plant and Others

The movements in utility plant and others are as follows:

		December 31, 2016								
	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)				
Cost:										
Balance at beginning of year		**₱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 end of year		**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 beginning of year		**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 end of year		**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**

		December 31, 2015								
	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)				
Cost:										
Balance at beginning of year		₱148,977	₱15,280	₱5,599	₱2,153	₱2,836	₱3,148	₱3,147	₱7,491	₱188,631
Additions		228	–	24	259	202	279	543	9,028	10,563
Disposals/retirements		(1,595)	–	(2)	(6)	(34)	(123)	(9)	–	(1,769)
Transfers from construction in progress		7,980	–	604	70	7	2	48	(8,711)	–
Reclassification and others	*9 and 10*	–	–	(12)	6	46	–	(16)	–	24
Balance at end of year		155,590	15,280	6,213	2,482	3,057	3,306	3,713	7,808	197,449
Less accumulated depreciation and amortization:										
Balance at beginning of year		59,217	–	2,266	917	1,759	1,770	1,872	–	67,801
Depreciation and amortization		5,309	–	163	182	303	311	207	–	6,475
Disposals/retirements		(1,595)	–	(1)	(6)	(31)	(98)	(9)	–	(1,740)
Reclassification and others		51	–	–	1	4	–	(56)	–	–
Balance at end of year		62,982	–	2,428	1,094	2,035	1,983	2,014	–	72,536
Net book value		₱92,608	₱15,280	₱3,785	₱1,388	₱1,022	₱1,323	₱1,699	₱7,808	₱124,913

As at December 31, 2016 and 2015, the net book values of customer-funded assets included in "Utility plant and others" account amounted to ₱2,657 million and ₱2,031 million, respectively. The corresponding liabilities to customers in the same amounts as at December 31, 2016 and 2015 are included in "Other noncurrent liabilities" account in the consolidated statements of financial position.

Construction in progress mainly pertains to on-going electric capital projects *("ECPs")* and non-*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 ₱190 million, ₱180 million and ₱182 million for the years ended December 31, 2016, 2015 and 2014, respectively.

The average annual interest rates used for capitalization in 2016, 2015 and 2014 ranged from 4.4% to 4.5%, 4.4% to 4.6% and 4.4% to 5.0%, respectively.

8. Investments in Associates and Interests in Joint Ventures

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

	Place of Incorporation	Principal Activity	2016	2015
			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")*	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**	22
AF Payments, Inc. ("*AFPI*")	Philipines	Electronic payment clearing and settlement system operator	**10**	10
MRail-DESCO Joint Venture ("*MDJV*")	Philippines	Maintenance of mass transit system	**50**	50
Joint Ventures				
SBPL	Philippines	Power generation	**51**	51
St. Raphael Power Generation Corporation ("*SRPGC*")	Philippines	Power generation	**50**	–
Rockwell Business Center Joint Venture ("*RCB JV*")	Philippines	Real estate	**30**	30
Pure Meridian Hydropower Corporation ("*PMHC*")	Philippines	Renewable energy	**49**	–
Mariveles Power Generation Corporation ("*MPGC*")	Philippines	Power generation	**49**	–

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

	2016	2015
	(Amounts in millions)	
Acquisition costs:		
Balance at beginning of year	**₱15,214**	₱14,883
Additions	**1,398**	334
Disposal	**(2,992)**	(3)
Balance at end of year	**13,620**	15,214
Accumulated equity in net losses:		
Balance at beginning of year	**(₱1,513)**	(₱680)
Equity in net losses	**(1,677)**	(27)
Dividends	**(491)**	(605)
Disposal	**(67)**	(201)
Balance at end of year	**(3,748)**	(1,513)

(Forward)

	2016	2015
	(Amounts in millions)	
Share in remeasurement adjustments on retirement liabilities:		
Balance at beginning of year	**(₱12)**	(₱20)
Actuarial loss	**–**	(1)
Effect of disposal	**–**	9
Balance at end of year	**(12)**	(12)
Share in cumulative translation adjustments:		
Balance at beginning of year	**(86)**	349
Translation adjustments	**1,150**	(435)
Balance at end of year	**1,064**	(86)
	₱10,924	₱13,603

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

	2016	2015
	(Amounts in millions)	
GBPC	**₱5,210**	₱8,186
FPM Power	**1,911**	2,777
Rockwell Business Center	**1,098**	1,234
MPGC	**959**	–
RP Energy	**934**	632
Indra Philippines	**238**	210
SBPL	**213**	258
AFPI	**185**	230
SRPGC	**58**	–
GEPMICI	**54**	65
MDJV	**28**	–
PMHC	**25**	–
BPPC	**11**	11
	₱10,924	₱13,603

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 power plants in operation in the Visayas. Panay Energy Development Corporation's ("*PEDC*") 150 *MW CFB* coal-fired facility in Iloilo City started commercial operations in November 2016. A *PSA* for 70 *MW* of the capacity has been filed with the *ERC* and is pending approval by the *ERC*.

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 2016, *FPM Power* recognized impairment charge with respect to its investment in *PacificLight Power*. The impairment charge, which relates solely to goodwill amounted to ₱1.2 billion and is included in the equity in net losses of associates in the 2016 consolidated statement of income.

RBC JV

The *RBC JV* is a joint venture between Rockwell Land Corporation ("*Rockwell Land")* and *MERALCO* over 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, accounted for using the equity method. *Rockwell Land* owns 70% interest in *RBC JV*.

MPGC

On June 16, 2016, *MERALCO* and *MPGC* entered a joint venture agreement to develop, construct, finance, own, operate and maintain a 4 x 132 *MW* (net) circulating fluidized bed coal-fired power plant and associated facilities in Mariveles, Bataan.

RP Energy

On July 22, 2011, *MGen* signed a Shareholders' Agreement with Therma Power, Inc. *("TPI")* and Taiwan Cogeneration International Corporation – Philippine Branch *("TCIC")* for the construction and operation of a 2 x 300 *MW CFB*, coal-fired power plant to be located in the Subic Bay Freeport Zone. The development and operations shall be undertaken by *RP Energy,* the joint venture entity.

On February 3, 2015, *RP Energy* received the *SC*'s decision denying the Writ of Kalikasan case previously filed by certain opposing parties against its planned power plant due to insufficiency of evidence. The *SC* upheld the validity of the Environment Compliance Certificate ("*ECC"*) and its first two amendments, as well as the Lease and Development Agreement ("*LDA"*) of *RP Energy* with Subic Bay Metropolitan Authority ("*SBMA"*). On February 23, 2016, the *LDA* and transmission line right-of-way lease agreement with *SBMA* were signed.

RP Energy will develop its 2x300 *MW* project in two (2) phases. On October 13, 2016, the *EPC* for the first 300 *MW* was executed.

In April 2016, *RP Energy* separately signed power supply agreements with *MERALCO* and Aboitiz Energy Solutions, Inc. *("Aboitiz Energy") RP Energy* is awaiting the approval 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 to certain investment promotion incentives.

On December 22, 2016, *RP Energy* signed loan agreements with local banks for the ₱31.5 billion funding for its project. 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 essentially completed, with commercial operations in early 2020. Meanwhile, work on the permanent transmission line interconnection is proceeding in preparation for the development of the second 300 *MW* unit.

Indra Philippines

Indra Philippines is an *IT* service provider in the country and in the Asia Pacific region, with a wide range of services across various industries. *Indra Philippines* provides services which meet certain of *MERALCO*'s *IT* requirements in the area of system development, outsourcing of Information Systems *("IS")* and *IT* operations and management consulting.

In October 2015, *MERALCO* completed the sale to *Metro Pacific* and Indra Sistemas S.A. of its 84,012 shares and 337 shares, respectively, in *Indra Philippines* for an aggregate purchase price of ₱330 million.

SBPL

On August 29, 2013, *MGen* signed a Joint Development Agreement with New Growth B.V., a 100% subsidiary of Electricity Generating Public Company Limited of Thailand *("EGCO")* for the development of a new 455 *MW* (net) supercritical coal-fired power plant in Mauban, Quezon. *MGen*'s equity in the joint venture company, *SBPL*, is 51%, with the option to assign or transfer 2% thereof to a separate entity. On November 11, 2014, the *DENR* granted *SBPL* an *ECC* covering the 455 *MW* (net) coal-fired power plant.

SBPL's *EPC* was executed with the Consortium of Daelim Industrial Co. Ltd. and Mitsubishi Corporation following a competitive selection process on October 8, 2014. The construction period is set at 42 months from the commencement date of December 8, 2015.

On May 29, 2014, *MERALCO* signed a long term *PSA* with *SBPL*. The *ERC*-approved *PSA* was accepted by *SBPL* on May 30, 2015.

On October 8, 2015, *SBPL* entered into an Omnibus Agreement and related agreements with certain financial institutions providing for a term loan facility in an amount of up to ₱42.15 billion for the financing of the project. *SBPL* made its initial borrowing on December 1, 2015. On December 11, 2015, *SBPL* entered into an Operation and Maintenance Agreement for the operations and maintenance of the power plant.

SBPL is expected to achieve commercial operations in 2019.

AFPI

MERALCO, through *Finserve*, has a 10% equity interest in *AFPI* since its incorporation in February 2014. *AFPI* was incorporated primarily to operate and maintain an electronic payment clearing and settlement system through a contactless automated fare collection system for public utility, including generic contactless micropayment solution. It shall also supply and issue fare media and store value cards or reloadable cards for use in transport and non-transport facilities and operate and maintain the related hardware and software. While *MERALCO* has 10% equity interest, management has assessed that *MERALCO* has significant influence over *AFPI* mainly through its representation in *AFPI*'s board.

SRPGC

On April 27, 2016, *MGen* and Semirara Mining and Power Corp. entered a joint venture agreement to develop a 2 x 350 *MW* (net) sub-critical pulverized coal-fired power plant in Calaca, Batangas. The development and operations shall be undertaken by *SRPGC*, the joint venture entity. A *PSA* was signed by *SRPGC* and *MERALCO* in April 2016 for the 400 *MW* of the plant's capacity. The *PSA* was submitted to the *ERC* in April 2016 for its review and approval. Target commercial operations of the power plant is in 2021.

GEPMICI

GEPMICI was established in 1979 together with General Electric Company of U.S.A., to serve the Philippine market for ANSI-type Watt-hour meters.

MDJV

On June 2, 2014, *MRail* and *DESCO* entered into a Joint Venture Agreement for the purposes of participating in the bidding/negotiated procurement and undertaking of the project for the General Overhaul and Rehabilitation of three of Diesel Electric Locomotives by the Philippine National Railways. The equity share is 50:50.

PMHC

On January 7, 2016, *MERALCO* and Repower Energy Development Corporation ("*REDC*") agreed to put up a joint venture corporation, *PMHC*, which shall undertake the development of various mini-hydroelectric power projects.

BPPC

BPPC was incorporated and registered with the Philippine *SEC* on February 3, 1993 to engage in the power generation business.

In accordance with the Build-Operate-Transfer *("BOT")* Agreement signed in 1993, First Private Power Corporation *("FPPC"),* then parent company, constructed the 215 *MW* Bauang Power Plant *("Bauang Plant")*, and operated the same under a 15-year Cooperation Period up to July 25, 2010.

The *Bauang Plant* has since been turned over to the National Power Corporation *("NPC")* without any compensation and free of any liens. In 2010, the Philippine *SEC* approved the merger of *FPPC* and *BPPC*, with *BPPC* as the surviving entity. *BPPC* management continues to evaluate its investment options in power generation and allied industries.

The condensed statements of financial position of material associates follow:

	2016		
	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**

	2015		
	GBPC	*FPM Power*	*RP Energy*
	(Amounts in millions)		
Current assets	₱22,043	₱5,831	₱130
Noncurrent assets	54,218	48,678	1,118
Current liabilities	(12,596)	(17,858)	(7)
Noncurrent liabilities	(31,827)	(28,083)	(2)
Non-controlling interests	(4,444)	(1,626)	–
Net assets	₱27,394	₱6,942	₱1,239

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

	2016			2015			2014		
	GBPC	***FPM Power***	***RP Energy***	*GBPC*	*FPM Power*	*RP Energy*	*GBPC*	*FPM Power*	*RP Energy*
				(Amounts in millions)					
Revenues	**₱17,637**	**₱28,654**	**₱5**	₱18,888	₱30,219	₱2	₱18,993	₱32,378	₱3
Costs and expenses	**(13,472)**	**(34,880)**	**(42)**	(15,065)	(32,732)	(31)	(14,182)	(34,642)	(31)
Net income (loss)	**4,165**	**(6,226)**	**(37)**	3,823	(2,513)	(29)	4,811	(2,264)	(28)
Non-controlling interests	**(1,372)**	**1,188**	**–**	(1,266)	845	–	(1,235)	736	–
Net income (loss) attributable to equity holders of the parent	**2,793**	**(5,038)**	**(37)**	2,557	(1,668)	(29)	3,576	(1,528)	(28)
Other comprehensive income (loss)	**–**	**2,874**	**–**	–	(1,085)	–	–	(84)	–
Total comprehensive income (loss)	**₱2,793**	**(₱2,164)**	**(₱37)**	₱2,557	(₱2,753)	(₱29)	₱3,576	(₱1,612)	(₱28)
Dividends received	**₱308**	**₱–**	**₱–**	₱572	₱–	₱–	₱400	₱–	₱–

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

	2016		
	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**

	2015		
	GBPC	*FPM Power*	*RP Energy*
	(Amounts in millions, except % of ownership)		
Net assets of associates	₱27,394	₱6,942	₱1,239
Proportionate ownership in associates (%)	22	40	47
	6,027	2,777	582
Goodwill	2,159	–	50
	₱8,186	₱2,777	₱632

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

	2016	2015	2014
		(Amounts in millions)	
Share in net income	**(₱84)**	₱1	₱30
Share in other comprehensive income	**–**	1	(1)
Share in total comprehensive income	**(₱84)**	₱2	₱29
Dividends received	**₱9**	₱11	₱–

Joint Ventures

The condensed statements of financial position of *RCB JV*, a material joint venture, follow:

	2016	2015
	(Amounts in millions)	
Current assets	**₱734**	₱946
Noncurrent assets	**3,301**	3,364
Current liabilities	**(374)**	(296)
Noncurrent liabilities	**–**	(10)
Net assets	**₱3,661**	₱4,004

Current assets include cash and cash equivalents of ₱553 million and ₱781 million as at December 31, 2016 and 2015, respectively. Noncurrent assets represent substantially the cost of the three (3) *BPO* towers for lease. The third tower was completed in December 2014 and fully let as at May 2016. Current liabilities represent trade payables.

The condensed statements of comprehensive income of *RCB JV* for the years ended December 31, 2016, 2015 and 2014 are as follows:

	2016	2015	2014
		(Amounts in millions)	
Revenues	**₱682**	₱527	₱335
Costs and expenses – net of other income	**(228)**	(180)	(182)
Provision for income tax - net	**(112)**	(60)	(54)
Net income	**342**	287	99
Other comprehensive income	**–**	–	–
Total comprehensive income	**₱342**	₱287	₱99
Dividends received	**₱174**	₱23	₱43

The foregoing condensed statements of comprehensive income include the following:

	2016	2015	2014
	(Amounts in millions)		
Depreciation	**₱200**	₱199	₱145
Interest income	**(11)**	(9)	(4)
Provision for income tax	**112**	60	54

The reconciliation of the net assets of *RCB JV* to the carrying amounts of the interest in *RCB JV* recognized in the consolidated financial statements is as follows:

	2016	2015
	(Amounts in millions, except % of ownership)	
Net assets	**₱3,661**	₱4,004
Proportionate ownership (%)	**30**	30
	1,098	1,201
Effect of difference between *MERALCO's* percentage share in net income and proportionate ownership	**–**	33
	₱1,098	₱1,234

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

	2016	2015	2014
	(Amounts in millions)		
Share in net income	**(₱54)**	₱16	₱73
Share in other comprehensive loss	**–**	(2)	(16)
Share in total comprehensive income	**(₱54)**	₱14	₱57
Dividends received	**₱–**	₱–	₱13

9. Investment Properties

The movements in investment properties are as follows:

	2016		
	Land	**Buildings and Improvements**	**Total**
	(Amounts in millions)		
Cost:			
Balance at beginning of year	**₱1,427**	**₱224**	**₱1,651**
Disposals	**–**	**(20)**	**(20)**
Balance at end of year	**1,427**	**204**	**1,631**
Less accumulated depreciation:			
Balance at beginning of year	**–**	**113**	**113**
Depreciation	**–**	**5**	**5**
Balance at end of year	**–**	**118**	**118**
	₱1,427	**₱86**	**₱1,513**

	Note	2015 Land	Buildings and Improvements	Total
		(Amounts in millions)		
Cost:				
Balance at beginning of year		₱1,446	₱187	₱1,633
Additions		–	33	33
Reclassifications	7	–	6	6
Disposals		(19)	(2)	(21)
Balance at end of year		1,427	224	1,651
Less accumulated depreciation:				
Balance at beginning of year		–	107	107
Depreciation		–	7	7
Disposals		–	(1)	(1)
Balance at end of year		–	113	113
		₱1,427	₱111	₱1,538

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

The aggregate fair values of the investment properties as at December 31, 2016 and 2015 are as follows:

	2016	2015
	(Amounts in millions)	
Land	**₱1,863**	₱1,863
Buildings and improvements	**150**	170

Land pertains primarily to properties where the *BPO* building and "Strip" mall are located and to other non-regulated asset base properties.

The fair values of investment properties were determined by independent, professionally qualified appraisers. The fair value represents the price that would be received to sell an investment property in an orderly transaction between market participants at the measurement date.

The fair value disclosures of the investment properties are categorized as Level 3 as there is no active market for identical or similar properties. The inputs include price per square meter ranging from ₱40 to ₱96,000. There have been no changes in the valuation techniques used.

In conducting the appraisal, the independent professional appraisers used any of the following approaches:

a. Market Data or Comparative Approach

   Under this approach, the value of the property is based on sales and listings of comparable property registered within the vicinity. This approach requires the establishment of a comparable property by reducing comparative sales and listings to a common denominator with the subject. This is done by adjusting the differences between the subject property and those actual sales and listings regarded as comparables. The properties used are either situated within the immediate vicinity or at different floor levels of the same building, whichever is most appropriate to the property being valued. Comparison was premised on the factors of location, size and physical attributes, selling terms, facilities offered and time element.

b. Depreciated Replacement Cost Approach

This method of valuation considers the cost to reproduce or replace in new condition the assets appraised in accordance with current market prices for similar assets, with allowance for accrued depreciation based on physical wear and tear and obsolescence.

10. **Other Noncurrent Assets**

This account consists of:

	Note	**2016**	2015
		(Amounts in millions)	
HTM investments	*14 and 26*	**₱34,997**	₱17,167
AFS financial assets	*26*	**10,186**	10,961
Intangible assets	*7*	**2,713**	2,585
Retirement surplus	*25*	**1,860**	–
Deferred input *VAT*		**1,733**	1,664
Advance payments to a supplier	*26 and 29*	**1,277**	1,030
Receivable from the *BIR*	*28*	**181**	181
Deferred reinsurance premium		**168**	119
Goodwill		**36**	36
Others		**608**	1,851
		₱53,759	₱35,594

HTM Investments

The details of *HTM* investments are as follows:

	2016			2015		
	Current Portion (*Note 14*)	**Noncurrent Portion**	**Total**	Current Portion	Noncurrent Portion	Total
			(Amounts in millions)			
Government securities	**₱1,350**	**₱33,914**	**₱35,264**	₱4,072	₱16,476	₱20,548
Private debt securities	**–**	**1,083**	**1,083**	–	691	691
	₱1,350	**₱34,997**	**₱36,347**	₱4,072	₱17,167	₱21,239

This account represents investments in government securities issued by the Republic of Philippines and private debt securities issued by Philippine listed corporations.

AFS Financial Assets

The details of *AFS* financial assets are as follows:

	2016	2015
	(Amounts in millions)	
Investments in government securities	**₱5,470**	₱1,792
Investments in Unit Investment Trust Funds *("UITFs")*	**3,825**	9,027
Investments in ordinary shares and club shares of stock:		
Quoted	**852**	107
Unquoted	**39**	35
	₱10,186	₱10,961

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

	2016	2015
	(Amounts in millions)	
Balance at beginning of year	**₱102**	₱112
Losses on change in fair value	**(373)**	(10)
Balance at end of year	**(₱271)**	₱102

Intangible Assets

The movements of intangible assets are as follows:

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

		2015			
	Note	Software	Franchise	Land and Leasehold Rights	Total
		(Amounts in millions)			
Cost:					
Balance at beginning of year		₱3,467	₱49	₱431	₱3,947
Additions		707	–	–	707
Reclassifications	*7*	(30)	–	–	(30)
Balance at end of year		4,144	49	431	4,624
Less accumulated amortization:					
Balance at beginning of year		1,389	–	222	1,611
Amortization		410	–	18	428
Balance at end of year		1,799	–	240	2,039
		₱2,345	₱49	₱191	₱2,585

Deferred Input VAT

The amount includes portion of input *VAT* incurred and paid in connection with purchase of capital assets in excess of ₱1 million per month. As provided for in *RA* No. 9337 *("EVAT Law")*, said portion of input *VAT* shall be deferred and credited evenly over the estimated useful lives of the related capital assets or 60 months, whichever is shorter, against the output *VAT* due.

Unbilled Receivables

This account represents generation and other pass-through costs covered by the approved recovery mechanism of the *ERC* incurred by *MERALCO* and *CEDC* as *DU*s and are still to be billed. The balance also includes other unbilled generation and pass-through charges of current and prior years, which are the subject of various applications for recovery and approval by the *ERC*.

Provision for impairment loss on unbilled receivables amounted to ₱1,371 million and ₱2,134 million as at December 31, 2016 and 2015, respectively.

11. **Cash and Cash Equivalents**

This account consists of:

	2016	2015
	(Amounts in millions)	
Cash on hand and in banks	**₱5,746**	₱5,098
Cash equivalents	**40,910**	45,742
	₱46,656	₱50,840

Cash in banks earn interest at prevailing bank deposit rates. Cash equivalents are temporary cash investments, which are made for varying periods up of to three (3) months depending on *MERALCO Group*'s immediate cash requirements, and earn interest at the prevailing short-term investment rates.

12. **Trade and Other Receivables**

This account consists of:

	Note	**2016**	2015
		(Amounts in millions)	
Trade:			
Electricity:			
Billed	*22 and 26*	**₱18,920**	₱19,898
Unbilled	*2 and 10*	**3,632**	4,116
Service contracts		**3,659**	3,624
Cost and estimated earnings in excess of billings on uncompleted contracts		**605**	780
Insurance receivable		**104**	99
Nontrade	*22 and 26*	**1,635**	1,909
		28,555	30,426
Less allowance for doubtful accounts		**3,214**	3,665
		₱25,341	₱26,761

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

	2016	2015
	(Amounts in millions)	
Residential	**₱8,834**	₱8,969
Commercial	**7,167**	7,574
Industrial	**2,665**	3,044
Streetlights	**254**	311
	18,920	19,898
Less allowance for doubtful accounts	**2,991**	3,459
	₱15,929	₱16,439

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

	2016			
	Balance at Beginning of year	**Provisions (Reversals)**	**Write-offs**	**Balance at End of year**
	(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**

	2016						
	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**

	2015			
	Balance at Beginning of year	Provisions (Reversals)	Write-offs	Balance at End of year
		(Amounts in millions)		
Billed trade receivables:				
Residential	₱1,806	₱805	(₱436)	₱2,175
Commercial	963	23	(77)	909
Industrial	291	(11)	(31)	249
Streetlights	147	(20)	(1)	126
	3,207	797	(545)	3,459
Other trade receivables	218	(15)	–	203
Nontrade receivables	2	1	–	3
	₱3,427	₱783	(₱545)	₱3,665

	2015						
	Residential	Commercial	Industrial	Streetlights	Other Trade Receivables	Nontrade Receivables	Total
			(Amounts in millions)				
Individually impaired	₱1,404	₱362	₱114	₱44	₱203	₱3	₱2,130
Collectively impaired	771	547	135	82	–	–	1,535
	₱2,175	₱909	₱249	₱126	₱203	₱3	₱3,665

Trade Receivables – Electricity

Trade receivables of *MERALCO* and *CEDC* include charges for pass-through costs. Pass-through costs consist largely of generation, transmission and *SL* charges, which represent 51%, 11% and 4%, respectively, of the total billed amount in 2016 and 54%, 11% and 4%, respectively, of the total billed amount in 2015. Billed receivables are due 10 days after bill date. *MERALCO*'s and *CEDC*'s trade receivables are noninterest-bearing and are substantially secured by bill deposits.

Unbilled receivables represent electricity consumed after the meter reading cut-off dates, which will be billed to customers in the immediately following billing period. This also includes the current portion of pass-through costs under-recoveries, net of over-recoveries, which are billed to the customers over the period approved by the *ERC*.

See *Note 17 – Customers' Deposits* and *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* and subsidiary, *CIS, Bayad Center*, *MRail*, and *MEI* for construction, engineering, related manpower, consulting, light rail maintenance, data transport, bills collection, tellering and e-business development and energy management services to third parties.

Receivables from service contracts and others are noninterest-bearing and are generally on 30- to 90-day terms.

13. **Inventories**

	2016	2015
	(Amounts in millions)	
Materials and supplies:		
At net realizable value *("NRV")*	**₱19**	₱160
At cost	**2,773**	2,113
	₱2,792	₱2,273

The reversal of previous write-down of inventory cost to *NRV* amounted ₱4 million, ₱2 million and ₱10 million in 2016, 2015 and 2014, respectively.

14. **Other Current Assets**

	Note	**2016**	2015
		(Amounts in millions)	
Advances to an associate	*22 and 26*	**₱5,644**	₱5,342
Prepayments and advances to suppliers		**2,418**	2,469
Pass-through *VAT* - net		**1,833**	1,550
Prepaid tax		**1,342**	1,438
HTM investments	*10 and 26*	**1,350**	4,072
Input *VAT*		**551**	477
Others		**81**	73
		₱13,219	₱15,421

Pass-through *VAT* pertains to *VAT* on generation and transmission costs billed to the *DU*, which are in turn billed to the customers. Remittance of such pass-through *VAT* to the generation companies is based on collection of billed receivables from the customers.

15. **Equity**

Common Stock

	2016	2015
	(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 44,110 and 44,193 shareholders of *MERALCO*'s common shares as at December 31, 2016 and 2015, respectively.

Unappropriated Retained Earnings

The unappropriated retained earnings include accumulated earnings of subsidiaries, associates and joint ventures, and the balance of *MERALCO*'s revaluation increment in utility plant and others and investment properties carried at deemed cost and deferred tax assets totaling to

₱41,402 million and ₱40,618 million as at December 31, 2016 and 2015, 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 on common shares in 2016, 2015 and 2014:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
July 25, 2016	August 24, 2016	September 19, 2016	₱13.48	₱15,193
April 25, 2016	May 25, 2016	June 17, 2016	1.68	1,894
February 26, 2016	March 23, 2016	April 15, 2016	9.92	11,181
July 27, 2015	August 26, 2015	September 18, 2015	6.76	7,619
February 23, 2015	March 23, 2015	April 15, 2015	8.49	9,569
July 28, 2014	August 25, 2014	September 18, 2014	5.91	6,661
March 17, 2014	April 15, 2014	May 8, 2014	6.45	7,270

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

Appropriated Retained Earnings

On February 22, 2010, retained earnings of ₱6,000 million were appropriated specifically for the *MERALCO Group*'s business expansion into power generation. The amount appropriated was increased by ₱5,000 million for the development of new projects and investments in power generation. The additional appropriation was approved on March 22, 2013 by the *BOD*. As at December 31, 2016, the development of the first project, a 2 x 300 *MW CFB* coal-fired plant through *RP Energy*, is proceeding with the decision of the *SC* denying the Writ of Kalikasan case previously filed by certain opposing parties against its planned power plant due to insuffiency of evidence. Site preparation has essentially been completed, with commercial operations by 2020. Meanwhile, work on the permanent transmission line interconnection is proceeding in preparation for the development of the second 300 *MW* unit.

Separately, *MERALCO* signed a Joint Development Agreement and Shareholders Agreement to co-develop a 455 *MW* (net) supercritical coal-fired power plant in Mauban, Quezon under *SBPL*, which has signed *PSA* and *EPC* contracts, has achieved financial close, is currently under construction and has a target completion in 2019.

On July 25, 2016, the *BOD* approved the reversal of the appropriated retained earnings of ₱11,000 million.

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

Treasury Shares

Treasury shares represent subscribed shares and the related rights of employees who have opted to withdraw from the *ESPP* in accordance with the provisions of the *ESPP* and which *MERALCO* purchased. As at December 31, 2016 and 2015, a total of 172,412 shares were acquired from employees who have opted to cancel their participation in the *ESPP*.

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 has previously set aside a total of 55 million common shares for *ESPP* awards. As at December 31, 2016, 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:

	2016	2015
	(Amounts in millions)	
Long-term portion of interest-bearing financial liabilities - Long-term debt	**₱26,999**	₱27,370
Current portion of interest-bearing financial liabilities:		
Long-term debt	**371**	373
Redeemable preferred stock	**1,502**	1,522
	1,873	1,895
	₱28,872	₱29,265

All of the redeemable preferred shares have been called for redemption as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. The accrued interests amounted to ₱250 million as at December 31, 2016 and 2015. Interest is no longer accrued when the preferred shares were called for redemption.

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

Description	**2016**	2015
	(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	**6,480**	6,840
₱130 Million Term Loan Facility	**106**	130
Floating Rate Loan		
₱2.5 Billion Term Loan Facility	**2,437**	2,450
Total long-term debt	**27,523**	27,920
Less unamortized debt issuance costs	**153**	177
	27,370	27,743
Redeemable Preferred Stock	**1,502**	1,522
	28,872	29,265
Less current portion	**1,873**	1,895
Long-term portion of interest-bearing financial liabilities	**₱26,999**	₱27,370

All of *MERALCO*'s interest-bearing long-term financial liabilities as at December 31, 2016 and 2015 are denominated in Philippine peso. The scheduled maturities of *MERALCO*'s outstanding long-term debt at nominal values as at December 31, 2016 are as follows:

	Amount
	(In millions)
Less than one (1) year	₱396
One (1) year up to two (2) years	2,809
More than two (2) years up to three (3) years	383
More than three (3) years up to four (4) years	11,883
More than four (4) years up to five (5) years	372
More than five (5) years	11,680
	₱27,523

₱18.5 Billion Fixed Rate Puttable Bonds

On September 23, 2013, the *BOD* of *MERALCO* authorized the offer, sale and issuance by way of public offering in the Philippines, 7- and 12-year corporate bonds, puttable in five (5) and 10 years, respectively, with an aggregate principal amount of up to ₱15 billion with an overallotment option of up to ₱5.0 billion. The 12-year corporate bonds also include a call option, where *MERALCO* may redeem (in whole but not in part only) the outstanding bonds on the 7th year from issue date at the early redemption price of 101.0%. The put and call options are clearly and closely related to the host instruments, and thus, were not recognized separately.

On December 12, 2013, the ₱11.5 billion fixed rate puttable bonds due in 2020 and ₱7.0 billion fixed rate puttable bonds due in 2025, were listed on the Philippine Dealing and Exchange Corporation.

The net proceeds of the bonds were utilized for refinancing certain loans including principal payments, accrued interest, prepayment penalties and other financing costs.

₱7.2 Billion Note Facility Agreement

In February 2014, *MERALCO* entered into a Fixed Rate Note Facility Agreement for its ₱7,200 million, 10-year note due in February 2024. The principal is payable in nominal annual amortizations with a balloon payment upon final maturity.

₱130 Million Term Loan Facility

On June 27, 2014, *MIESCOR* obtained a ₱130 million, 7-year fixed rate term loan. The principal is payable over six (6) years with final maturity in June 2021.

₱2.5 Billion Term Loan Facility

The ₱2,500 million, 7-year Floating Rate Term Loan Facility, was drawn in January 2011 from a local bank. Interest rate is repriced every six (6) months based on 6-month *PDST-F* plus a spread. The principal is payable in nominal annual amortizations with a balloon payment on final maturity in January 2018.

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

	2016	2015
Fixed Rate Loans	**4.38% to 5.50%**	4.38% to 5.50%
Floating Rate Loans	**2.29% to 2.71%**	2.52% to 2.63%

Debt Covenants

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

As at December 31, 2016 and 2015, *MERALCO* is in compliance with all covenants of the loan agreements.

Unamortized Debt Issuance Costs

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

	Note	**2016**	2015
		(Amounts in millions)	
Balance at beginning of year		**₱177**	₱200
Amortization charged to interest and other financial charges	*24*	**(24)**	(23)
Balance at end of year		**₱153**	₱177

Redeemable Preferred Stock

The movements in the number of shares of the redeemable preferred stock, which have all been called, are as follows:

	2016	2015
Balance at beginning of year	**152,231,414**	154,901,389
Redemptions	**(2,073,617)**	(2,669,975)
Balance at end of year	**150,157,797**	152,231,414

The original "Terms and Conditions" of *MERALCO*'s Special Stock Subscription Agreement*,* which required an applicant to subscribe to preferred stock with 10% dividend to cover the cost of extension of, or new, distribution facilities, have been amended by the *Magna Carta* and the *DSOAR,* effective June 17, 2004 and January 18, 2006, respectively. The amendment sets forth the guidelines for the issuance of preferred stock, only if such instrument is available.

17. Customers' Deposits

This account consists of:

	2016			2015		
	Current Portion (*Note 21*)	**Noncurrent Portion**	**Total**	Current Portion (*Note 21*)	Noncurrent Portion	Total
			(Amounts in millions)			
Bill deposits	**₱2,594**	**₱23,501**	**₱26,095**	₱2,470	₱23,584	₱26,054
Meter deposits	**489**	**–**	**489**	497	–	497
	₱3,083	**₱23,501**	**₱26,584**	₱2,967	₱23,584	₱26,551

Bill Deposits

Bill deposits serve to guarantee payment of bills by a customer in accordance with existing regulations.

As provided for under the *Magna Carta* and *DSOAR*, all captive customers are required to pay a deposit to the *DU* an amount equivalent to the estimated monthly bill calculated based on applied load, which shall be recognized as bill deposit of the captive customer. Such deposit shall be adjusted after one year based on the historical 12-month average bill. A captive customer who has paid his electric bills on or before due date for three (3) consecutive years may apply for the full refund of the bill deposit, together with the accrued interests, prior to the termination of his service; otherwise bill deposits and accrued interests shall be refunded within one (1) month from the termination of service, provided all bills have been paid.

On February 22, 2010, the amended *DSOAR,* which became effective on April 1, 2010, was promulgated by the *ERC*. Under the amended *DSOAR,* interest on bill deposits for both residential and non-residential customers shall be computed using the equivalent peso savings account interest rate of the Land Bank of the Philippines *("Land Bank")* or other government banks, on the first working day of the year, subject to the confirmation of the *ERC.* Interest rate for bill deposits is 0.250% per annum starting January 1, 2014.

As provided for under *ERC* Resolution No. 1, *A Resolution Adopting the Revised Rules for the Issuance of Licenses to Retail Electricity Suppliers*, a local *RES* may require security deposits from its contestable customers, which shall earn interest equivalent to the actual interest earnings of the total amount of deposits received from the customers.

The following are the movements of the bill deposits account:

	Note	**2016**	2015
		(Amounts in millions)	
Balance at beginning of year		**₱26,054**	₱27,906
Additions		**4,453**	4,807
Refunds		**(4,412)**	(6,659)
Balance at end of year		**26,095**	26,054
Less portion maturing within one year	*21*	**2,594**	2,470
Noncurrent portion of bill deposits and related interests		**₱23,501**	₱23,584

Meter Deposits

Meter deposits were intended to guarantee the cost of meters installed.

The *Magna Carta* for residential customers (effective June 17, 2004) and *DSOAR* (effective January 18, 2006) for non-residential customers exempt all customer groups from payment of meter deposits beginning July 2004 for residential customers and April 2006 for non-residential customers.

The *ERC* released Resolution No. 8, Series of 2008, otherwise known as "Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers" ("*Rules")* which required the refund of meter deposits from the effectivity of the said *Rules* on July 5, 2008. Under the *Rules*, a customer has the option of receiving his refund in cash, credit to future monthly billings, or as an offset to other due and demandable claims of the *DU* against him.

The total amount of refund shall be equivalent to the meter deposit paid by the customer plus the total accrued interest earned from the time the customer paid the meter deposit until the day prior to the start of refund.

On August 8, 2008, in compliance with the *Rules*, *MERALCO* submitted to the *ERC* an accounting of the total meter deposit principal amount for refund. The actual refund of meter deposits commenced on November 3, 2008.

As at December 31, 2016 and 2015, total meter deposits refunded by *MERALCO* amounted to ₱2,604 million (inclusive of ₱1,351 million interest) and ₱2,599 million (inclusive of ₱1,349 million interest), respectively.

18. Provisions

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

	Note	**2016**	2015
		(Amounts in millions)	
Balance at beginning of year		**₱37,402**	₱30,393
Additions for the year - net		**1,504**	7,026
Settlements		**(682)**	(17)
Balance at end of year		**38,224**	37,402
Less current portion	*21*	**19,054**	16,388
Noncurrent portion of provisions		**₱19,170**	₱21,014

The balance of provisions substantially represents the amounts of claims related to a commercial contract which remains unresolved and local taxes being contested as discussed in *Note 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 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.

20. Notes Payable

Notes payable represent unsecured interest-bearing working capital loans obtained from local banks. Annual interest rates range from 2.5% to 4.25% and 2.9% to 4.25% as at December 31, 2016 and 2015, respectively, on peso-denominated loans.

Interest expense on notes payable amounted to ₱20 million, ₱26 million and ₱7 million for the years ended December 31, 2016, 2015 and 2014, respectively.

See *Note 24 – Expenses and Income*.

21. Trade Payables and Other Current Liabilities

This account consists of the following:

	Note	**2016**	2015
		(Amounts in millions)	
Trade accounts payable	*22 and 23*	**₱31,319**	₱29,458
Provisions	*18 and 28*	**19,054**	16,388
Output *VAT* - net		**7,081**	6,437
Accrued expenses:			
Employee benefits		**1,940**	1,734
Taxes		**1,553**	1,635
Interest	*16*	**115**	115
Others		**989**	2,007
Current portions of:			
Bill deposits and related interests	*17*	**2,594**	2,470
Meter deposits and related interests	*17*	**489**	497
Deferred income		**1,005**	1,037
Refundable service extension costs		**2,502**	2,502

(Forward)

	Note	2016	2015
		(Amounts in millions)	
Dividends payable on:			
Common stock	*15*	**604**	450
Redeemable preferred stock	*17*	**250**	250
Payable to customers		**8,279**	8,009
Universal charges payable		**2,365**	2,256
Feed-in-tariff allowance		**631**	217
Regulatory fees payable		**181**	275
Reinsurance liability		**131**	86
Other current liabilities		**2,838**	3,734
		₱83,920	₱79,557

Trade Accounts Payable

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

Trade payables are non-interest-bearing and are generally settled within the 15- to 60-day trade term. Other payables are non-interest-bearing and are due within one (1) year from incurrence.

See *Note 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 on April 1, 2010, requires such advances from customers to be refunded at the rate of 75% of the distribution revenue generated from the extension lines and facilities until such amounts are fully refunded. The related asset forms part of the rate base only at the time a refund has been paid out. Customer advances are non-interest-bearing.

As at December 31, 2016 and 2015, the noncurrent portion of refundable service extension costs of ₱4,927 million and ₱4,234 million, respectively, is presented as "Refundable service extension costs - net of current portion" account in the consolidated statements of financial position.

Universal Charges Payable

Universal charges payable are charges passed on and collected from customers on a monthly basis by *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 financial year. The outstanding balances are unsecured, non-interest-bearing and settled in cash.

Pole Attachment Contract with Philippine Long Distance Telephone Company ("PLDT")

MERALCO has a Pole Attachment Contract with *PLDT* similar to third party pole attachment contracts of *MERALCO* with other telecommunication companies. Under the Pole Attachment Contract, *PLDT* shall use the contracted cable position exclusively for its telecommunication cable network facilities.

Sale of Electricity under Various Service Contracts

MERALCO sells electricity to related party shareholder groups within the franchise area such as *PLDT*, *Metro Pacific* and *JG Summit* and their respective subsidiaries, and affiliates for their facilities within *MERALCO*'s franchise area. The rates charged to related parties are the same *ERC*-mandated rates applicable to customers within the franchise area.

Purchase of Telecommunication Services from PLDT and Subsidiaries

The *MERALCO Group*'s telecommunications carriers include *PLDT* for its wireline and Smart Communications, Inc. and Digitel Mobile Philippines, Inc., for its wireless services. Such services are covered by standard service contracts between the telecommunications carriers and each legal entity within the *MERALCO Group*.

Purchase of Goods and Services

In the ordinary course of business, the *MERALCO Group* purchases goods and services from its affiliates and sells power to such affiliates.

PSAs with Joint Ventures and Associates

As discussed in Note 22, *MERALCO* signed long-term PSAs with the following related parties: *SBPL*, *RPE*, *SRPGC*, *MPGC* and *PEDC*.

Following is the summary of related party transactions for the years ended December 31, 2016, 2015 and 2014 and the outstanding balances as at December 31, 2016 and 2015:

Category	Amount of Transactions			Outstanding Receivable (Liability)			
	2016	2015	2014	**2016**	2015	Terms	Conditions
		(Amounts in millions)					
Sale of electricity:							
JG Summit Group	**₱2,869**	₱3,404	₱3,263	**₱201**	₱242	10-day; noninterest-bearing	Unsecured, no impairment
PLDT Group	**1,213**	1,438	1,941	**45**	64	10-day; noninterest-bearing	Unsecured, no impairment
Metro Pacific Group	**141**	157	179	**3**	6	10-day; noninterest-bearing	Unsecured, no impairment
Purchases of IT services - *Indra Philippines*	**678**	786	829	**(1)**	(50)	30-day; noninterest-bearing	Unsecured
Purchases of meters and devices - *GEPMICI*	**254**	399	312	**(13)**	(19)	30-day; noninterest-bearing	Unsecured
Revenue from pole attachment - *PLDT*	**281**	285	250	**25**	16	Advance payment	Unsecured, no impairment
Purchases of wireline and wireless services - *PLDT Group*	**82**	72	58	**(9)**	(11)	30-day; noninterest-bearing	Unsecured
Purchases of power:							
Panay Power Corporation (*"PPC"*)	**285**	143	340	**74**	–	30-day; noninterest-bearing	Unsecured
Toledo Power Corporation (*"TPC"*)	**163**	100	918	**45**	–	30-day; noninterest-bearing	Unsecured

Advances to FPM Power

On March 22, 2013, *FPM Power* availed of a non-interest-bearing loan from *MPG Asia* amounting to US$110 million, which is payable on demand. The loan is outstanding as at December 31, 2016 and 2015.

See *Note 14 – Other Current Assets.*

Transaction with MERALCO Retirement Benefits Fund ("Fund")

The *MERALCO Group's Fund* holds 6,000 common shares of *RP Energy* at par value of ₱100 per share, with total carrying amount of ₱600,000 or an equivalent 3% equity interest in *RP Energy*. The fair value of *RP Energy*'s common shares cannot be reliably measured as these are not traded in the financial market. As at December 31, 2016 and 2015, the fair value of the total assets being managed by the Fund amounted to ₱37.0 billion and ₱36.2 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:

	2016	2015	2014
		(Amounts in millions)	
Short-term employee benefits	**₱667**	₱635	₱538
Long-term employee incentives and retirement benefits	**285**	300	297
Total compensation to key management personnel	**₱952**	₱935	₱835

Each of the directors is entitled to a per diem of ₱120,000 for every *BOD* meeting attended. Each member of the Audit and Risk Management, Remuneration and Leadership Development, Finance, Governance and Nomination Committees is entitled to a fee of ₱20,000 for every committee meeting attended.

On March 22, 2013, the *BOD* approved the amendment of *MERALCO'*s By-Laws which entitles all directors to a reasonable per diem for their attendance in meetings of the *BOD* and Board Committees plus an additional compensation, provided that the total value of such additional compensation, in whatever form so given, shall not exceed one (1) percent of the income before income tax of *MERALCO* during the preceding year.

Consistent with the foregoing, the *BOD* approved the increase in the compensation of all members of the *BOD* up to a maximum of the pre-agreed amount per annum. The increase in compensation shall be through a stock grant based on a pre-approved number of shares for each director. The implementation of such plan was approved by the stockholders in the annual general meeting of stockholders on May 28, 2013.

As at December 31, 2016, there are no agreements between the *MERALCO Group* and any of its key management personnel providing for benefits upon termination of employment or retirement, except with respect to benefits provided under (i) a defined benefit retirement plan, (ii) a program which aims to address capability refresh and organizational optimization requirements, and (iii) a contributory provident plan. Post-retirement benefits under the defined benefit retirement plan cover employees hired up to December 31, 2003 only. The provident plan, which is implemented on a voluntary basis, covers employees hired beginning January 1, 2004.

23. Purchased Power

The details of purchased power are as follow:

	2016	2015	2014
	(Amounts in millions)		
Generation costs	**₱153,751**	₱157,904	₱169,033
Transmission costs	**36,102**	34,213	34,209
	₱189,853	₱192,117	₱203,242

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 ₱49,522 million, ₱45,702 million and ₱44,204 million in 2016, 2015 and 2014, 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 6.35%, 6.47% and 6.49% in 2016, 2015 and 2014, respectively.

The details of purchased power follow:

	2016	2015	2014
	(Amounts in millions)		
First Gas Power Corporation *("FGPC")* and FGP Corp. *("FGP")*	**₱39,472**	₱49,111	₱53,772
NGCP	**35,870**	34,005	34,016
South Premiere Power Corporation *("SPPC")*	**28,416**	29,572	36,344
PEMC/WESM	**17,637**	13,078	5,975
QPPL	**13,817**	13,605	14,480
San Miguel Energy Corporation *("SMEC")*	**13,063**	12,987	12,979
Masinloc Power Partners Co. Ltd. *("MPPCL")*	**12,628**	11,462	12,515
Therma Luzon, Inc. *("TLI")*	**10,076**	9,393	9,334
Sem-Calaca Power Corporation *("Sem-Calaca")*	**10,020**	10,097	10,486
Therma Mobile, Inc. *("TMO")*	**2,892**	3,231	3,987
Trans-Asia Oil and Energy Development Corporation *("Trans-Asia")*	**2,268**	2,152	2,281
Southwest Luzon Power Generation Corp.	**2,214**	–	–
1590 Energy Corporation	**849**	1,370	1,359
Others	**631**	2,054	5,714
	₱189,853	₱192,117	₱203,242

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 December 31, 2016 and 2015, the total transmission costs and *SL* charge over-recoveries included in "Other noncurrent liabilities" account in the consolidated statements of financial position amounted to ₱6,592 million and ₱5,829 million, respectively.

24. Expenses and Income

Salaries, Wages and Employee Benefits

	Note	2016	2015	2014
			(Amounts in millions)	
Salaries, wages and related employee benefits		**₱11,576**	₱11,056	₱9,704
Retirement benefits	*25*	**1,157**	1,237	1,186
Other long-term post-employment benefits	*25*	**108**	127	118
		₱12,841	₱12,420	₱11,008

Other Expenses

	Note	**2016**	2015	2014
			(Amounts in millions)	
Materials used	*13*	**₱2,332**	₱2,783	₱820
Rent and utilities		**732**	852	718
Advertising		**346**	306	438
Transportation and travel		**371**	476	396
Insurance		**350**	295	327
Communication	*2*	**135**	134	101
Others		**1,185**	1,305	965
		₱5,451	₱6,151	₱3,765

Interest and Other Financial Charges

	Note	**2016**	2015	2014
			(Amounts in millions)	
Interest expense on interest-bearing long-term financial liabilities, net of interest capitalized	*7 and 16*	**₱1,046**	₱1,050	₱1,210
Interest expense on bill deposits	*17*	**65**	83	84
Interest expense on notes payable	*20*	**171**	26	7
Amortization of debt issuance costs	*16*	**24**	23	43
Others		**37**	34	95
		₱1,343	₱1,216	₱1,439

Interest and Other Financial Income

	Note	**2016**	2015	2014
			(Amounts in millions)	
Interest income on cash in banks and cash equivalents	*11*	**₱654**	₱898	₱720
Income from *HTM* and *AFS* investments		**1,238**	389	–
Carrying costs on *ERC*-approved under-recoveries		**–**	198	–
Others		**188**	53	50
		₱2,080	₱1,538	₱770

25. **Long-term Employee Benefits**

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

	2016	2015
	(Amounts in millions)	
Retirement benefits liability	**₱307**	₱2,021
Long-term incentives	**1,244**	3,287
Other long-term post-employment benefits	**1,568**	1,599
	3,119	6,907
Less current portion	**–**	3,287
	₱3,119	₱3,620

Defined Benefit Retirement Plans

The features of the *MERALCO Group*'s defined benefit plans are discussed in *Note 4 – Significant Accounting Policies, Changes and Improvements.*

Actuarial valuations are prepared annually by the respective independent actuaries engaged by *MERALCO* and its subsidiaries.

Expense recognized for defined benefit plans (included in "Salaries, wages and employee benefits" account in the consolidated statements of income)

	2016	2015	2014
	(Amounts in millions)		
Current service costs	**₱1,079**	₱1,216	₱1,101
Net interest costs	**60**	14	76
Net retirement benefits expense	**₱1,139**	₱1,230	₱1,177

Retirement Benefits Liability (Asset)

	2016	2015
	(Amounts in millions)	
Defined benefit obligation	**₱35,301**	₱38,220
Fair value of plan assets	**(36,854)**	(36,199)
Retirement benefits liability (asset)	**(₱1,553)**	₱2,021

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

	2016	2015
	(Amounts in millions)	
Retirement surplus under other noncurrent assets	**(₱1,860)**	₱–
Retirement benefits liability	**307**	2,021
Retirement benefits liability (asset)	**(₱1,553)**	₱2,021

Changes in the net retirement benefits liability are as follows:

	2016	2015
	(Amounts in millions)	
Retirement benefits liability at beginning of year	**₱2,021**	₱685
Net retirement benefits expense	**1,139**	1,230
Contributions by employer	**(1,271)**	(775)
Amounts recognized in *OCI*	**(3,442)**	881
Retirement benefits liability (asset) at end of year	**(₱1,553)**	₱2,021

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

	2016	2015
	(Amounts in millions)	
Defined benefit obligation at beginning of year	**₱38,220**	₱37,129
Interest costs	**1,833**	1,620
Current service costs	**1,079**	1,216
Benefits paid	**(1,903)**	(1,720)
Actuarial losses (gains) due to:		
Changes in financial assumptions	**(2,006)**	(1,550)
Experience adjustments	**(1,922)**	1,525
Defined benefit obligation at end of year	**₱35,301**	₱38,220

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

	2016	2015
	(Amounts in millions)	
Fair value of plan assets at beginning of year	**₱36,199**	₱36,444
Benefits paid	**(1,903)**	(1,720)
Interest income	**1,773**	1,606
Return on plan assets, excluding amount included in net interest on the net defined benefit obligation and interest income	**(486)**	(906)
Contributions by employer	**1,271**	775
Fair value of plan assets at end of year	**₱36,854**	₱36,199

The Board of Trustees *("BoT")* which manages the *Fund*, is chaired by the chairman of *MERALCO*, who is neither an executive nor a beneficiary. The other members of the *BoT* are (i) an 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 December 31, 2016 and 2015 amounted to ₱36,854 million and ₱36,199 million, respectively. The major categories of plan assets are as follows:

	2016	2015
	(Amount in millions)	
Cash and cash equivalents	**₱1,922**	₱3,007
Investments quoted in active markets:		
Quoted equity investments		
Holding firms	**3,161**	2,973
Electricity, energy, power and water	**1,048**	1,576
Telecommunication	**676**	915
Food, beverages and tobacco	**650**	722
Property	**611**	743
Banks	**532**	671
Retail	**161**	14
Mining	**137**	78
Construction, infrastructure and allied services	**103**	53
Transportation services	**87**	90
Others	**903**	25
Quoted debt investments		
“AAA” rated securities	**15,294**	12,670
Government securities	**8,754**	9,813
Unquoted investments		
Receivables	**1,861**	1,895
Property	**954**	954
Fair value of plan assets	**₱36,854**	₱36,199

Marketable equity securities, government securities, bonds and commercial notes are investments held by the trustee banks. The *Fund* does not have any direct equity interests in *MERALCO*.

Other Long-term Post-employment Benefits (included as part of “Salaries, wages and employee benefits” account in the consolidated statements of income)

	2016	2015	2014
		(Amounts in millions)	
Interest costs	**₱80**	₱84	₱79
Current service costs	**28**	39	36
Actuarial loss	**–**	4	3
	₱108	₱127	₱118

Other Long-term Post-employment Benefits Liability

Changes in the present value of other long-term post-employment benefits liability are as follows:

	2016	2015
	(Amounts in millions)	
Balance at beginning of year	**₱1,599**	₱1,899
Interest costs	**80**	84
Current service costs	**28**	39
Benefits paid	**(70)**	(70)
Actuarial gains due to change in assumptions	**(69)**	(353)
Balance at end of year	**₱1,568**	₱1,599

Actuarial Assumptions

The principal assumptions used as at December 31, 2016 and 2015 in determining retirement benefits and other long-term post-employment benefits obligations are shown below:

	2016	2015
Annual discount rate	**4.78% to 5.62%**	4.86 to 5.08%
Future range of annual salary increases	**4.0% - 10.0%**	4.0% - 11.0%

Sensitivity Analysis

The calculation of the defined benefit obligation is sensitive to the assumptions set above. The following table summarizes how the impact on the defined benefit obligation at the end of the reporting period would have increased (decreased) as a result of a change in the respective assumptions by:

		Effect on Present Value of Defined Benefit Obligation	
	% Change	**2016**	2015
		(Amounts in millions)	
Annual discount rate	+1.0%	**(₱4,838)**	(₱4,393)
	-1.0%	**4,543**	5,407
Future range of annual salary increases	+1.0%	**4,333**	1,752
	-1.0%	**(4,549)**	(1,588)

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 the actuary.

The following is the maturity profile of the undiscounted benefit obligation as at December 31, 2016:

	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:

<u>*Credit Risk*</u>
The *Fund*'s exposure to credit risk arises from its financial assets which comprise cash and cash equivalents, investments and rental receivable. The credit risk results from the possible default of the issuer of the financial instrument, with a maximum exposure equivalent to the carrying amounts of the instruments.

The credit risk is minimized by ensuring that the exposure to the various chosen financial investment structures is limited primarily to government securities and bonds or notes duly recommended by the Trust Committees of the appointed fund managers of the *Fund*.

<u>*Share Price Risk*</u>
The *Fund*'s exposure to share price risk arises from the shares of stock it holds and being traded at the *PSE*. The price share risk emanates from the volatility of the stock market.

The policy is to limit investment in shares of stock to blue chip issues or issues with good fair values or those trading at a discount to its net asset value so that in the event of a market downturn, the *Fund* may still consider to hold on to such investments until the market recovers.

By having a balanced composition of holdings in the equities portfolio, exposure to industry or sector-related risks is reduced. The mix of various equities in the portfolio reduces volatility and contributes to a more stable return over time. Equity investments are made within the parameters of the investment guidelines approved by the *BoT*. The *BoT* also meets periodically to review the investment portfolio based on financial market conditions. Share prices are also monitored regularly.

<u>*Liquidity Risk*</u>
Liquidity risk is the risk that the *Fund* is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. Liquidity risk is being managed to ensure that adequate fixed income and cash deposits are available to service the financial obligations of the *Fund*. The schedule of the maturities of fixed income investment assets are staggered by tenure or term. Policies are established to ensure that all financial obligations are met, wherein the timing of the maturities of fixed income investments are planned and matched to the due date of various obligations. Thus, for this investment class, maturities are classified into short-, medium- and long-term. A certain percentage of the portfolio is kept as cash to manage liquidity and settle all currently maturing financial obligations.

Defined Contribution Provident Plan

MERALCO has a defined contributory Provident Plan effective January 1, 2009, intended to be a Supplemental Retirement Benefit for employees hired beginning 2004, the participation of which is on a voluntary basis. Each qualified employee-member who chooses to participate in the plan shall have the option to contribute up to a maximum of 25% of his base salary. *MERALCO* shall match the member's contribution up to 100% of employee's contribution or 10% of the member's monthly base salary, subject to a certain threshold. Upon resignation, the member shall be entitled to the total amount credited to his personal retirement account immediately preceding his actual retirement date, subject to provisions of the Provident Plan. *MERALCO*'s contribution to the Provident Plan amounted to ₱18 million, ₱7 million and ₱9 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Consolidated Retirement Benefits Cost (included in "Salaries, wages and employee benefits" account in the consolidated statements of income)

	2016	2015	2014
		(Amounts in millions)	
Expense recognized for defined benefit plans	**₱1,139**	₱1,230	₱1,177
Expense recognized for defined contribution plan	**18**	7	9
Retirement benefits expense	**₱1,157**	₱1,237	₱1,186

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-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* investments and *HTM* investments. The principal financial liabilities consist of bank loans, redeemable preferred shares, trade and nontrade payables, which are incurred to finance operations in the normal course of business. Accounting policies related to financial assets and financial liabilities are set out in *Note 4 – Significant Accounting Policies, Changes and Improvements*.

The following table sets forth the financial assets and financial liabilities as at December 31, 2016 and 2015:

	Loans and Receivables	***HTM* Investments**	**Fair Value through Profit or Loss**	**Held-for-trading**	***AFS* Financial Assets**	**Liabilities Carried at Amortized Cost**	**Total Financial Assets and Liabilities**
			(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**
Advances to an associate	**5,644**	**–**	**–**	**–**	**–**	**–**	**5,644**
Other current assets	**–**	**1,350**	**–**	**–**	**–**	**–**	**1,350**
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**

	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, 2015							
Noncurrent							
Other noncurrent assets	₱1,030	₱17,167	₱–	₱–	₱10,961	₱–	₱29,158
Current							
Cash and cash equivalents	50,840	–	–	–	–	–	50,840
Trade and other receivables	22,645	–	–	–	–	–	22,645
Advances to an associate	5,342	–	–	–	–	–	5,342
Other current assets	–	4,072	–	–	–	–	4,072
Total assets	₱79,857	₱21,239	₱–	₱–	₱10,961	₱–	₱112,057
Liabilities as at December 31, 2015							
Noncurrent							
Interest-bearing long-term financial liabilities - net of current portion	₱–	₱–	₱–	₱–	₱–	₱27,370	₱27,370
Customers' deposits - net of current portion	–	–	–	–	–	23,584	23,584
Refundable service extension costs - net of current portion	–	–	–	–	–	4,234	4,234
Current							
Notes payable	–	–	–	–	–	1,043	1,043
Trade payables and other current liabilities	–	–	–	–	–	46,677	46,677
Customers' refund	–	–	–	–	–	5,550	5,550
Current portion of interest-bearing long-term financial liabilities	–	–	–	–	–	1,895	1,895
Total liabilities	₱–	₱–	₱–	₱–	₱–	₱110,353	₱110,353

Fair Values

The fair values of the financial assets and financial liabilities are prices that would be received to sell the financial assets or paid to transfer the financial liabilities in orderly transactions between market participants at the measurement date. Set out below is a comparison of carrying amounts and fair values of the *MERALCO Group*'s financial instruments as at December 31, 2016 and 2015.

	2016		2015	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
	(Amounts in millions)			
Financial assets				
Loans and receivables -				
Advance payments to a supplier	**₱1,277**	**₱1,083**	₱1,030	₱963
AFS financial assets	**10,186**	**10,370**	10,961	10,961
HTM investments	**36,347**	**35,663**	21,239	21,230
	₱47,810	**₱47,116**	₱33,230	₱33,154
Financial liabilities				
Financial liabilities carried at amortized cost -				
Interest-bearing-long-term financial liabilities	**₱28,872**	**₱30,129**	₱29,265	₱30,531

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and Cash Equivalents, Trade and Other Receivables, Advances to an Associate, Trade Payables and Other Current Liabilities and Notes Payable

Due to the short-term nature of transactions, the fair values of these instruments approximate their carrying amounts as at reporting date.

Advance Payments to a Supplier

The fair values of advance payments to a supplier were computed by discounting the instruments' expected future cash flows using the rates of 4.74% as at 3.93% as at December 31, 2016 and 2015.

AFS Financial Assets

The fair values were determined by reference to market bid quotes as at reporting date. The unquoted equity securities were carried at cost.

HTM Investments

The fair values were determined by discounting the expected future cash flows using the interest rate as at 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 amount of bill deposits approximates their fair values as bill deposits are interest-bearing.

Interest-bearing Long-term Financial Liabilities

The fair values of interest-bearing long-term debt (except for redeemable preferred stock) were computed by discounting the instruments' expected future cash flows using the rates ranging from 0.47% to 4.16% as at December 31, 2016 and 0.48% to 4.22% as at December 31, 2015.

Redeemable Preferred Stock

The carrying amount of the preferred stock represents the fair value. Such preferred shares have been called and are payable anytime upon presentation by the shareholder of their certification. This is included under "Interest-bearing long-term financial liabilities" account.

Refundable Service Extension Costs

The fair values of refundable service extension costs cannot be reliably measured since the timing of related cash flows cannot be reasonably estimated and are accordingly measured at cost.

Fair Value Hierarchy

Below is the list of financial assets and financial liabilities that are classified using the fair value hierarchy:

	2016				2015			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
				(Amounts in millions)				
Financial assets								
Advance payments to a supplier	**₱–**	**₱–**	**₱1,083**	**₱1,083**	₱–	₱–	₱963	₱963
AFS investments	**10,331**	**–**	**39**	**10,370**	10,926	–	35	10,961
HTM investments	**35,521**	**–**	**142**	**35,663**	21,110	–	120	21,230
	₱45,852	**₱–**	**₱1,264**	**₱47,116**	₱32,036	₱–	₱1,118	₱33,154
Financial liabilities								
Interest-bearing long-term financial liabilities	**₱–**	**₱–**	**₱30,129**	**₱30,129**	₱–	₱–	₱30,531	₱30,531

For the years ended December 31, 2016 and 2015, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Financial Risk Management Objectives and Policies

The main risks arising from the financial instruments are interest rate risk, foreign currency risk, commodity price risk, credit risk and liquidity risk. The importance of managing these risks has significantly increased in light of the considerable change and volatility in the Philippine and international financial markets. The *BOD* reviews and approves policies for managing each of these risks. Management monitors the market price risk arising from all financial instruments. The policies for managing these risks are as follows:

Interest Rate Risk

The *MERALCO Group*'s exposure to the changes in market interest rates relate primarily to the long-term interest-bearing financial liabilities.

The *MERALCO Group*'s policy is to manage its interest rate risk exposure using a mix of fixed and variable rate debts. The strategy, which yields a reasonably lower effective cost based on market conditions, is adopted. Refinancing of fixed rate loans may also be undertaken to manage interest cost. Approximately 91% of the borrowings bear fixed rate of interest as at December 31, 2016 and 2015, respectively.

The following table sets out the maturity profile of the financial instruments that are exposed to interest rate risk (exclusive of debt issuance costs):

	Within 1 Year	Over 1–2 Years	Over 2–3 Years	Over 3–4 Years	Over 4–5 Years	More than 5 Years	Total
				(Amounts in millions)			
2016	**₱12**	**₱2,425**	**₱–**	**₱–**	**₱–**	**₱–**	**₱2,437**
2015	13	12	2,425	–	–	–	2,450

Floating interest rate of bank loans is repriced at intervals of less than one year. The other financial liabilities of the *MERALCO Group* that are not included in the foregoing have fixed interest rate and are therefore not subject to interest rate risk.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the *MERALCO Group*'s income before income tax for the years ended December 31, 2016 and 2015 through the impact on floating rate borrowings. There is no other impact on the *MERALCO Group*'s equity other than those already affecting the consolidated statement of income.

	2016		2015	
	Increase (Decrease) in Basis Points	**Effect on Income before Income Tax**	Increase (Decrease) in Basis Points	Effect on Income before Income Tax
		(Amounts in millions)		
Floating rate loans from various banks	**+100**	**(₱24)**	+100	(₱25)
	(100)	**24**	(100)	25

Interest expense of floating rate loans for the year 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 December 31, 2016 and 2015, translated to Philippine peso at ₱49.72 and ₱47.06 to US$1, respectively.

	2016		2015	
	U.S. Dollar	**Peso Equivalent**	U.S. Dollar	Peso Equivalent
		(Amounts in millions)		
Financial assets:				
Cash and cash equivalents	**$289**	**₱14,382**	$240	₱11,295
Trade and other receivables	**2**	**113**	2	101
AFS investments	**5**	**249**	–	–
Advances to an associate	**110**	**5,469**	110	5,177
Advance payments to a supplier	**52**	**2,605**	51	2,408
	458	**22,818**	403	18,981
Financial liabilities -				
Trade payables and other liabilities	**(7)**	**(357)**	(3)	(137)
	451	**₱22,461**	$400	₱18,844

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 years ended December 31, 2016 and 2015 (due to changes in the fair value of financial assets and financial liabilities). There is no other impact on the *MERALCO Group*'s equity other than those already affecting the consolidated statement of income.

	2016		2015	
	Appreciation (Depreciation) of U.S. Dollar	**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**	**₱1,123**	+5	₱942
and financial liabilities	**–5**	**(1,123)**	–5	(942)

Foreign exchange gain or loss for the year is computed based on management's best estimate of a +/–5 percent change in the closing Philippine peso to *U.S.* dollar conversion rate using the year-end balances of *U.S.* dollar-denominated cash and cash equivalents, receivables and liabilities. There has been no change in the methods and assumptions used by management in the above analysis.

Commodity Price Risk

Commodity price risk is the risk that the fair value or cash flows of a financial instrument will fluctuate because of changes in commodity prices. The exposure of *MERALCO* and *CEDC* to price risk is minimal. The cost of fuel is part of *MERALCO*'s and *CEDC*'s generation costs that are recoverable through the generation charge in the billings to customers.

Credit Risk

Credit risk is the risk that the *MERALCO Group* is exposed to as a result of its customers, clients or counterparties failing to discharge their contracted obligations. The *MERALCO Group* manages and controls credit risk by setting limits on the amount of risk that it is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

MERALCO as a franchise holder serving public interest cannot refuse customer connection. To mitigate risk, the *DSOAR* allows *MERALCO* to collect bill deposit equivalent to one month's consumption to secure credit. Also, as a policy, disconnection notices are sent three (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 December 31, 2016 and 2015. The maximum exposure is equivalent to the nominal amount of the accounts.

	Gross Maximum Exposure	
	2016	2015
	(Amounts in millions)	
Cash and cash equivalents:		
Cash in banks	**₱5,627**	₱4,976
Cash equivalents	**40,910**	45,742
Trade and other receivables:		
Billed electricity	**15,929**	16,439
Service contracts	**3,446**	3,427
Insurance receivable	**104**	99
Cost and estimated earnings in excess of billings on uncompleted contracts	**599**	774
Nontrade receivables	**1,631**	1,906
Other current assets:		
Advances to an associate	**5,644**	5,342
HTM investments	**1,350**	4,072
Other noncurrent assets:		
HTM investments	**34,997**	17,167
AFS investments	**10,186**	10,961
Advance payments to a supplier	**1,277**	1,030
	₱121,700	₱111,935

The credit quality of financial assets is managed by *MERALCO* using "High Grade", "Standard Grade" and "Sub-standard Grade" for accounts, which are neither impaired nor past due as internal credit ratings. The following tables show the credit quality by asset class:

	2016					
	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**
Advance payments to a supplier	**–**	**–**	**1,277**	**–**	**–**	**1,277**
	₱88,011	**₱7,496**	**₱10,460**	**₱5,547**	**₱3,214**	**₱114,728**

	2015					
	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	₱50,718	₱–	₱–	₱–	₱–	₱50,718
Trade and other receivables:						
Billed electricity	3,457	2,054	9,107	1,821	3,459	19,898
Service contracts	867	–	397	2,163	197	3,624
Insurance receivable	17	–	57	25	–	99
Cost and estimated earnings in excess of billings on uncompleted contracts	–	–	463	311	6	780
Nontrade receivables	1,022	11	232	641	3	1,909
Other current assets:						
Advances to an associate	–	5,342	–	–	–	5,342
HTM investments	4,072	–	–	–	–	4,072
Other noncurrent assets	17,167	–	1,030	–	–	18,197
	₱77,320	₱7,407	₱11,286	₱4,961	₱3,665	₱104,639

Credit ratings are determined as follows:

- High Grade

  High grade financial assets include cash in banks and cash equivalents to counterparties with good credit rating or bank standing. Consequently, credit risk is minimal. These counterparties include large prime financial institutions, large industrial companies and commercial establishments, and government agencies. For trade receivables, these consist of current month's billings (less than 30 days) that are expected to be collected within 10 days from the time bills are delivered.

- Standard Grade

  Standard grade financial assets include trade receivables that consist of current month's billings (less than 30 days) that are expected to be collected before due date (10 to 14 days after bill date).

- Sub-standard Grade

  Sub-standard grade financial assets include trade receivables that consist of current month's billings, which are not expected to be collected within 60 days.

The following table shows the aging analysis of financial assets as at December 31, 2016 and 2015:

2016						
	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:						
Advance payments to a supplier	**1,277**	**–**	**–**	**–**	**–**	**1,277**
HTM investments	**34,997**	**–**	**–**	**–**	**–**	**34,997**
	₱105,967	**₱938**	**₱374**	**₱4,235**	**₱3,214**	**₱114,728**

2015						
	Neither Past Due nor Impaired	Past Due But Not Impaired			Impaired Financial Assets	Total
		31–60 Days	61–90 Days	Over 90 Days		
	(Amounts in millions)					
Cash and cash equivalents:						
Cash equivalents	₱4,976	₱–	₱–	₱–	₱–	₱4,976
Cash in banks	45,742	–	–	–	–	45,742
Trade and other receivables:						
Trade:						
Billed electricity	14,618	924	302	595	3,459	19,898
Service contracts	1,264	121	57	1,985	197	3,624
Insurance receivable	74	1	2	22	–	99
Cost and estimated earnings in excess of billings on uncompleted contracts	463	48	29	234	6	780
Nontrade receivables	1,265	143	44	454	3	1,909
Other current assets:						
Advances to an associate	5,342	–	–	–	–	5,342
HTM investments	4,072	–	–	–	–	4,072
Other noncurrent assets:						
Advance payments to a supplier	1,030	–	–	–	–	1,030
HTM investments	17,167	–	–	–	–	17,167
	₱96,013	₱1,237	₱434	₱3,290	₱3,665	₱104,639

Liquidity Risk

Liquidity risk is the risk that the *MERALCO Group* will be unable to meet its payment obligations when these fall due. The *MERALCO Group* manages this risk through monitoring of cash flows in consideration of future payment of obligations and the collection of its trade receivables. The *MERALCO Group* also ensures that there are sufficient, available and approved working capital lines that it can draw from at any time.

The *MERALCO Group* maintains an adequate amount of cash and cash equivalents, which may be readily converted to cash in any unforeseen interruption of its cash collections. The *MERALCO Group* also maintains accounts with several relationship banks to avoid significant concentration of funds with one institution.

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

	2016				
	Less than 3 Months	**Over 3–12 Months**	**Over 1–5 Years**	**More than 5 Years**	**Total**
			(Amounts in millions)		
Notes payable	**₱11,475**	**₱–**	**₱–**	**₱–**	**₱11,475**
Trade payables and other current liabilities	**43,561**	**–**	**–**	**–**	**43,561**
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**	**2,733**	**4,993**	**18,508**	**26,584**
Refundable service extension costs	**424**	**2,078**	**4,161**	**766**	**7,429**
Total undiscounted financial liabilities	**₱62,610**	**₱6,052**	**₱28,395**	**₱32,682**	**₱129,739**

	2015				
	Less than 3 Months	Over 3–12 Months	Over 1–5 Years	More than 5 Years	Total
			(Amounts in millions)		
Notes payable	₱1,043	₱–	₱–	₱–	₱1,043
Trade payables and other current liabilities	41,208	–	–	–	41,208
Customers' refund	5,550	–	–	–	5,550
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	27	39	2,518	–	2,584
Fixed rate borrowings	290	1,216	5,941	25,741	33,188
Redeemable preferred stock	1,522	–	–	–	1,522
Customers' deposits	242	2,725	4,811	18,773	26,551
Refundable service extension costs	44	2,458	1,766	2,468	6,736
Total undiscounted financial liabilities	₱49,926	₱6,438	₱15,036	₱46,982	₱118,382

The maturity profile of bill deposits is not determinable since the timing of each refund is linked to the cessation of service, which is not reasonably predictable. However, *MERALCO* estimates that the amount of bill deposits (including related interest) of ₱2,594 million and ₱2,470 million will be refunded within a year. This is shown as part of "Trade payables and other current liabilities" account in the consolidated statement of financial position as at December 31, 2016 and 2015, respectively.

Capital Management

The primary objective of the *MERALCO Group*'s capital management is to enhance shareholder value. The capital structure is reviewed with the end view of achieving a competitive cost of capital and at the same time ensuring that returns on, and of, capital are consistent with the levels approved by its regulators for its core distribution business.

The capital structure optimization plan is complemented by efforts to improve capital efficiency to increase yields on invested capital. This entails efforts to improve the efficiency of capital assets, working capital and non-core assets.

The *MERALCO Group* monitors capital using, among other measures, debt to equity ratio, which is gross debt divided by equity attributable to the holders of the parent. The *MERALCO Group* considers long-term debt, redeemable preferred stock and notes payable as debt.

	2016	2015
	(Amounts in millions, except debt to equity ratio)	
Long-term debt	**₱27,370**	₱27,743
Redeemable preferred stock	**1,502**	1,522
Notes payable	**11,475**	1,043
Debt (a)	**40,347**	30,308
Equity attributable to the holders of the parent (b)	**74,417**	80,276
Debt to equity ratio(a)/(b)	**0.54**	0.38

27. **Income Taxes and Local Franchise Taxes**

Income Taxes

The components of net deferred tax assets and liabilities as at December 31, 2016 and 2015 are as follows:

	Note	2016	2015
		(Amounts in millions)	
Deferred tax assets:			
Provisions for various claims	*18 and 21*	**₱21,027**	₱17,621
Allowance for doubtful accounts	*12*	**898**	1,039
Unfunded retirement benefits cost and unamortized past service cost	*25*	**935**	1,008
Accrued employee benefits	*25*	**843**	1,466
Allowance for excess of cost over net realizable value of inventories	*13*	**58**	57
Others		**55**	84
		23,816	21,275
Deferred tax liabilities:			
Revaluation increment in utility plant and others	*15*	**7,160**	7,285
Capitalized interest		**763**	760
Depreciation method differential		**666**	777
Capitalized duties and taxes deducted in advance		**617**	608
Actuarial gains	*25*	**1,482**	426
Net book value of capitalized/realized foreign exchange losses		**–**	3
Others		**145**	137
		10,833	9,996
		₱12,983	₱11,279

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

	2016	2015
	(Amounts in millions)	
Deferred tax assets - net	**₱13,019**	₱11,296
Deferred tax liabilities - net	**(36)**	(17)
	₱12,983	₱11,279

Provision for (benefit from) income tax consists of:

	2016	2015	2014
		(Amounts in millions)	
Current	**₱10,099**	₱9,732	₱9,961
Deferred	**(2,746)**	(4,045)	(1,624)
	₱7,353	₱5,687	₱8,337

A reconciliation between the provision for income tax computed at statutory income tax rate of 30% for the years ended December 31, 2016, 2015 and 2014, and provision for income tax as shown in the consolidated statements of income is as follows:

	2016	2015	2014
		(Amounts in millions)	
Income tax computed at statutory tax rate	**₱8,008**	₱7,463	₱7,941
Income tax effects of:			
Nondeductible expenses	**(455)**	–	454
Interest income subjected to lower final tax rate	**(602)**	(387)	(206)
Nondeductible interest expense	**248**	160	85
Nontaxable income	**(234)**	(88)	(55)
Equity in net losses (earnings) of associates and joint ventures	**503**	8	(84)
Others	**(115)**	(1,469)	202
	₱7,353	₱5,687	₱8,337

On December 18, 2009, the *BIR* issued Revenue Regulations *("RR")* No. 16-2008, which implemented the provisions of *RA* No. 9504 on Optional Standard Deductions *("OSD")*. Such regulation allows both individual and corporate taxpayers to use *OSD* in computing their taxable income. For corporations, they may elect to adopt standard deduction in an amount not exceeding 40% of gross income in lieu of the allowed itemized deductions. In 2016 and 2015, *MERALCO* elected to adopt the *OSD* in lieu of itemized deductions beginning with its first quarter income tax return.

The temporary difference for which deferred tax assets have not been recognized pertains to the tax effect of net operating loss carryover ("*NOLCO*") amounting ₱1,629 million and ₱1,240 million as at December 31, 2016 and 2015, respectively.

NOLCO totaling to ₱1,629 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	338
December 31, 2016	December 31, 2019	791
		₱1,629

NOLCO amounting to ₱402 million and ₱193 million expired in 2016 and 2015, respectively.

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, *MERALCO* filed a claim on November 27, 2003 for the recovery of such excess income taxes paid. After examination of the books of *MERALCO* for the covered periods, the *BIR* determined that *MERALCO* had in fact overpaid income taxes in the amount of ₱6,690 million. However, the *BIR* also maintained that *MERALCO* is entitled to a refund amount of only ₱894 million, which pertains to taxable year 2001, claiming that the period for filing a claim had prescribed in respect to the difference between *MERALCO*'s overpayment and the refund amount *MERALCO* is entitled to.

The *BIR* then approved the refund of ₱894 million for issuance of tax credit certificates *("TCCs")*, proportionate to the actual refund of claims to utility customers. The *BIR* initially issued *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 December 31, 2016 and 2015, 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 February 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.

Real Property Tax ("RPT") Assessments

Several Local Government Units *("LGUs")* 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 has secured a favorable decision from the *CA*. Such decision was appealed by *MERALCO* to the *SC* for the benefit of *MERALCO* customers. On October 22, 2015, *MERALCO* received a copy of the *SC* Decision promulgated on August 5, 2015 declaring, among others, that the transformers, electric posts, transmission lines, insulators, and electric meters of *MERALCO* are not exempted from *RPT* under the *LGU.* *MERALCO* did not appeal 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 process of settlement with various local governments.

Mediation with NPC

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

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

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

MERALCO's actual purchases from *NPC* exceeded the contract level in the first seven (7) years of the *CSE*. However, the 1997 Asian crisis resulted in a significant curtailment of energy demand.

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

The mediation resulted in the signing of a Settlement Agreement *("SA")* between the parties on July 15, 2003. The *SA* was approved by the respective *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 of February 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 main parts are the Araneta to Balintawak leg and the Sucat to Araneta leg, which cuts through Dasmariñas Village, Makati City.

On March 10, 2000, certain residents along Tamarind Road, Dasmariñas Village, Makati City or plaintiffs, filed a case against *NPC* with the *RTC-Makati*, enjoining *NPC* from further installing high voltage cables near the plaintiffs' homes and from energizing and transmitting high voltage electric current through said cables because of the alleged health risks and danger posed by the same through the electromagnetic field emitted by said lines. Following its initial status quo Order issued on March 13, 2000, *RTC-Makati* granted on April 3, 2000 the preliminary injunction sought by the plaintiffs. The decision was affirmed by the *SC* on March 23, 2006, which effectively reversed the decision of the *CA* to the contrary. The *RTC-Makati* subsequently issued a writ of execution based on the Order of the *SC. MERALCO*, in its capacity as an intervenor, was constrained to file an Omnibus Motion to maintain status quo because of the significant effect of a de-energization of the Sucat-Araneta line to the public and economy. Shutdown of the 230 *kV* line will result in widespread and rotating brownouts within *MERALCO*'s franchise area with certain power plants unable to run at their full capacities.

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

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

This case remains pending and is still at the pre-trial stage. During the pre-trial stage, plaintiffs filed a Manifestation stating that they are pursuing the deposition, a supposed expert in electromagnetic field, through oral examination without leave of court in late January or early February 2016 or on such date as all the parties may agree amongst themselves at the Consulate Office of the Philippines in Vancouver, Canada. *NPC* and intervenors filed their Opposition and Counter-Manifestation. Intervenor *NGCP* filed a Motion to Prohibit the Taking of the Deposition of Dr. Blank. Intervenor *MERALCO* intends to file its Comment/Opposition in due course. As at February 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 (*"SGCs"*) is ₱4.7 billion. Additionally, *MERALCO* was directed to file a petition against the following *SGCs*: *MPPCL,* Aboitiz Power

Renewables, Inc. *("APRI")*, *TLI*, *SMEC* and *Sem-Calaca*, within 30 days from receipt thereof, to recover the line loss collected by them. On April 19, 2013, *MERALCO* filed a Motion for Clarification with the *ERC* regarding the directives contained in the March 4, 2013 Order. On April 30, 2013 and May 8, 2013, *PSALM* and *NPC*, respectively, filed motions seeking reconsideration of the March 4, 2013 Order. *MERALCO* filed a motion seeking for an additional 15 days from its receipt of the *ERC*'s Order resolving its Motion for Clarification, within which to file its Petition against the *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 February 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*. As at February 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 February 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 February 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 February 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 February 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 core groups for the conduct of hearings and to designate the commissioners to act as presiding officers in anti-competition cases. The raffle pursuant to said Resolution was conducted on June 15, 2016.

In a Notice of Pre-Trial Conference dated June 16, 2016, the *ERC* set the pre-trial conference on August 18, 2016 and required *MERALCO* and *TMO* to submit their respective pre-trial briefs. However, on July 27, 2016, the complainant filed two (2) omnibus motions for the consolidation and deferment of the pre-trial conferences. Hence, in an Order dated August 1, 2016, the respondents were given 10 days to submit their comments on the Motion for Consolidation, with the complainant given five (5) days to file his reply. As such, the pre-trial conferences as scheduled were deferred until further notice and all parties were granted a period of 20 days to submit their respective pre-trial briefs.

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

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

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

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.

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. *SPPC* has elevated these orders to the *CA* through a Petition for Certiorari.

Others

Liabilities for certain local taxes amounting to ₱2,972 million and ₱6,103 million as at December 31, 2016 and 2015, respectively, are included in the "Other noncurrent liabilities" account in the consolidated statements of financial position.

Management and its internal and external counsels believe that the probable resolution of these issues will not materially affect the *MERALCO Group's* financial position and results of operations.

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, 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)*
2017	3,080	₱39,760
2018	2,880	39,481
2019	2,460	34,268
2020	455	8,159
2021	455	8,203
2022-2039	455	157,150

FGPC and *FGP*

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

Accordingly, *MERALCO* entered into separate 25-year *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* is committed to purchase a specified volume of electric power and energy from *QPPL*, subject to certain terms and conditions. The *PPA* is for a period of 25 years from the start of commercial operations up to July 12, 2025.

In a Letter Agreement signed on February 21, 2008, the amount billable by *QPPL* included a transmission line charge reduction in lieu of a previous rebate program. The Letter Agreement also provides that *MERALCO* make advances to *QPPL* of US$2.85 million per annum for 10 years beginning 2008 to assist *QPPL* in consideration of the difference between the transmission line charge specified in the Transmission Line Agreement *("TLA")* and the *ERC*-approved transmission line charge in March 2003. *QPPL* shall repay *MERALCO* the same amount at the end of the 10-year period in equal annual payments without adjustment. However, if *MERALCO* is able to dispatch *QPPL* at a plant capacity factor of no less than 86% in any particular year, *MERALCO* shall not be required to pay US$2.85 million on that year. This arrangement did not have any impact on the rates to be charged to consumers and hence, did not require any amendment in the *PPA*, as approved by *ERC*.

See *Note 10 – Other Noncurrent Assets.*

Committed Energy Volume to be Purchased

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

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

Philippine Power and Development Company ("PPDC")

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

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

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

After a series of negotiations, *MERALCO* and *BEI* signed the Letter Agreements dated March 1, 2013 and March 5, 2013, extending the *CSE* between said parties for another two (2) years from March 16, 2013, or until March 16, 2015. In its Order December 9, 2013, the *ERC* allowed the *CSE* to be extended until March 15, 2015. On March 12, 2015, *MERALCO* and *BEI* executed a Letter of Agreement extending the *CSE* until March 16, 2016. On March 16, 2015, *MERALCO* filed a Manifestation with motion to the *ERC* for approval of the extended term. On March 1, 2016, *BEI* requested for another extension of the *CSE* for another two (2) years. In its letter dated April 7, 2016, *MERALCO* denied *BEI*'s request to extend the *CSE*. As of February 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 February 27, 2017, the case is pending decision by the *ERC*.

TMO

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

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

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

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

In an Order dated April 5, 2016, the *ERC* ruled that the provisional authority granted to *MERALCO* and *TMO* is extended unless revoked or made permanent. On June 10, 2016 and July 5, 2016, respectively, *MERALCO* and *TMO* filed a Motion for Clarification of the *ERC* Order dated April 5, 2016. As at February 27, 2017, the case is pending decision by the *ERC*.

SBPL

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

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

Bacman Geothermal, Inc. (*"BGI"*)

On November 25, 2014, *MERALCO* signed a *PSA* with *BGI* for the purchase of up to 50 *MW* capacity and energy from the latter's power plant. The *PSA* shall expire on December 25, 2019, extendible by an additional two (2) years upon mutual agreement of the parties. On March 4, 2015, the Joint Application for approval of said *PSA* was filed with the *ERC*. Hearings have been completed and as at February 27, 2017, the case is submitted for decision.

Redondo Peninsula Energy, Inc. ("RP Energy")

On April 20, 2016, *MERALCO* signed a 20 year term *PSA* with *RP Energy* for the purchase of 225 *MW* capacity and energy from the 300 *MW* coal-fired power plant that *RP Energy* intends to construct, own, operate, manage and maintain in the Municipality of Subic in the Province of Zambales, within the Subic Bay Freeport Zone. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. Hearings have been completed. As of February 27, 2017, *MERALCO* and *RP Energy* are now awaiting the Order of the *ERC* directing them to file their Formal Offer of Evidence

Atimonan One Energy, Inc. ("A1E")

On April 26, 2016, *MERALCO* signed a 20 year term *PSA* with *A1E* for the purchase of 1,200 *MW* of electrical output from the 2 x 600 *MW* supercritical coal-fired power generating facility that *A1E* intends to construct, own, operate, manage and maintain in the Municipality of Atimonan, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. Continuation of hearing on the Joint Application is set on March 6, 2017 for *MERALCO's* and *A1E's* oral Formal Offer of Evidence and *NASECORE*'s presentation of evidence, if necessary.

St. Raphael Power Generation Corporation ("SRPGC")

On April 26, 2016, *MERALCO* signed 20 year term *PSA* with *SRPGC* for the purchase of up to 400 *MW* of electrical output from the 2 x 350 *MW* coal-fired power generating facility that *SRPGC* intends to construct, own, operate, manage and maintain in Calaca, Batangas. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. Hearings have been completed. As of February 27, 2017, *MERALCO* and *SRPGC* are now awaiting the Order of the *ERC* directing them to file their Formal Offer of Evidence.

Central Luzon Premiere Power Corp. ("CLPPC")

On April 26, 2016, *MERALCO* signed a 20 year term *PSA* with *CLPPC* for the purchase of up to 528 *MW* of electrical output from the 4 x 150 *MW* circulating fluidized bed coal-fired power generating facility that *CLPPC* intends to construct, own and operate in Pagbilao, Quezon. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. In its Order dated January 25, 2017, the *ERC* held the processing of the application in abeyance. On February 9, 2017, *CLPPC* filed a Motion for Reconsideration of the said *ERC* Order.

Mariveles Power Generation Corporation ("MPGC")

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

Order dated August 9, 2016, the *ERC* held the processing of the application in abeyance. On September 30, 2016, *MPGC* filed a Motion for Reconsideration of the August 9, 2016 Order of the *ERC.* On October 3, 2016, *MERALCO* filed a Manifestation.

Panay Energy Development Corporation ("PEDC")

On April 26, 2016, *MERALCO* signed a 20 year term *PSA* with *PEDC* for the purchase of up to 70 *MW* of electrical output from the 1 x 150 *MW* coal-fired power generating facility that *PEDC* owns and operates in Brgy. Ingore, La Paz, Iloilo. 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 Formal Offer of Evidence 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 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*. As at February 27, 2017, *MERALCO* is preparing its Compliance with said *ERC* directive.

Global Luzon Energy Development Corporation ("GLEDC")

On April 27, 2016, *MERALCO* signed a 20 year term *PSA* with *GLEDC* for the purchase of 600 *MW* of electrical output from the 2 x 335 *MW* coal-fired power generating facility that *GLEDC* intends to construct, own, operate, manage and maintain in Brgy. Luna, La Union. On April 29, 2016, the Joint Application for approval of said *PSA* was filed with the *ERC*. 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. As at February 27, 2017, the said Motion is pending resolution by the *ERC*.

Powersource First Bulacan Solar, Inc. ("PFBSI")

On September 16, 2016, *MERALCO* signed a 20 year term *PSA* with *PFBSI* for the purchase of 50 *MW* of electrical output from its solar plant in San Miguel, Bulacan. The *PSA*'s effectivity is subject to a competitive selection process, and if *SPTC* declared as the winning power supplier, upon approval of the *ERC*. The Application for approval of the *PSA* with *PFBSI* was filed on February 23, 2017.

Solar Philippines Tanauan Corporation ("SPTC")

On September 16, 2016, *MERALCO* signed a 20 year term *PSA* with *SPTC* for the purchase of 50 *MW* of electrical output from its solar plant in Tanauan, Batangas. The *PSA*'s effectivity is subject to a competitive selection process, and if *SPTC* is declared as the winning power supplier, upon approval of the *ERC*. The Application for approval of the *PSA* with *SPTC* was filed on February 23, 2017.

The *PSA*s shall become effective upon approval of the *ERC*.

Interim Power Supply Agreements (*"IPSAs"*)

On January 19, 2016, after the conduct of a price challenge in compliance to *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed an *IPSA* with 1590 Energy Corporation. The *IPSA* is for the 170 *MW* (firm from February 26 to July 25, 2016; non-firm from July 26, 2016 to February 25, 2017) output from the Bauang power plant – a 215 *MW* bunker oil-fired diesel engine power plant in Bauang, La Union. The term of the *IPSA* is until February 25, 2017, and shall be automatically extended for an additional period of one year up to two times, unless terminated by either party prior to the expiration of its term. The *IPSA* was filed for approval by the *ERC* on February 10, 2016 and shall become effective upon the approval by the *ERC*. In an Order dated April 5, 2016, the *ERC* provisionally approved the *IPSA*.

On January 21, 2016, after the conduct of a price challenge in compliance to *ERC* Resolution No. 13, Series of 2015, *MERALCO* signed two separate *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 year up to four 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*. As of February 27, 2017, *ERC* has yet to issue an Order setting the application for hearing.

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 as regards the extended use of said line.

Interconnection Agreement with Maibarara Geothermal, Inc. ("MGI")

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

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

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

In 2015, the *TSA* was amended to limit the scope to the provision of technical services only for *IBEDC* and revised the fixed monthly fees accordingly.

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 with a term of 25 years, whereby *MERALCO* has been contracted to operate the distribution system of *CEZ* beginning May 26, 2014.

On January 24, 2013, *MERALCO* entered into a tripartite agreement with *PEZA* and *Trans-Asia* for the sale of power to *CEZ* and its locators beginning January 26, 2013.

On December 29, 2014, *MERALCO* has secured its Certificate of Registration No.10-01-U from *PEZA*, which confirms *MERALCO* as an Ecozone Utilities Enterprise at the Cavite Economic Zone.

30. Earnings Per Share Attributable to Equity Holders of the Parent

Basic and diluted earnings per share are calculated as follows:

	2016	2015	2014
	(In millions, except per share data)		
Net income attributable to equity holders of the Parent (a)	**₱19,176**	₱19,098	₱18,053
Weighted average common shares outstanding (b)	**1,127**	1,127	1,127
Per Share Amounts:			
Basic and diluted earnings per share (a/b)	**₱17.01**	₱16.94	₱16.02

Basic and diluted earnings per share amounts are calculated by dividing net income for the year attributable to common shareholders of the parent by the weighted average number of common shares outstanding during the year. There are no potential dilutive common shares in 2016 and 2015.

There are no other transactions involving common shares or potential common shares between the reporting date and the date of completion of these consolidated financial statements.

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 their January 2010 billing. Said cap is one percentage point lower than the *SL* cap of 9.5% provided under *RA* No. 7832. The actual volume of electricity used by *MERALCO* (administrative loss) is treated as part of the operation and maintenance expense beginning July 2011. The manner by which the utility is rewarded for its efforts in *SL* reduction is addressed by the *ERC* in the Performance Incentive Scheme *("PIS")* under the *PBR*.

On December 8, 2009, *MERALCO* filed a Petition to amend said Resolution with an urgent prayer for the immediate suspension of the implementation of the new *SL* cap of 8.5% starting January 2010. The proposed amendment is aimed at making the Resolution consistent with the provisions of *RA No. 9136* and *RA No. 7832*, by increasing the *SL* cap to not less than 9%. The hearings on this case have been completed. As at February 27, 2017, this Petition is pending decision by the *ERC*.

Benefit-Sharing Scheme to Lower System Loss

On January 26, 2011, *MERALCO*, together with Private Electric Power Operators Association, Inc. *("PEPOA")* and Philippine Rural Electric Cooperative Association *("PHILRECA")*, filed a joint petition to the *ERC* to initiate rule-making to adopt the *Proposed Guidelines for the Implementation of an Incentive Scheme to Lower the System Losses of Private Distribution Utilities and Electric Cooperatives to Level Below the System Loss Cap, for the Benefit of End-Users*. This was aimed to encourage the *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 February 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 operation of *RCOA* started on June 26, 2013.

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

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

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

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

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

On May 12, 2016, the *ERC* issued Resolutions No. 10 and 11, Series of 2016, which:

1. Provided for Mandatory contestability. Failure of a Contestable Customer to switch to *RES* upon date of mandatory contestability (December 26, 2016 for those with average demand of at least one (1) *MW* and June 26, 2017 for at least 750 *MW*) shall result in the physical disconnection from the *DU* system unless it is served by the *SOLR*, or, if applicable, procures power from the *WESM*.

2. Prohibits *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. It enjoined *DOE* and *ERC* from implementing the Assailed Rules insofar as:

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

Meanwhile, *ERC* filed a Petition for Certiorari and Prohibition with prayer for *TRO* and/or *WPI* before the *SC* ("*SC* Petition"), which asserted that *RTC*-Pasig has no jurisdiction to take cognizance of *MERALCO*'s Petition, citing Sec. 78 of the *EPIRA*. 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 motion for reconsideration 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* 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 separate Petition by Philippine Chamber of Commerce and Industry ("*PCCI*"), San Beda College Alabang, Inc., Ateneo de Manila University and Riverbanks Development Corporation*,* the Supreme Court *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, *ERC* Resolution Nos. 10, 11 and 28 Series of 2016.

Interim Pre-Emptive Mitigating Measure in the WESM

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

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

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

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

The imposition of the mitigating measure was questioned by the Philippine Independent Power Producers Association *("PIPPA")* in the *RTC* of Pasig through a Petition for Declaratory Relief with Application for *TRO* and/or Writ of Preliminary Injunction. The Petition prayed for, among others, that the *ERC* Resolutions pertaining to the Secondary Cap mechanism be declared void *ab initio*. The original petition was subsequently amended to reflect the promulgation of the subsequent *ERC* resolutions extending the effectivity of the *WESM* price cap. On July 21, 2014, *MERALCO* filed its Motion for Leave to Intervene and to Admit Attached Comment-in-Intervention. The *RTC-Pasig* admitted *MERALCO's* intervention and comment in its Order dated October 28, 2014. However, in a Motion for Leave to Admit Supplement Petition, *PIPPA* moved for leave to file a supplemental petition to include *ERC* Resolution No. 20, Series of 2014 which provides for a permanent mitigating measure in the *WESM*. In an Order dated May 5, 2015, the *RTC* denied the Motion for Leave to File and Admit Supplemental Petition. *PIPPA* filed a Motion for Partial Reconsideration which was denied by the *RTC* in its Resolution dated September 10, 2015. *PIPPA* filed a Petition for Certiorari with the *CA*. The parties have filed their respective memoranda and are awaiting the decision of the *CA*.

On December 7, 2015, the *RTC* rendered a Decision dismissing the Petition for Declaratory Relief. The motion for reconsideration filed by *PIPPA* was denied in a Resolution dated June 16, 2016.

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

On February 6, 2017, the *ERC* posted on its website the Draft Resolution Adopting Amendments to the Pre-emptive Mitigating Measure in the Wholesale Electricity Spot Market. The Draft Resolution states that "the *ERC* deems it necessary to introduce some refinements to the secondary cap scheme." The *ERC* proposed a recalculated cumulative price threshold level of ₱1,080,000 and a shorter 5-day (120-hour) rolling average period. *MERALCO* submitted its comments on February 17, 2017.

PEZA – ERC Jurisdiction

On September 13, 2007, *PEZA* issued “Guidelines in the Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones” and “Guidelines for the Supply of Electric Power in Ecozones”. Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *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 Court issued an Order setting a clarificatory hearing on April 15, 2015. During the said hearing, *MERALCO* manifested that it previously filed a Motion to Withdraw as Plaintiff on the basis of letter agreements between *MERALCO* and *PEZA*, which is pending before the Court. *MERALCO* submitted the Tripartite Agreement among *PEZA*, *PEPOA* and *MERALCO* for approval of the Court. In a Decision dated July 3, 2015, the *RTC* approved the Compromise Agreement between *PEZA*, *PEPOA* and *MERALCO*. In the hearing on February 10, 2016, the *RTC* dismissed the petition upon motion by *PEZA*. The *ERC* filed a motion for reconsideration which is pending resolution by the *RTC*.

Purchase of Subtransmission Assets (“STAs”)

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

On May 22, 2014, *MERALCO* and *TransCo* received an *ERC* Order dated May 5, 2014 denying *MERALCO* and *TransCo*’s Motions. On June 5, 2014, *MERALCO* filed a clarificatory motion and an *MR* of the May 5, 2014, *ERC* Order, which was denied by the *ERC* through an Order dated June 16, 2014. On October 10, 2014, *MERALCO* filed a Motion to Reopen Proceedings for the reception of new evidence to support *MERALCO*’s position on the acquisition of excluded *STAs*. The Motion was heard by the *ERC* on October 17, 2014. After the parties have submitted their respective comments and pleadings, the *ERC* conducted another hearing on February 23, 2015.

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

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

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

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

The applications for approval of the Consortium Agreement between *MERALCO* and *BATELEC II* and the Contract to Sell among *TransCo*, *MERALCO* and *BATELEC II* 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*-Allowance charge will be imposed on all end-users. The *FiT*-All will be established by the *ERC* upon petition by the *TransCo*, which had been designated as the *FiT* Fund Administrator.

On February 5, 2014, the *ERC* released the *FiT*-Allowance Disbursement and Collection Guidelines to supplement the *FiT* Rules. This set of guidelines will govern how the *FiT*-All will be calculated using the formulae provided. It will also outline the process of billing and collecting the *FiT*-All from the electricity consumers, the remittance to a specified fund, the disbursement from the *FiT*-All fund and the payment to eligible *RE* developers.

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

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

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

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

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

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

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*.

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 December 31, 2016, *MERALCO* has already installed 754 meters and energized 677 Net Metering customers. *MERALCO* is the first *DU* in the country which implemented the Net Metering Program.

Interruptible Load Program ("ILP")

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

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

As at December 31, 2016, there are 215 companies with a total committed de-loading capacity of 793.07 *MW* that have signed up with *MERALCO*, *MPower* and with other retail electricity supplier as *ILP* participants.

Long Term Indebtedness Application

On June 25, 2015, *MERALCO* filed an Application, with prayer for provisional authority, for continuing authority to (a) issue bonds or other evidence of indebtedness for as long as it maintains 50:50 long-term debt to equity ratio; and (b) whenever necessary, to mortgage, pledge or encumber any of its property to any creditor in connection with its authority to issue bonds or any other evidence of long-term indebtedness. The hearing on the application was conducted on October 6, 2015. In an Order dated October 12, 2015, the *ERC* directed *MERALCO* to submit additional documents in support of its Application which *MERALCO* complied with. However, due to changes in the financial climate which may affect the terms and conditions of any financial borrowings, *MERALCO* has filed a motion to withdraw the application without prejudice to its refiling at a later date. In an Order dated March 22, 2016, the *ERC* granted *MERALCO*'s motion to withdraw but still required *MERALCO* to submit certain documents. *MERALCO* filed a Motion for Partial Reconsideration questioning the requirement which is pending before the *ERC*. As at February 27, 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 December 31, 2016, there are 40,982 customers availing of *PRES*.

Competitive Selection Process ("CSP") for Power Supply Agreements

As early as February 2013, the *ERC* posted the first draft of rules on *PSA* Approval, solicited comments from stakeholders thereon and conducted various focused group discussions. Said draft required *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 even 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 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*, *CLPP*, *SRPGC*, *PEDC*, *MPGC*, *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 comment to the Petition.

34. Subsequent Event

On February 27, 2017, the *BOD* of *MERALCO* approved the declaration of cash dividends of ₱9.30 a share to all shareholders of record as at March 27, 2017, payable on April 21, 2017. This consists of a final regular cash dividend of ₱4.08 per share and a special cash dividend of ₱5.22 per share.