

#### **Empowering Partnerships**

Today, Meralco is about extraordinary vision. The trust and support of our stakeholders has empowered our business, allowing us to invest in key partnerships that will result in operational efficiencies, and in time, a more diversified portfolio of services. Though still in its early stages, the entry of new perspectives into the company has already had a significant impact on how we engage our markets, enhancing customer satisfaction and pointing us towards new opportunities to create superior value for our owners, employees and customers. Moving forward, we see Meralco as a partner for growth whose direct footprint in the communities and businesses we serve defines our continuing commitment to progress and nation-building.



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#### YOUR COMPANY

Since 1903, Meralco has powered the growth of the Philippines and its people. As the premier electric service distributor, it is an inseparable partner for progress. Consistently in the list of the Philippines' top five corporations and cited among Asia's finest, Meralco today serves the country's prime business districts and top corporations.

The 9,337 sq. km. franchise area covers 31 cities and 80 municipalities including Metro Manila, the entire provinces of Bulacan, Rizal and Cavite; parts of the provinces of Laguna, Quezon, Batangas and Pampanga. Electrification level in the franchise is 98.7%.

Meralco's service area, equivalent to only about 3% of the country's total land area, produces almost 46% of the gross domestic product (GDP), 33% from Metro Manila alone. The franchise area is home to 24.7 million people, roughly a quarter of the entire Philippine population of 92 million.

With its newly-formed partnerships with San Miguel Corporation (Southeast Asia's largest food conglomerate) and Philippine Long Distance Telephone Company (the country's leading telecommunications provider), Meralco is now more equipped to try other businesses and introduce new innovations to better serve its customers.

# Chairman's Message

### Continuous Renewal by Breaking Grounds



#### To our Shareholders, Partners and Customers,

Your Company continues its basic mission of keeping those lights on and those factories running, as we create and give value to our investors. Meralco is both a public trust and a business proposition. Through our 107 years, we have been true to this twin mission – through all the challenges, changes and turmoil. "Bumaha man o bumagyo," Meralco had always been and will always be a most viable business to be of greatest service to our customers.

Our 2009 performance again makes true this promise and more, as we prepare for this new deregulated world of the electric power industry and as we deliver competitive returns to our investors and stakeholders.

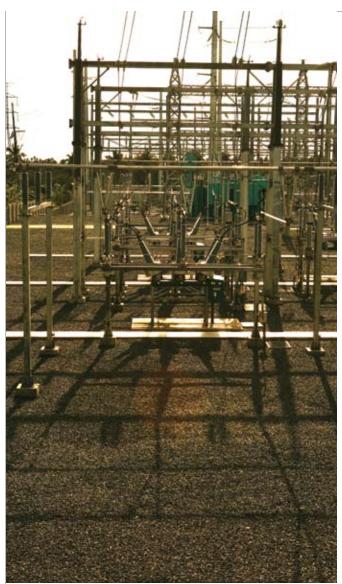
Our consolidated core net income increased by 169% from P2.6 billion to P7 billion from 2008 to 2009. The 2009 consolidated reported net income at P6.0 billion was an increase of 114 % than the level attained in 2008.

Our core earnings per share were up by an impressive 168% to P6.32 while the basic earnings per share on reported net income amounted to P5.42, a definite impressive improvement of 114% from 2008. This was the result of the 1.7% improvement in energy sales, a 6% decrease in total costs and expenses, and the Performance Based Regulation (PBR) adjustment in distribution rate which took effect in May 2009. This distribution rate increase under the performance-based regime, of P0.257 per kWh, was the first distribution rate adjustment for your Company after almost six (6) years.

Total number of billed customers increased by 3 % registering at 4.7 million by the end of 2009 consuming 27,516 GWh (consolidated). This was an increase of 1.7 % from that of last year, in spite of the global economic crisis and amidst a period of unstable electricity rates and highly volatile industry.

Consolidated EBITDA increased by 22 % to P13.5 billion from the 2008 level.

The Board approved a dividend policy for the Company to pay out regular dividends equivalent to 50% of core earnings, which may be supplemented by special dividends on a "look back" basis.





The highest share price in 15 years was attained within the trading day of July 29, 2009 at P302.50 per share with the highest closing price since 1994 at P295 per share recorded on the same day.

Most impressive is the result of our operations on three basic distribution system performance parameters - a 2009 average of 6.01 occurrences of no power (Interruption Frequency Rate - IFR) which is the lowest in 21 years; a Cumulative Interruption Time (CIT) for the whole year of 6.11 hours; and, an almost heretofore unthinkable system loss level of 8.61%, the lowest level attained in 29 years. The strategy and implementation of the system loss reduction program is a model of technical and engineering design as well as of analytical decision-making, flawless and daring implementation and moreso progressive leadership.

Coupled with this outstanding record is the equally impressive performance in all customer touch points from service application to complaints processing. All these performance parameters were inputs to the PBR-determined and PBR-approved distribution rate, our MAP (Maximum Average Price) under the Performance Incentive Scheme (PIS) and the Guaranteed Service Level (GSL). We are very proud

"... our labor productivity surpassed even the stretch target level we set last year. Our 2009 customer per employee ratio was 771 customers served per employee while the MWh sales per employee was 4,480 MWh."

of our employees who made possible such performance results where there was a reward to the Company and to the customers for half of those indicators while there was no penalty for the rest. This translated to a lower distribution charge and a straight cash award for both the Company and the customers who were instrumental and influenced by such a performance in 2009.

#### **OUR BUSINESS AND OUR OPERATIONS**

While the service of Meralco is the most familiar to all our customers, it remains mostly unknown and oftentimes misunderstood among the basic services needed by the modern world.

We entered into the performance based era in July 2007 where our capital investment and operating expenses were declared and approved in advance to pre-determine the price of electricity every year for the three-year regulatory period tempered and/or bolstered, as the case may be, by committed targets in distribution networks and customer service performance areas.

Meralco acts as the buying, billing, collecting and customer service agent for the whole electricity supply chain in the franchise even if generation remains to be the major determinant of the total price and quality of electricity. With a two-year business model based on forward performance and committed goals under the PBR regime, we are again transforming our policies, systems and people to be able to adapt our operations for our entry into the competitive arena of customer retail services.

Various players vital to the power industry, such as those in generation and transmission, are also mandated and forced to change adding extra dimensions in an already very difficult business environment. The simultaneous changes in regulation, contracts and management of the generation and transmission companies provide one of the toughest

"We have started focusing some of our attention to the businesses outside the core distribution business, as dictated and enabled by the new regulation, new technology and new opportunities."

# 7.56 all-time high Customer Satisfaction Index (CSI)

challenges in our business planning. Our 2009 is our base year for such a new world and with the results of our operations, we are confident that we are ready for this future.

In 2009, our Customer Satisfaction Index (CSI) reached an alltime high of 7.56, surpassing our targets. Both the residential customers which make up the greatest bulk of our customer base and our core customers, which make up the greatest share in our sales, contributed to this impressive performance.

Generation charge or the price for electricity supply from the power plants, contributing 57% of the cost of electricity, remains our main focus in our continuous drive to reduce the final electric bill to our customers. NPC remains still as one of our main suppliers of our total energy requirement at 40.73%. The Wholesale Electricity Spot Market (WESM) contributed 12.85% of total energy supplied in 2009 and our IPPs produced 46.42%. Meralco increased its off-take from WESM to take advantage of the very low clearing price especially during the second half of 2009.

The share of generation from natural gas to total energy requirement in 2009 was at 50.66% while generation coming from renewable energy was at 17.54%. Overall, the share of clean energy in Meralco's energy mix for 2009 remains at still an impressive 68.20% level. We remain committed to environmental protection and management as we seek to encourage renewable energy on power supply.

With complaints handling and meter reading as the other main concerns of our customers, based on our regular surveys, the direct correlation between customer satisfaction and employee satisfaction remains even stronger than ever. At the heart of our product quality is the fact that our service is embedded in each Meralco employee. Side by side with the CSI therefore is the conduct of our employee satisfaction survey where the result of said index in 2009 was also at an outstanding 8.57. Executing well and delivering on our commitments were made possible by the competence, dedication and abiding loyalty of our employees. With this, our labor productivity surpassed even the stretch target level we set last year. Our 2009 customer per employee ratio was 771 customers served per employee while the MWh sales per employee was 4,480 MWh. These are most favorable levels compared with our benchmark companies as these are already world class standards. Whatever the future holds for this Company, we are confident as long as our employees are on our side.

#### **OUR STRATEGY AND OUR FUTURE**

In this business more than perhaps any other, the long-term view, remains to be the key. Capital investment even in the distribution infrastructure needs two years to complete and even a longer time than that, to feel its overall effects on performance. Power plants take time to capitalize, to build and to put on stream. The impressive performance of the distribution system these recent years was the cumulative result of the efficient technical design and implementation of a targeted and planned system improvement program. It is therefore imperative that we put into motion the strategies we have committed today.

We will maintain, adapt and seek to constantly enhance our brand of customer service in whatever role or area your Company will finally find itself, in the emerging competitive environment.

We are committed to keep those lights on and even more committed to explore and create more values in synergistic and related businesses as well, to ensure continuous energy supply and to reduce the price of electricity to our customers.

We will find ways to make a difference in the regulatory management and direction, through our active and timely submission of technical papers backed up by meaningful data; by engaging partners and even other interest group in cooperative efforts towards common positions and goals; and, launching more aggressive participation in debates on issues vital and critical to the industry and therefore to your Company.

We have started focusing some of our attention to the businesses outside the core distribution business, as dictated and enabled by the new regulation, new technology and new opportunities. Our present involvement in real estate development, fiber optic operation, construction, information and telecommunications technology and retail electricity services will further create value heretofore untapped. At the same time, network facilities, IT and telecoms technology

"We are committed to keep those lights on and even more committed to explore and create more values in synergistic and related businesses as well, to ensure continuous energy supply."

can be tapped to even decrease our costs and generate more revenues in a variety of ways - buy electricity through prepaid loads; multiple use of compatible and complementary technical network and business infrastructure elements such as fiber optic backbones, power poles and business offices; common use and business opportunities in the business continuity processes and backroom assets such as those in data management, wireless bill payments and meter reading via wireless telemetry, among others.

We know that all these require new skills, new processes, new ways of doing things and new parameters of performance and results. Meralco has increased the potential and the capability of our people, organization, processes and most especially in our common and shared will to succeed in becoming a participant and a leader in the wires platform for multi-media products even in the broadband technology.

We have an exceptionally strong and professional management team, able to perform under the toughest challenges and an even more volatile environment – able to execute our strategy; perform every single day, every minute of the day; perform under the harshest conditions, such as calamities and management changes; and, deliver even more than the results committed and expected.

We have proven time and again that the cornerstone in the preparation and the constant reminder to all Meralco employees on our mission to be of service to our customers and their communities, is the continuous personal and aggressive involvement of all our employees in the corporate social responsibility projects of the Company. For 2009, 17,014 volunteer manhours were given by 5,046 employees personally participating in twenty-three (23) major projects in education, nutrition, health, environment and community welfare. Such personal experiences serve to provide a most valuable input to all our employees on the actual circumstances of the people we serve, on their most critical and immediate needs, and most importantly, on looking for ways on how to serve them even better. Our employees not only touched the lives of 23 million of our countrymen through electric service but also are able to directly interact with them in other equally meaningful ways through our community service, beyond company duty and beyond work and professional responsibility. We are grateful that we are given this chance and more hopeful of the future where we can participate more in alleviating tragedies, in community building and in environmental development. That these are all given in the true spirit of volunteerism adds more meaning to our oneness with the communities we serve.

Oftentimes, working and strategizing with economic and political crisis constantly present, one question is in the minds of even the best management teams – when will the situation be normal? The argument and indeed the answer, for us in Meralco, given our experience is that crisis situation is the normal way of life these days and even in the future – uncertainties, changes, crisis after crisis, constantly shifting business and industry networks and varying business and regulatory landscapes. This new world therefore calls for a more agile approach to decision-making and a more adaptable management style. Indeed, our experience and our operations in Meralco, with its popularly heretofore known as staid and stable business, have prepared us for this new way of life. We are therefore committed to deliver the results required from us and much more by being true to our

strategies as follows:

First, our time-tested and constantly renewed philosophy of not taking our customers for granted will not only be strengthened but more so will even be subjected to a substantial upliftment and shift in our core services. As we review our customer service from end-to-end, dictated by new regulations and the need to migrate to a new IT platform, our foremost consideration in all these changes we will do, are the needs and preferences of our customers. We are thinking more and more out-of-the-box this time in our customer service approaches as we explore the possibilities and new frontiers that technology offers and the new regulatory environment makes possible.

Second, every member of the management team and all employees are working doubly hard with me to understand and prepare this new 21st century business environment and the power industry structure. Our individual and collective experience backed up by meaningful use and incisive analysis of information and data paint the big picture, while providing the details that can direct strategies and guide daily operations.

We are continuously exploring answers to such questions as where is the value being created in our industry; are we focusing on the right areas; is our cost structure most defensible and at its most viable; and, are our strategies and directions correct. The details and specifics of our daily operations are our building blocks to a much better implementation of our strategies, not obstacles nor burdens in our way.

Third, we are well beyond pronounced rhetoric and general promises. Our numbers do not lie as we constantly gather and use them with much attention and utmost consideration. We are very much aware that the environment is very tough and getting even tougher. We are resolved not to deceive ourselves and most especially you, our partners and publics, that everything is alright nor be lulled into thinking, that we can rest on our present impressive performance. As always, we are here for the long haul and we all know what this will take and extract from all of us to sustain our very viability and success in the future.

We are very much cognizant of the chicken-and-the-egg cycle of our business - the electric company waits for business to fuel sales and business waits for the electric power to be available first. We have to provide power and/or convincingly show our capability to supply it in the future, so that businesses can come in, increase their production, and even relocate new businesses and operations in the country. We make bets in our capital investment programs for our facilities and our skill sets, and invest in infrastructure even for future needs - in timing, location, capacity and quality. Through all of these what is critical is the confidence of our investors, our customers, our employees and our publics to be able to plan for the long-term and commit resources. One cannot put a good company down and we are determined to continue being your good Company as our results will continuously show just that. Although there will continue to be many changes at Meralco, there is one thing we are confident will never change - our culture. Our DNA embedded in each of us cannot be taken away. We will continue to operate with honesty, integrity and "malasakit."

By executing well and adhering to our core values, we are determined to do even much more to give better quality and better priced power to our people. We are cognizant of the unique role we play in giving our customers a better way of life.

On behalf of the 6,000 employees, we thank all of you for your confidence and continued support. We especially thank the distinguished members of our Board of Directors for providing the direction and the impetus for an even better Meralco. Thank you for being with us through all these years.

No matter what happens, "bumaha man o bumagyo," Meralco service goes on. That we are committed to all of you.

"Makakaasa kayo na sa Meralco, laging may liwanag ang buhay."

"We are thinking more and more out-of-the-box this time in our customer service approaches as we explore the possibilities and new frontiers that technology offers and the new regulatory environment makes possible."

MANUEL M. LOPEZ
Chairman and Chief Executive Officer

# Report of the President

Proving once again the reciprocity principle of "reaping what you sow," our determined steps to re-focus on the customer during the year 2009 have reaped a harvest of positive feedback, as shown in increased energy sales and improved customer loyalty. It was a year of discovering new ways of doing essentially the same things—and discovering that such seemingly modest policy or program shifts are bringing customer satisfaction.

Our re-oriented customer-focus was not meant to introduce anything earth-shaking. We have simply provided a new emphasis on, and passion for, attaining customer satisfaction levels.

It was also the year when Meralco was able to implement rates set under a new regime called Performance-Based Regulation (PBR). PBR, which applies to Meralco and other private distribution utilities (DUs), has become the new ethic and metric which govern Meralco's rate-setting mechanisms.

PBR has replaced the return-on-rate base (RORB) as the methodology for adjusting distribution charges. Whereas RORB was retrospective, PBR is prospective. Under the PBR regime, the Energy Regulatory Commission (ERC) evaluates and conducts public consultations on the distribution utility's application on forecasted levels of capital and operating expenditures, prior to approving the rates that the distribution utility will charge for a four-year regulatory period. Under the superseded RORB policy, the utility firm first undertakes the capital and operating expenditures, seeks recovery of these through a rate petition at the ERC – and only at this point would the Regulator decide to approve or disapprove the proposed rate adjustment.

One feature of PBR that contributes to customer confidence and loyalty is the ERC-approved Guaranteed Service Levels (GSL) system – a rewards and "fining" program – that has kept Meralco veritably "on its toes" in assuring the best service to its millions of customers. The GSL has impressed on customers that we match rhetoric with action, particularly paying out "fines" – which are cash payments to customers - whenever our results fall below standards set by ERC.

## ENERGY SALES: A RESULT INITIATIVES TO DEAL WITH EXTERNAL SHOCKS

During the year under review —against a backdrop of global recession, domestic inflation, and a public clamor for rate reduction – Meralco took initiatives to somehow neutralize the effects of the economic slowdown, implemented cost improvement programs to effectively deal with the increasing consumer price index (CPI), and optimized its sourcing mix, in order to give our customers the lowest possible power cost.





### 2009 energy sales surpassed the stretch goal and rose to

27,275gwh

Thus, our energy sales exhibited a momentum for growth. Four key factors served as "drivers" of our increased energy sales – namely:

- Growth in residential consumption, principally driven by sustained money remittances from our overseas Filipino workers;
- (2) Robust performance of retail trade and communications;
- (3) Return of self-generating customers to the grid, to avail of the Napocor-Meralco ecozone rate program; and
- (4) Integration of new industry client, Carmelray Industrial Park 2, into the Meralco distribution system.

Overall, these factors drove energy sales in 2009 upwards to 27,516 GWh (consolidated), up by 1.7% from a year-ago figure of 27,049 GWh.

The 2009 energy sales of the parent company at 27,275 GWh, also surpassed the stretch goal of 27,034 GWh.

The residential sector posted the highest growth rate of 3.3% — from the 2008 figure of 8,620 GWh to 2009's 8,904 GWh. A close second in sales achievement was the commercial sector which saw sales growth from 10,605 GWh in 2008 to 10,922 GWh in 2009. Coming in third is the flat streetlights sector, which experienced an increase of 1.4 % from 140 GWh in 2008 to 142 GWh in 2009.

The industrial sector, however, showed a decline in energy sales. Our 2008 sales of 7,684 GWh slipped to 7,548 GWh, a 1.8% drop. But that is not the entire story. This sector exhibited a strong turnaround performance: its negative performance of 18.7% in January 2009 greatly improved to a negative of only 1.8% at year-end. In other words, the decline was stopped short by the resurgence of the industrial sector, driven by factories that have begun recovering from the global pattern of economic deceleration, indicating bright prospects for the sector in the foreseeable future.

It is noteworthy that the commercial sector contributed the lion's share -39.7% of total energy sales - followed by residential which accounted for 32.4% of the sales pie. The resurgent industrial sector shared 27.4% of the pie.

Meralco's customer base expanded to 4.7 million at year-end, a 3.1% increase over 2008. This indicates that the year-end rebound was experienced across all categories of customers being served by Meralco.

#### SYSTEM PERFORMANCE: LOWEST SYSTEM LOSS IN 29 YEARS

Throughout the year 2009, Meralco's system performance ran efficiently on an even keel – cascading such positive development to all system indicators.

The indicators, according to our Performance Incentive Scheme (PIS), include the following:

- Interruption Frequency Rate (forced and pre-arranged)
- Cumulative Interruption Time (forced and pre-arranged)
- Probability of Voltage Violations
- Average Time to Process Applications
- Average Time to Connect Premises
- Call Center Performance
- System Loss

Notable of such indicators is system loss which the regulator monitors with an eagle's eye and our millions of customers are constantly watching out if such a system loss would reflect heavily on their bill.

Meralco's system loss level dropped to a 29-year low – or since 1981! We achieved a level of 8.61%, which is way below the regulatory cap of 9.5%. In 2005, our system loss was 10.21%, and steadily has been falling since. We began to have a single-digit system loss in 2008, at 9.28%.

How was this accomplished?

- We sent a strong signal that "we mean business" in running after power pilferers because they hurt the industry and our customers. Our deterrence drives included apprehending offenders and confiscating, among others, 580 tons of wires used in illegal connections.
- We used Elevated Metering Centers for our metering facilities, especially in known pilferage-prone areas.
- We waged aggressive information campaigns, notably through the "Kuryente Watch" hotline.
- We increased the share of primary-metered sales by opening the sub-transmission grid to large customer connections.
- We continued to seek and receive the support of local government leaders in our anti-pilferage drive.

#### SERVICE PERFORMANCE: CUSTOMER INDEX RISES

Alongside our continuing emphasis on system performance is another top priority: service performance – which is centrally focused on the customer.

During the year under review, Meralco's Customer Satisfaction Index (CSI) rose to 7.56, which surpassed our own 2009 target of 7.41. It is higher than our 10-year average of 7.17. As a matter of fact the 7.56 is our highest CSI rating in 12 years since we started measuring it in 1998.

The CSI is a measure of customer's satisfaction over Meralco's different customer service processes, covering 11 key service attributes. We value the CSI ratings as they serve as inputs to our service improvement programs and the design of our communication programs. It is also used in crafting different value added service offerings.

#### SYSTEM PERFORMANCE: TESTED BY A TYPHOON

Meralco's fidelity to running its electric distribution system is a 24/7 affair – in good times and bad, in times of excellent climate and in times of raging storms. Meralco's system was tested when, on September 26 last year, typhoon "Ondoy" hit Metro Manila and neighboring provinces – precisely Meralco's franchise area – with floods causing untold suffering, misery and even loss of lives.

Closer to home, the typhoon wrought havoc on and downed 15 of our 115 substations, 215 distribution circuits -- affecting about 1.54 million of our customers. Our business centers which directly serve our customers ceased operating for a few days. It is during these times that our calamity-tested crews whir into action and are immediately available to repair facilities and even perform rescue operations. Our Meralco crews worked round-the-clock, losing no time in restoring and replacing damaged facilities, most of them posing hazards to life and limb.

Power was restored in a systematic way throughout our franchise area, while safety tips were circulated and broadcast. The result: electricity was flowing through the wires to homes, offices and factories, even while the floods had yet to completely recede. Understandably, our Call Center recorded a dramatic increase in calls received in the wake of the devastating typhoon. About 34,700 callers were in touch with our Center on September 27, a Sunday. In normal times, our Center receives only about 4,000 calls.

This calamity also resulted in Meralco foregoing about 66 GWh in energy sales. And yet, viewed from how our system saved the day for the flooded metropolis, our loss is far outweighed by gain in terms of lives saved and in the convenience restored to our residential, commercial and industrial customers.

PERFORMANCE-BASED REGULATION: A CLOSER LOOK Under PBR, Meralco operates under a Performance Incentive Scheme (PIS) – which has two components: first, the S-factor which measures Meralco's over-all system performance; and second, the Guaranteed Service Level (GSL), which assures service delivery to individual customers.

Under the first component or the S-Factor, Meralco's performance improved in six out of eight indicators.

With regard to the Guaranteed Service Levels (or GSL),
Meralco's performance—for 2009 on the prescribed measures
—achieved the standards set by ERC.

The importance of the ERC-mandated PIS is that our tariff are adjusted upwards or downwards depending upon our performance within a certain regulatory year.

As we recall, on April 23, 2009 the ERC issued an Order approving Meralco's RY MAP (Regulatory Year Maximum Average Price) for 2009, which was implemented in Meralco's May 2009 billing. The timing was perfect. The 25.7 centavos per kWh increase in Meralco charges was cushioned by reductions in the transmission charge following the yearly updates under the Transmission Rate Adjustment Mechanism (TRAM) and the acceleration of the Currency Exchange Rate Adjustment (CERA) refund.

Also in 2009, under-recoveries were substantially addressed. In January 2009, P2.11 billion in Wholesale Electricity Spot Market (WESM) congestion-related cost was recovered hrough the Generation Charge. The level of transmission under-recoveries, confirmed at P5.42 billion and their collection, was implemented in November. Collection on lifeline and inter-class cross-subsidies started in December.

Thus, we ended 2009 with a greater measure of regulatory stability and predictability with the release by the ERC of two decisions:

- The approval of Meralco's RY 2010 Maximum Average Price or MAP of P1.4917 per kWh, eight months after the release of the order approving the RY 2009 MAP. Meralco's MAP for RY 2009 and 2010 is in the midrange of those of two other distribution utilities that entered PBR at the same time as Meralco.
- The resolution of the Motion for Reconsideration (MR) on transmission under-recoveries of P1.5 billion.

Similar to the implementation of the rate adjustment in May 2009, the 27-centavo PBR adjustment this January 2010 was again offset by reductions in the generation and other charges resulting in a January net reduction of 6.6 centavos per kWh.

**OUTLOOK: NEW OPPORTUNITIES AND CHALLENGES**We will continue to address the issues on system loss with the following steps:

- Sustain the momentum of our system loss reduction program, both Technical and Non-Technical;
- Determine the desired energy supply mix for the least electricity cost.

Another major challenge we face is our reset filing for the 3rd Regulatory Period this June. Some of the key things that need to be done are asset valuation, Opex and Capex forecast, the application of the PIS, business separation and addressing under-recoveries from the second Regulatory Period.

In an environment under PBR, we basically operate under the framework involving three key factors: service, investment and tariffs, with each driving the other two, and vice-versa. Since July 2007, when we started on PBR, we have become more aware of the essence of PBR in terms of optimizing our investments, serving our customers in a manner that would reduce our fines and increase our rewards, and working toward timely adjustments in our rates that would reflect our levels of investment and service.

The year 2010 will also be the critical year in our preparation for open access and retail competition (OARC). Already four of the five preconditions to retail competition have been met: unbundling of tariffs, removal of subsidy, start of WESM, and privatization of NPC assets. With the transfer of the IPP administration of Ilijan to the private sector within the first semester, the fifth condition, the transfer of NPC IPP contracts to IPP Administrators will have been met, and we expect open access to commence as early as January 2011. Preparing for a smooth transition will be a key objective. There is a need to establish the necessary infrastructure and to conform to pertinent regulations. The succeeding months will be critical in this regard.

We are looking forward to serving the Cavite Economic Zone and other end-users that are currently directly connected to the grid, thus bypassing Meralco, by offering them attractive solutions for their electric service needs. By doing so, we will hold them up as examples, to prevent or minimize any future bypass of our facilities.

We will also actively explore and, if justified, take advantage of opportunities beyond our congressional franchise, to bring the Meralco-brand of service to areas outside our current borders.

We will explore opportunities to return to the generation business as source of new growth.

In our commitment to improve customer service delivery, we will continue with our service delivery improvement activities, such as:

- Promote the expanded Meralco Time of Use or TOU programs
- Rationalize customer service touch points for more efficient and friendly service delivery
- Implement a Quick Install Program (QIP) where possible
- Benchmark industry standard on call center operations
- Encourage new service innovations and ideas

 Continue customer education on the electricity industry development and policy changes

With the available new technology, we will explore the expansion of mobile services which will enable us to acquire:

- Information on meter reading thru SMS
- Payment of electricity bills thru Smart Money
- Support for our Electronic Bill
- Study Payment via Credit Card within Business Centers
- Study use of mobile technology for real time field findings report

We will regularly monitor our performance through available measures such as Customer Satisfaction Index/Mystery Client Survey, One-Ring project monitoring, and project covered applications.

On collections and payment processes, it is very important to institute proper checks and balances to mitigate risks.

We also recognize that as a key player in the industry, we have the responsibility of shaping the environment we are operating in. Eight years after the Electric Power Industry Reform Act (EPIRA), some basic questions linger. Will there be adequate power supply three to four years from now? Will power rates be competitive enough for industries in their bid to thrive? We are hoping that the changes in the national leadership that the May elections will bring about will provide an opportune time towards effecting changes that are salutary to the growth of the power industry sector.

Our performance in 2009 augurs well for our collective ability to address emergent and new opportunities, as well as challenges in the year 2010 and the ensuing years.

With our supportive shareholders, stakeholders, customers and our own employees – we know we can make more inroads into the market and contribute significantly to strengthening the foundations of our economy. We are committed to telling the truth more compellingly about the way we do business, anchored on the principles of free enterprise, fair play and enlightened corporate management.

JOSE P. DE JESUS

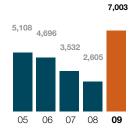
President and Chief Operating Officer

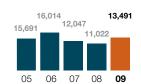


# Business Review

### (In Million Pesos)

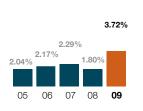
EBITDA (In Million Pesos)

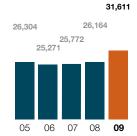




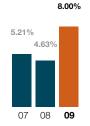


DISTRIBUTION REVENUES (In Million Pesos)





RETURN ON REGULATORY ASSET BASE (Parent Company)



#### **FINANCIALS**

Core Net Income. This measures the run-rate of the Company. The company calculated the core net income as consolidated net income attributable to equity holders of parent company (Meralco) adjusted to exclude the effect of foreign exchange and mark-to-market gains or losses and other one-time, exceptional transactions.

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). This measures financial performance excluding the effects of capital structure, interest and depreciation. It is a substitute for operating cash flow. The Company calculates EBITDA by deducting interest income, equity in net earnings of associates and joint venture, and foreign exchange gains from consolidated net income and adding back interest expenses, taxes, foreign exchange losses, depreciation and amortization.

Return on Assets (ROA). This measures the overall efficiency of the company in generating profits with its available assets. The Company calculates ROA as the ratio of consolidated net income to averages total assets. Average total assets is derived by computing the simple average of total assets at the beginning and at the end of the year.

**Distribution Revenues**. Revenue from providing Regulated Distribution Services to consumers. It includes the revenues from distribution, supply and metering services.

Return on Regulatory Asset Base (RORAB). This measures the profitability of the power distribution business in relation to the regulatory asset base as defined by the Rules on Setting Distribution Wheeling Rates (RDWR). The Company calculates RORAB as the ratio of its after-tax operating income to average regulatory asset base.

# >> system loss level dropped to a 8.61%

# probability of voltage violations dropped to 75% from the 0.88%

#### **ENERGY SALES**

Meralco achieved a modest growth in energy sales in 2009 despite the challenging economic environment. The residential and commercial sectors both showed improvements, offsetting the decline in sales to the industrial sector. In spite of the decline, however, volume sold to the industrial segment continued to recover, at first slowly during the first half of the year before improving significantly towards the second half.

Propelling the increase in residential consumption were sustained remittances, lower inflation and lower electricity prices.

Retail trade grew by 8.7% while telecommunications rose 18.3% to push sales in the commercial segment.

Self-generating customers returned to the grid to take advantage of lower ecozone rates, contributing 237 GWh to the 2009 volume. The integration of Carmelray Industrial Park 2 (CIP2) to the Meralco distribution system added 47 GWh to the 2009 sales volume.

#### Rates

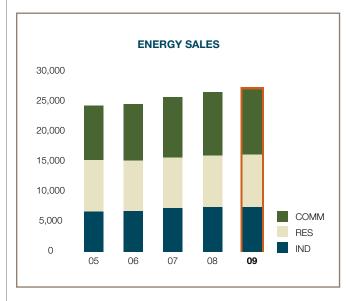
Overall, electricity rates in 2009 were lower than in 2008 and 2007. This reduction was largely due to the lower cost of purchased power.

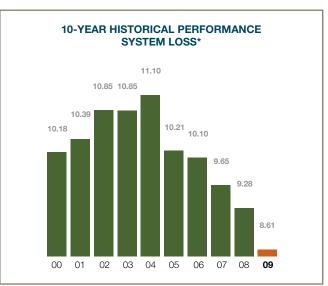
In particular, the Generation Charge showed a declining trend beginning May 2009, with the generation charge registering its lowest level in five years in the month of October 2009 at less than P4 per kilowatthour.

#### SYSTEM RELIABILITY AND EFFICIENCY

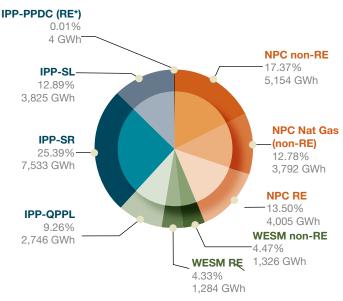
Meralco achieved excellent results in system reliability and efficiency as it established new highs during a year marked by natural catastrophes, economic and transmission grid instability.

System efficiency had a breakthrough performance as system loss level dropped to a 29-year low at 8.61%. For the second straight year, it was below the 9.5% system loss cap imposed by the Energy Regulatory Commission (ERC). As a result, Meralco had no unrecoverable purchased power cost for the year. This unprecedented achievement was due to intensified deterrence drives and apprehension, relocation of metering



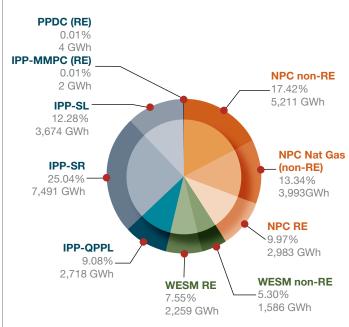


\* Meralco system loss, excluding that of Clark Electric Distribution Corp. (CEDC). Starting 2008, system loss was computed excluding kilowatthour recoveries from Violation of Contract (VOC) and Illegal Service Connection (ISC) cases.



#### **2008 ENERGY PURCHASES**

Note: IPP-MMPC Purchase is 0.00% for 2008 \*Renewable Energy



#### **2009 ENERGY PURCHASES**

facilities in pilferage-prone areas and partnerships with local government units (LGUs) to promote safety and to eliminate electricity pilferage.

The reduction of pilferage-related cases in high-loss areas also contributed to the improvement of power quality in the Meralco franchise. The probability of voltage violations dropped to 0.75% from the 0.88% recorded in 2008. The strategic placement of voltage regulators and capacitor banks and the use of on-load tap-changer (OLTC) to regulate the output voltage of Meralco's power transformers were also factors in improving power quality.

System reliability likewise sustained outstanding performance. The average number of interruptions experienced by a customer, measured by the Interruption Frequency Rate (IFR), was at an all-time low at 6.01 times besting the 6.53 times in 2008. This was due to the commissioning of two new substations and 14 distribution circuits, the upgrading of two existing substations and the installation of remote-controlled line switches that speed up the detection and isolation of line and substation troubles.

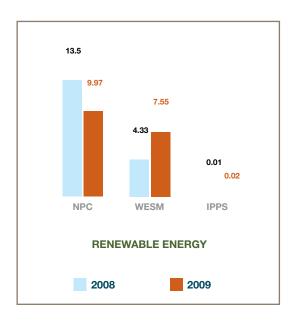
There was a slight rise in the Cumulative Interruption Time
(CIT) or the average duration of interruptions experienced
by a customer. The total duration of planned interruptions
increased to 1.94 hours from 1.62 hours in 2008 mainly due
to the relocation of electrical facilities affected by government
projects including the Light Rail Transit (LRT) extension, roadwidening and other infrastructure projects. In addition, several
corrective measures were implemented on facilities that
were submerged in floodwaters caused by typhoon Ondoy.
Unplanned interruptions, on the other hand, slightly rose to
4.17 hours in 2009 from 4.15 hours in 2008.

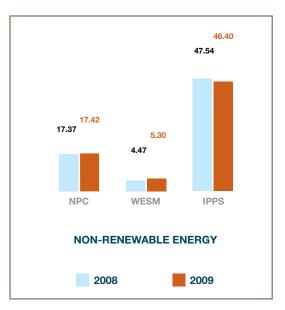
#### **POWER SUPPLY MIX**

Meralco's energy purchases of 29,922 GWh in 2009 remained practically the same as the volume of 29,669 GWh purchased in 2008.

The National Power Corporation (NPC) still provided the biggest chunk of Meralco's total energy requirement at 40.73%, a slight decrease from the 43.65% share in 2008. This included sales under the Transition Supply Contract (TSC), Customer Choice Program, Ecozone Rate Program and sales to Sunpower Philippines Manufacturing, Ltd., a solar panel manufacturer.

# Interruption Frequency Rate (IFR), was at an all-time low at 6.01 times besting the 6.53 times in 2008





The three Meralco independent power producers collectively contributed 46.42% of the energy requirement, slightly lower than the 2008 level. WESM, on the other hand, increased its share to 12.85%, up from 8.80% the year before.

Of the 40.73% NPC supply, 13.34% was supplied by the 1,200 MW Ilijan power plant (up from 12.78% in 2008) which is fueled by Malampaya natural gas. On the other hand, the renewable energy (RE) component of NPC's energy, such as those from hydro and geothermal plants, went down to 9.97% in 2009 from 13.50% in 2008. Such apparent reduction was merely an accounting, and not a real, reduction because the privatized power plants were removed from the NPC category. Non-renewable energy from NPC remained at practically the same level at 17.42% vs. 17.37% in 2008.

As a whole, Meralco's renewable energy purchases in 2009 dipped slightly to 5,249 GWh from 5,293 in 2008. Correspondingly, the RE share also decreased slightly to 17.54% from 17.84% in 2008.

It should be noted that Sta Rita, San Lorenzo and Ilijan while not considered renewable energy resources, are nonetheless clean and indigenous energy resources because they emit much less greenhouse gases than coaland oil-fired power plants.

In 2009, clean energy from natural gas accounted for 50.66% of Meralco's total energy purchases, which is essentially at the same level as the 51.06% share recorded in 2008. In total, the renewable and clean energy resources accounted for 68.20% of the total energy mix.

#### **MERALCO MOBILE SERVICES**

The service offers: broadcast of pre-arranged power interruption schedules, emergency interruptions and typhoon-related safety tips; business center contact numbers; a facility where customers can send feedback, queries, reports and messages to Meralco.

#### **CUSTOMER SERVICE**

Customer service delivery scaled new heights in 2009, meeting and even exceeding the performance standards set by the regulator for customer service and at the same time gaining a high level of satisfaction from customers. Sustained focus on the customer in different areas of operations was largely responsible for the excellent performance.

Focus on the customer was central and reinforced in various areas:

Competent, inspired work force

- Training and development of frontliners were implemented persistently.
- The Annual Service Excellence Congress gathered Business Center personnel for a presentation of new ideas to further improve and strengthen service to customers.
- Inspiring "delight stories" on outstanding customer service were featured at road shows.

#### Outstanding service delivery

- Meralco customer service performance standards set by the Energy Regulatory Commission (ERC) under Performance Incentive Scheme were either met or exceeded, specifically in:
  - a) Call Center Performance attained a level of 9.03%, better than the required service bandwidth of 12.66% to 25.5%.
  - b) Time to Process Applications and Time to Connect Premises - at 11.61 days and 2.35 days, respectively. These two performance standards met their bandwidths of seven days to less than 19 days and two days to less than four days, respectively.

As part of its commitment under the Guaranteed Service Level (GSL) of the first regulatory year of Performance Based Regulation (PBR), the company implemented its first GSL pay outs beginning September 2009.

- Fifteen Business Centers were upgraded in 2009 with a new, appealing look. To date, 22 out of the total 30 Business Centers have been upgraded for customer comfort and convenience.
- The Meralco Consumer Assistance Office (MCAO) colocated in the same edifice as the ERC, opened in October.
   A breakthrough idea in providing cost-effective but enhanced customer care, customer concerns brought to the regulator's attention are attended to in just one place.

Improved service and product offering

- The Meralco Mobile Services was launched in October providing customers with a tool that connects them to Meralco anytime, anywhere. The project, in partnership with Smart Communications, Inc. began its pilot run on November 15 in selected areas, and will be made available franchise-wide by 2010.
- Rate options were made available to qualified commercial, industrial and residential customers through the Customer Choice Program (CCP). These enabled our customers to choose the best pricing scheme. Under this program:
  - a) 470 industrial/commercial customers and 2,905 residential customers realized savings in their electricity bills through the program.
  - b) Self-generating companies returned to the Meralco grid, bringing in 237.4 GWh of recovered energy sales. Carmelray Industrial Park 2 alone brings in P3.4 M per month in gross distribution revenue
  - c) Customers who availed of the CCP in 2009 grew 72% to 3.293 from 1.916 recorded in 2008.
- Meralco submitted an application to the ERC to lower the threshold for Time of Use (TOU) rates, extending the benefits of the TOU scheme. This enables customers to manage their load usage and save on electricity bills. The Company asked to lower the threshold to 500 kWh for residential customers.
- Meralco is actively developing its Smart Grid vision

   a modernized electric grid using digital technology with the aim of increasing energy efficiency and reliability. The Company's Corporate Information and Technology (CIT) and Networks organizations explored proof of concept projects involving the Smart Grid and Broadband over Power Lines (BPL) technologies in 2009. The aim was to identify the possible uses, benefits and applicability of these technologies to Meralco.
- In August 2009, the CIT replaced the aging mainframes with two z10 enterprise servers to address the implications of increased demand for computing capacity. The risk of obsolescence and the issues of peaking demands and resource contentions were all mitigated by the installation of the new

technology servers. Statistics showed improvement in online transaction response time and reductions in the turnaround time of the batch processes. This translates to faster processing of customer transactions in the Business Centers as well as in the generation of electric bills.

 To prepare for the forthcoming Open Access, the Company strived to develop new processes and systems for Meralco's role as a distribution utility in a competitive environment.

#### Partnerships with institutions and interest groups

- Meralco sustained relationship-building programs for specific groups, such as the Liwanag Card for loyal and prompt paying customers, the Mothers' Day and Ilaw ng Tahanan events to honor mothers; and, the Maliwanag ang Pasko campaign for residential customers to uplift the spirit of sharing and hope during the Christmas season.
- Partnerships with both government and private sectors were established to promote its advocacies, specifically in public safety, system loss reduction, energy efficiency and cleaner environment.
- Meralco supported efforts to uplift the living conditions of the underprivileged through the North and South Rail projects in partnership with the National Housing Authority. A total of 45,412 services were relocated as of year-end 2009.
- Memoranda of Agreement (MOA) were signed with the local government units of Cavite, Cainta, Taytay and Caloocan to strengthen public safety and eliminate pilferage of electricity.
- Meralco and leading developers and realty companies banded together in building energy efficient homes and promoting an energy efficient lifestyle.
- MOAs on Rural Electrification were also signed with unelectrified municipalities in Quezon and Laguna provinces. The agreement supports government commitment to complete the electrification of the remaining 6.35% unenergized barangays in the franchise.

#### Effective Customer Communication

Meralco created the Corporate Marketing organization in 2009 to integrate efforts enhancing corporate image and relationship management. It is tasked to reinforce service delivery through customer-oriented programs and effective communication. During the year, the organization implemented massive information campaigns, image-building and promotional activities, as well as media briefings. The briefings with media gave the Company more exposure in the different platforms – print, television, radio and the internet.

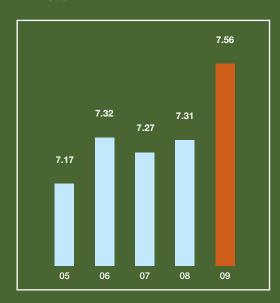
The diverse campaigns and image building activities focused on the Company's advocacies, expert service delivery and

"Excellent customer service delivery will carry us through any crisis. But we must continue with our service delivery strength and customer service programs and communicate them well."

- Chairman & CEO Manuel M. Lopez

# **CUSTOMER SATISFACTION INDEX**: A measure of customers' expectations and impressions with respect to Meralco's services. It captures the general disposition of Meralco customers across different segments. It is defined by attributes such as product quality, rates, meter reading, company image and other attributes related to different customer processes.

- The 7.56 CSI level in 2009 surpassed the year's target of 7.41.
- The highest achieved since the company started measuring Customer Satisfaction in 1998.
- Reasons: Good performance in service reliability, safeness of facilities, good voltage regulation and lower rates in the latter part of 2009.



continuing customer education on Company policies and regulatory developments:

- In communicating advocacies, Meralco actively participated and showcased its promotion of energy efficiency, load management and renewable energy at the Powertrends International Exposition in September. It also joined in the celebration of Energy Week by hosting energy efficiency lecture to high school students at the Philippine Science Centrum.
- The Company also reinforced its role as every Filipino household's partner in comfort, convenience, wellness and safety by introducing new electric appliance trends and innovation in urban living at the Lifestyle Expo 2009. Meralco showed its commitment for a cleaner environment through an active participation in Earth Hour last March 23.
- Communicating policies and company positions
  were also conducted through information campaigns
  for local government and building officials, leading
  real estate developers, electrical contractors, core
  customers and targeted small medium enterprises
  (SMEs).
- There were regular gatherings with media and the business community to tackle current issues and other public concerns. The President & COO was present in the gatherings, underlining the persistent goals of satisfying customers and its various stakeholders, growing businesses, expanding markets and making lives better.
- Meralco increased its presence on the digital platform with its own Twitter account, recognizing the growing capacity and effectiveness of such media in reaching out to customers.

#### Results

Put together, the diverse approaches on customer care gained public approval. The Customer Satisfaction Index (CSI) reached an all-time high level of 7.56, which also surpassed the 7.41 targeted for 2009. The rise in customer satisfaction was drawn across all customer segments, but was most evident in the residential segment at 7.42, which in 2004 was at a low of 6.50. Satisfaction among core customers (those with a demand of 1 MW and up for the past 12 months) also improved to 7.82 from 7.65 in 2008. The satisfaction level in the non-core segment, all those remaining non-residential accounts, meanwhile, recovered at 7.54 after two consecutive years of decline.

#### **HUMAN RESOURCES**

Meralco optimizes the quantity and quality of its human resources to ensure that they help the company fully meet the standards of performance, productivity and cost efficiencies needed under PBR and support corporate strategies. To support these thrusts, HR undertook major initiatives in 2009.

These include:

#### Competency-based HR Systems (CBHRS)

The sustained implementation of the Competency-based HR Systems (CBHRS), a fundamental strategy for the continued transformation and development of a competitive work force. Four offices implemented their respective competency frameworks in 2009. As a result, 97% of organizations are now governed by the CBHRS.

#### Organizational changes

Six organizational changes were implemented in 2009 to drive operational cost-efficiencies, show clearer accountabilities to support corporate thrusts and business strategies, and to strengthen the Meralco organization in the management of its core and non-core businesses. The organization changes involved Network Asset Management, Corporate Information and Technology, Finance, Investment Management, Crporate Marketing and Business Centers.

#### Performance Management System (PMS)

The Performance Management System was reinforced with more stringent performance standards and an enhanced infrastructure to better monitor and measure individual contribution. This provides high-performing employees true recognition and reward based on realized contribution to the attainment of team, organization and corporate goals through the PMS and the Meralco Incentive Plan (MIP).

#### Performance-based Organization Plan

The Performance-based Organization Plan was sustained, thereby, enhancing the link between compensation and attained company goals and performance targets through the MIP. The plan is a key driver in creating and continuously developing a high performing compesation under the PBR.

#### Educational advocacy programs for employees

The company pursued educational advocacy programs for employees, particularly on good governance rules, on the codes of conduct and behavior in the performance of duties and responsibilities, and on the implementation of a drug-free workplace.

#### Employee communication

The lines of communication were kept open for the two unions, First Line Association of Meralco Supervisory Employees (FLAMES) and Meralco Employees and Workers Association (MEWA), through quarterly briefings on company developments and organizational impact of the forthcoming retail competition and other matters of importance to the employees.

#### Training, certification and development

Training and certification programs were pursued as in prior

years, to continuously build and develop competencies across all levels. A total of 21,370 employees underwent training in 2009, each receiving 2.13 training man-days on the average. Training programs were developed to target the specific needs of identified groups of employee-participants in the areas of regulatory education, engineering, management development, and organization-based processes and skills. HR also stepped up individual career management initiatives to continue supporting employees' competency development.

#### Environment, safety and health

Safety and environment programs geared towards protecting employees, contractors and the public against unsafe conditions, as well as ensuring their safety and health while on the job have always been organizational priorities.

In 2009, more substation and building facilities, work areas and line crews were audited and inspected to intensify efforts on safety compliance. In addition, safety-related information campaigns stepped up along with sustained installation of safety and environmental protection programs.

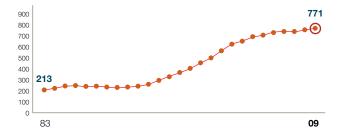
#### Head count control

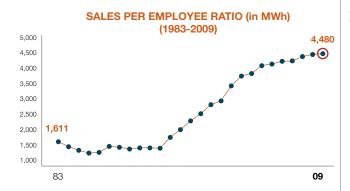
There was minimal average growth rate in head count of 0.7% for the years 2003-2009, ending the year with 6,112 employees. This was brought about by:

- Prioritization of core and frontline positions to manage the company's manning requirements in a manner that is cost-effective and in full compliance with the performance and cost parameters and standards set by regulation.
- Optimal use of competent service providers to help achieve goals and targets in a more cost-efficient way. In 2009, the thrust was to further strengthen contract administration functions at the organizationlevel to help ensure the quality and cost-effectiveness of outsourced jobs. Moreover, to ensure adherence to outsourcing directions, compliance to outsourcing management programs is used as a standard indicator in the measurement of organization performance.

As proof of continuing improvement in employee productivity and over-all human resource performance, Meralco achieved a 771 customer per employee ratio (CPER) and 4,480 MWh sales per employee ratio (SPER) in 2009. Both CPER and SPER were at highest levels ever been attained since their measurement and reporting in 1987 and 1983, respectively.

### CUSTOMER PER EMPLOYEE RATIO (1983-2009)

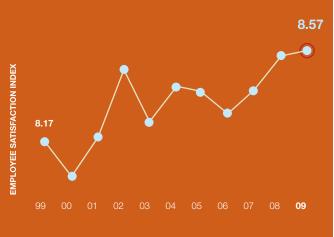




### THE 2009 EMPLOYEE SATISFACTION INDEX (ESI) at 8.57:

- The highest level in 11 years, since the start of ESI measurement and reporting in 1999. The 2009 ESI was 0.23% higher than 8.55 in 2008.
- It is a key driver of customer satisfaction, profitability and revenue growth.
- Indicated that pride and commitment have remained consistently high – a positive indicator of employees' loyalty and dedication to the Company.

#### HISTORICAL TREND OF OVERALL ESI (1999-2009)





# Regulatory & Industry Highlights

#### TRANSITION TO PERFORMANCE-BASED REGULATION

Meralco, along with the Dagupan Electric Corporation (DECORP) and Cagayan Electric Power and Light Company (CEPALCO), is a pioneer of Performance Based Regulation (PBR) in the Philippines. Under PBR, tariffs are set according to forecasts of capital and operating expenditures to meet a predetermined level of operational performance. Utilities are penalized or rewarded depending on technical and customer service performance.

On January 11 and April 1, 2008 Meralco filed separate applications under PBR for its proposed translation of the Maximum Average Prices (MAP) for Regulatory Years (RY) 2008 and 2009, respectively, into rate schedules for various customer segments. In October 2008, the ERC approved a MAP for RY 2009 of P1.2280 per kWh.

However, the ERC, acting on a motion filed by a group of electricity consumers, deferred the implementation of the approved charges until ERC can resolve a Motion for Reconsideration (MR) to be filed by the group and by other intervenors.

On April 23, 2009 the ERC resolved the MRs filed by the various consumer groups. The ERC amended its earlier approved MAP for RY 2009 to P1.2227 per kWh. Implementation of the approved rates began in May 2009.

On May 28, 2009 a number of consumer groups filed a Petition before the Court of Appeals to question the ERC's rulings on the RY 2009 MAP and rate translation application. Eventually, in a Decision dated January 29, 2010 the Court of Appeals dismissed the consumer groups' Petition.

Meanwhile, on August 7, 2009 Meralco filed a petition for the verification of the MAP for RY 2010 and its translation into tariffs by customer category. In a Decision dated December 14, 2009 the ERC approved the company's application to adopt the MAP for RY2010 of P1.4917/kWh and directed Meralco to implement the approved charges starting January 2010.

However, on January 26, 2010 Meralco manifested before the ERC that it would suspend implementation of the RY 2010 MAP, in view of an MR filed by an intervenor on the December 14, 2009 Decision.

On February 1, 2010 the ERC granted the manifestation, saying that the RY 2010 MAP implementation would be suspended until ERC has resolved the pending MR and addressed all other issues that other intervenors may raise.

On March 10, 2010 the ERC resolved the pending MR and lifted the suspension of the RY 2010 MAP implementation. The ERC revised the rate schedules to better ensure that there will be no cross-subsidies, other than the lifeline subsidy, in Meralco's rates, while maintaining a MAP of P1.4917 per kWh. The implementation of the RY 2010 MAP resumed in April 2010.

On April 5, 2010 Meralco filed a verification and translation application for RY 2011, proposing a MAP of P1.6464 per kWh. The petition is pending before the ERC.

#### UNDER-RECOVERIES IN PASS-THROUGH COSTS

#### Generation Cost Under-recoveries

During the suspension by the ERC of the Automatic Generation Rate Adjustment (AGRA), the Company filed 10 separate applications for the full recovery of generation costs incurred for the supply months of August 2006 to May 2007, which resulted in under-recoveries of P12,679M for generation charges and P1,295M for system loss charges.

After the conduct of hearings and regulatory evaluation, the ERC allowed the Company to collect P9,978 million in generation costs, plus P813M in carrying charges. However, a portion of the company's purchases from the Wholesale Electricity Spot Market (WESM) for the period December 2006 to May 2007, amounting P2,701M of the total amount applied for, was disallowed. The Company was also ordered to file a separate application for recovery of P1,295M of system loss adjustments after the ERC confirms the average transmission rate to be used in the calculation of the system loss rate.

Meralco filed a Motion for Partial Reconsideration on the disallowance of P2,701M because it believed that these were just and reasonable pass-through costs recoverable from its consumers. A hearing on the Motion was held on November 3, 2009. The ERC has yet to resolve the motion.

During the supply month of February 2010, the cost of generation went up to P6.77 per kWh and would have translated into a generation charge of P6.76 per kWh for the March 2010 bills, an increase of P1.83 per kWh from the preceding month's level.

The higher generation cost was a result of various factors. While demand for power was high supply was low, affecting WESM prices, which increased from P6.08 per kWh in the January 2010 supply month to P12.16 per kWh in February. The tightness in generation supply was due to the de-rating of almost all hydroelectric power plants in Luzon with El Niño. The scheduled maintenance shutdown of the Camago-Malampaya pipeline starting February 10, 2010 and some other power plant units also curtailed supply. During the pipeline's outage, the natural gas plants had to use higher-priced condensate fuel to continue power production.

To mitigate the impact to consumers of the high generation cost, Meralco petitioned to the ERC on March 9, 2010 that it be allowed deferred recovery of the fuel cost differential pertaining to the use of liquid condensate by the First Gas plants, equivalent to P1.04 billion. In the Company's petition, the recovery of this differential would be spread over six months starting April 2010, so that the increase in the generation charge would be shaved from P1.83 to P1.38/kWh.

On March 10, 2010 ERC issued an Order modifying Meralco's proposal. In addition to approving the deferred recovery of the condensate cost differential, ERC limited to the NPC average rate the pricing of WESM purchases beyond 10%. The ERC said that this WESM cost differential, of about P1,120M, would undergo further evaluation by the Commission. Thus, the ERC provisionally approved a March 2010 generation charge of P5.8417 per kWh.

#### Recovery of Transmission Cost Under-recoveries

On September 26, 2007 Meralco filed an application to

recover P5,554M in transmission charge under-recoveries accumulated between June 2003 to July 2007, along with a corresponding carrying cost.

From August 2007 to April 2009, Meralco accumulated a net over-recovery of P4,528M. Thus, on July 29, 2009 it filed a petition for the confirmation of transmission charges imposed during the said period and also proposed to offset the over-recoveries against the under-recoveries covered in its September 26, 2007 petition.

On October 21, 2009 the ERC issued its decision on the Company's application to recover P5,554M of transmission cost under-recoveries. The Company subsequently filed a Motion for Partial Reconsideration on October 30, 2009 and, on December 29, 2009 received an Order dated December 14 in which ERC confirmed the total under-recoveries of Meralco in transmission charges for June 2003 to July 2007 in the revised amount of P5,418M and carrying costs amounting to P1,507M.

Also, on October 21, 2009 the ERC released an Order on the separate application of Meralco to offset transmission cost over-recoveries against the claimed under-recoveries. The ERC provisionally approved the offsetting proposal and directed the Company to refund over-recoveries amounting to P4,917M and carrying costs of P257M. The Company implemented the above Decisions starting November 2009.

## Recovery of Under-recoveries in the Implementation of the Inter-Class Subsidy Removal

Meralco filed a petition on November 14, 2007 to recover P1,054M of under-recoveries and a corresponding carrying charge, incurred in implementing the Inter-Class Cross Subsidy system.

In a Decision dated November 16, 2009 the ERC approved



with modification Meralco's application to collect the total interclass cross subsidy under-recovery for June 2003 to October 2006 amounting to P1,049M, equivalent to P0.0103 per kWh. The Decision was implemented beginning December 2009.

### Recovery of Under-recoveries in the Implementation of the Lifeline Rates

On February 19, 2008 the Company filed an application with the ERC for the collection of the under-recoveries incurred in the implementation of the lifeline subsidy rate amounting to P864M, with a corresponding carrying cost.

On November 27, 2009 ERC released its Decision and authorized Meralco to recover the total lifeline subsidy underrecovery for June 2003 to December 2007 amounting to P856M, equivalent to P0.0068 per kWh. The Decision was implemented starting December 2009.

#### **REVISION OF SYSTEM LOSS CAPS**

On December 8, 2008 the ERC promulgated Resolution No. 17, Series of 2008, entitled "A Resolution Adopting a New System Loss Cap for Distribution Utilities," which lowered the maximum rate of system loss (technical and non-technical) that a private utility can pass on to its customers to 8.5% starting January 2010, one percentage point lower than the previous cap of 9.5%.

In a letter dated August 11, 2009 Meralco appealed to the ERC for a deferment of the imposition of the 8.5% system loss cap, because certain developments beyond the Company's control would make it difficult to comply with the new cap in 2010. In particular, the abrupt and substantial decline in industrial energy sales due to the economic downturn reduced high voltage sales, while the continued increase in residential sales pushed up the share of low voltage energy sales.

In a letter dated November 23, 2009 while agreeing with the adverse impact on system loss of the reduced share of high voltage sales, the ERC replied that "both the existing and the proposed new caps were set regardless of whether or not the franchise area is highly urbanized" and that there are "more than sufficient means and incentives" for DUs like Meralco to deter or curb electricity pilferage. As a result, the ERC denied Meralco's request.

On December 8, 2009 the company filed a Petition to amend the Resolution with an urgent prayer for the immediate suspension of the implementation of the 8.5% cap starting January 2010. The proposed amendment would align the Resolution with the provisions of EPIRA and Republic Act No. 7832, by increasing the level of system loss cap to not less than 9%. The ERC has yet to act on the Petition.

#### POWER SUPPLY OPTION PROGRAM

On May 23, 2008 Meralco, together with other industry players, filed a Petition with the ERC for the implementation of Interim Open Access (IOA) in the Luzon and Visayas grids, in accordance with a proposed "Terms of Reference of the Interim Implementation of Open Access."

The Petition sought to allow eligible customers with an average peak demand of 1 MW and up to contract and purchase their electricity requirements from Eligible Generating Companies through Retail Electric Suppliers. Eligible Generation Companies are those which meet the mandated generation market share caps of EPIRA.

In a Decision dated November 10, 2008 the ERC renamed IOA as the Power Supply Option Program (PSOP) and approved the Petition, subject to rules to be promulgated by the ERC.

On September 14, 2009 the ERC released an Order stating that PSOP would commence ninety (90) days after completion of either of the following conditions, whichever comes earlier:

- The transfer of the operation of the Calaca Generation Assets to the private generation companies concerned or its equivalent in terms of capacity; or
- b) The privatization of at least 70% of the total capacity of generating assets of NPC in Luzon and Visayas.

Eventually, on December 3, 2009 the Power Sector Assets and Liabilities Management Corporation (PSALM) turned over the 600-MW Calaca Coal-Fired Power Plant to Sem-Calaca Power Corp. Thus, the target commencement date for PSOP became March 4, 2010.

On January 25, 2010 ERC approved the "Rules for the Power Supply Option Program." On January 27, 2010 the ERC directed the PSOP proponents to submit to ERC harmonized procedures for retail settlement under PSOP by February 23, 2010.

On February 26, 2010 PEMC filed a Manifestation with the ERC, taking the position that it could not exercise a role beyond that of market operator under the WESM Rules. PEMC, however, stated that it was willing to provide data to the DU or Supplier to calculate the settlement amounts of PSOP customers.

Meanwhile, on the same date, Meralco filed a Manifestation with the ERC, taking the position that the PEMC is best suited to take on the role of the Settlement Agent because it has the necessary infrastructure, systems, procedures and policies to fulfill the role. The ERC released an Order on March 8, 2010 directing other Petitioners to comment on the Manifestations. The matter is currently pending before the Commission.

#### **PEZA-ERC JURISDICTION**

Meralco and the Private Electric Power Operators Association (PEPOA) held compromise talks with the Philippine Economic Zone Authority (PEZA) to resolve the injunction case filed by the DUs at the Pasig Regional Trial Court (RTC) against PEZA's "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." These Guidelines effectively give PEZA franchising and regulatory powers in ecozones.

PEZA, PEPOA, and Meralco agreed that:

- In the case of power utilities or entities currently operating a power distribution system inside the ecozone, the PEZA Board shall approve the registration of such entities upon compliance of all registration requirements.
- The franchised distribution utility operating immediately outside a newly proclaimed ecozone shall have the right of first refusal to operate a power distribution system subject to compliance with all registration requirements.
- 3. Until such time that PEZA and ERC have agreed on principles of asset recognition and boundaries for rate-setting and PEZA has fixed the appropriate distribution charge, the prevailing distribution and other distribution-related charges, as may be adjusted in accordance with ERC's guideline, shall apply.

Subsequently, Meralco and PEPOA filed their respective motions to withdraw as plaintiffs in the RTC case, which are awaiting decision by the Court.

Meantime, in support of the government's objective of providing lower cost power to ecozone locators, the company entered into a Memorandum of Agreement with the NPC on September 17, 2007 for the provision of special ecozone rates to high load factor PEZA-accredited industries. The ERC allowed the immediate implementation the program, which is still ongoing.

On March 6, 2009, Meralco submitted an Application for Registration to PEZA to be an Economic Zone Utilities Enterprise for the establishment, operation, and maintenance of distribution facilities at the Carmelray Industrial Park II (CIP II) Special Economic Zone in Calamba, Laguna. The PEZA Board subsequently approved the application via its Resolution No. 09-16 and, on January 18, 2010, Meralco signed a Registration Agreement with PEZA.

## SHUTDOWN OF TRANSCO'S SUCAT-ARANETA TRANSMISSION LINE

The Sucat-Araneta-Balintawak 230kV Transmission Line Project was conceptualized in the early 1990s to improve the overall electric system reliability and efficiency in Metro Manila and was finished and energized in July 2000.

The distribution lines of Meralco are "physically connected" to the transmission grid and are configured to operate in synchronicity with the lines of TransCo. The subject Sucat-Araneta-Balintawak 230kV Transmission Line of TransCo is located in the heart of Meralco's franchise area and the unrestrained operation of the line is vital to the company's ability to deliver continuous electricity to all its customers.

On March 10, 2000 the residents of Tamarind Road, Dasmariñas Village, Makati asked the RTC-Makati to enjoin NPC from further installing high voltage cables to the steel pylons erected near their homes and from transmitting high voltage electric current through said cables, citing alleged health risks and danger posed by the same. Eventually, the trial court granted the preliminary injunction prayed for by the plaintiffs, which was subsequently reversed by the Court of Appeals. However, on appeal, the Supreme Court of the Philippines (SC) on March 23, 2006 reinstated the orders of the trial court restraining NPC.

When the aforesaid Order of the SC became final, the plaintiffs moved for the execution of the orders rendered by the trial court, which then issued a writ of execution on October 13, 2008. The Company, although initially not a party to the case, was constrained to file an Omnibus Motion (1) for Leave to Intervene and to admit Answer in Intervention, (2) to lift orders, and (3) to maintain status quo due to the significant impact of the de-energization of the Sucat-Araneta line to the public and the economy. In the said Omnibus Motion, Meralco argued that the shutdown of the 230 kV line would result in widespread and rotating brownouts across its franchise area and in a much higher additional purchased power cost to be charged to consumers.

On November 28, 2008 the trial court accepted the Company's Omnibus Motion. It held in abeyance the writ of execution until after the trial court finally rules on the Company's Omnibus Motion for intervention and other incidents.

On September 11, 2009 the trial court issued an Omnibus Order dated September 8, 2009 granting the motions for intervention filed by Meralco and the National Grid Corporation of the Philippines (NGC P) and dissolved the Writ of Preliminary Injunction issued pursuant to the Orders of the trial court dated April 3, 2000 and October 13, 2008 upon the posting of a counter bond, subject to the condition that defendant NPC and intervenors will pay all damages which the plaintiffs may suffer by the dissolution of the Writ of Preliminary Injunction.



# **Subsidiaries**

#### CIS BAYAD CENTER, INC. (CBCI)

CBCI is the country's trailblazer and brand leader in the outsourced over-the-counter (OTC) payment collection industry. It is one of the few corporations in the country certified as an "Investor in People" (IiP) by the People Management Association of the Philippines and the UK-based IiP Quality Centre.

Since its incorporation in 1997, Bayad Center continues to be trusted by top multinational and local organizations with its payment collection requirements and now accepts bills for over 160 leading brands through its strategically located branches all over the Philippines.

Moving forward to 2010, Bayad Center will continue to define and raise the bar in the industry by further increasing its branch network, forging more strategic corporate partnerships and introducing innovative service lines.

#### CLARK ELECTRIC DISTRIBUTION CORPORATION (CEDC)

Clark Electric was organized in 1997 as a joint venture of Clark Development Corporation (CDC) and Meralco Industrial Engineering Services Corporation (MIESCOR), and was created to serve the requirements of the Clark Economic Zone.





CEDC is currently 65% owned by Meralco and 35% by Angeles Electric Corporation. CEDC owns and operates the power distribution facilities within the Clark Special Economic Zone (CSEZ). CEDC is regulated by the ERC and is also subject to the regulation of the CSEZ, insofar as these are consistent with the EPIRA.

#### e-MERALCO VENTURES, INC. (e-MVI)

e-MVI is a 100% Meralco-owned subsidiary tasked to leverage Meralco's fiber optic resources and turn it into a profitable new business.

It operates a telecommunications infrastructure within the Meralco franchise area, offering data transport and connectivity services to local and international carriers, internet service providers, data centers and other businesses.

It is committed to continuously expand its 1,500 km fiber optic network to keep up with the demands of its customers. It has established partnerships in the industry and has been consistent to its carrier's carrier model.

#### MERALCO ENERGY, INC. (MEI)

MEI was formally established in June 2000 to provide demand-side energy services to Meralco's key accounts to complement its parent company with other services facility owners may require. Services include energy management solutions, preventive maintenance of customer substations, electrical testing, emergency troubleshooting and supply and installation of major electrical equipment.

MEI managed its existing services to areas outside of the Meralco franchise on a more sustainable basis. It was also able to explore opportunities from emerging technologies

that further promote energy efficiency such as thermal energy systems, storage battery and advance lighting efficiency programs, while maintaining traditional services in electric facilities and energy management.

MEI, being a wholly-owned subsidiary of the largest distribution utility in the Philippines has a unique advantage in understanding primary and processed energy as well as developing solutions for various energy related concerns.

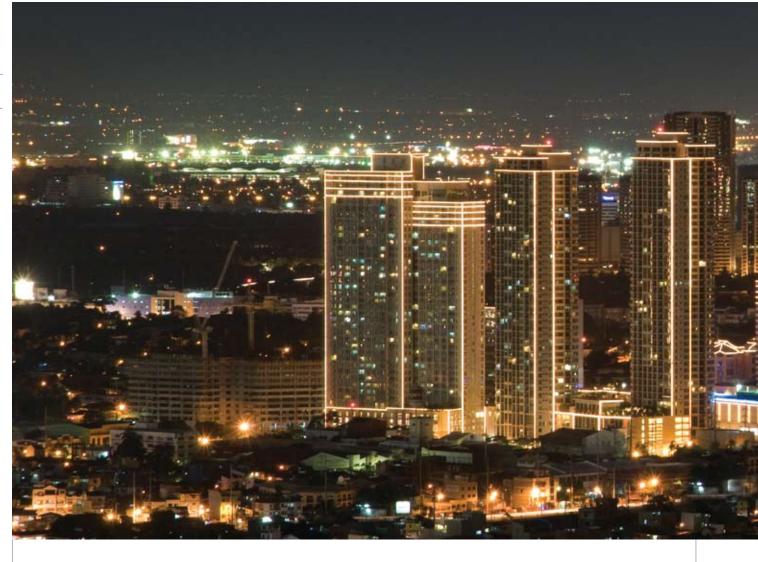
# MERALCO FINANCIAL SERVICES CORPORATION (FINSERVE)

FINSERVE lives true to its vision to create shareholder value by enhancing the range of value-adding services provided by Meralco through a portfolio of products and services that cater to retail and corporate clients.

For the retail base, Finserve together with Banco de Oro created HOME MasterCard, the first home and family oriented credit card that allows Meralco customers to pay their electricity and other utility bills under convenient charging schemes including auto charge and payment on demand.

In servicing the corporate market, Finserve continues to operate its Integrated Direct Marketing (iDM) service which includes direct mail campaigns, targeted advertising and a publication, Current magazine. iDM services are frequently availed by insurance companies, banks, consumer goods companies and educational institutions wanting to reach out to their specific markets.

Also catering to corporate clients, Finserve provides loyalty/ rewards program management to aid companies in their marketing and consumer retention programs such as the Meralco Liwanag Card program.



## MERALCO INDUSTRIAL ENGINEERING SERVICES CORPORATION (MIESCOR)

MIESCOR is engaged in engineering and construction activities related to power generation, transmission, distribution, industrial plants, water resources and telecommunications.

While MIESCOR remains to be Meralco's reliable provider in electro-mechanical works, engineering, distribution and technical services, it also handles telecommunication projects for Meralco, e-MVI and Philippine Long Distance Telephone Company (PLDT). MIESCOR operations is supported by its subsidiaries' MIESCOR Builders Inc. (MBI) and Landbees Corporation. Through their support, MIESCOR was able to expand and provide more diversified services.

Entering into a joint venture with Genials Trading and Contracing Company (GTC), a new subsidiary called Miescorrail, was created. This newly-established subsidiary has recently started its electro-mechanical works for LRT Line 1 North Extension Project-Package C.

GTC, on the other hand, is a general engineering and construction company classified as "B" with the Philippine Contractors Accreditaion Board. It specializes in transit railways, highways and intermodal transit-oriented development projects.

# REPUBLIC SURETY AND INSURANCE COMPANY, INC. (RSIC)

RSIC is professional non-life insurance company acquired in 2007 to align with Meralco's recognition of a disciplined approach in managing its risk exposures.

RSIC envisions itself to be a total risk solution provider and become a major player in the local insurance industry in the near future. It aims to be the most dynamic, pro-active risk management and underwriting company – not just for the parent company and its subsidiaries and affiliated companies in terms of synergistic opportunities, but for the insurance industry as a whole. It has committed to implement risk management methods with the emphasis on risk analysis and mitigation, loss control management and general insurance management.

From a Fire license only when it was acquired, RSIC is now licensed to write the full spectrum of non-life insurance



business to include property (fire and allied perils, industrial all risks and commercial all risks) and engineering, casualty, marine and aviation, motor, surety and special packages.

RSIC continues to renew an insurance program that provides coverage to Meralco's transmission and distribution assets.

#### ROCKWELL LAND CORPORATION (ROCKWELL LAND)

Rockwell Land is one of the premier real estate developers in the Philippines.

It was formed 1995, after the shutdown of the thermal power plant, by the Lopez Group. Its primary task was to transform the old thermal plant property into a high-end commercial business district. The company is 51%-owned by the Manila Electric Company (Meralco) and 49% by First Philippine Holdings Corporation.

Rockwell Center, the company's flagship project, sits on a 15.5-hectare site in Makati City. It is strategically located between the three major commercial business districts of Makati City, Bonifacio Global City and Ortigas. Rockwell Center has been developed into a self-contained, mixeduse community consisting of seven (one under construction) highrise upscale residential towers, three office buildings, a lifestyle shopping mall, a city club, and a leading business graduate school.

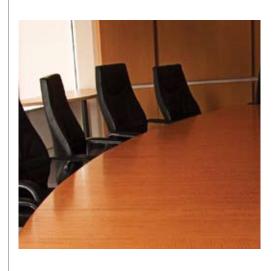
In recent years, Rockwell Land has built a strong brand and track record in property development with its new projects outside the Center such as The Grove, a 5.4-prime hectare property along E. Rodriguez Avenue (commonly known as C-5 Road) and the Rockwell Business Center inside the Meralco Ortigas compound.

#### LIGHTHOUSE OVERSEAS INSURANCE LIMITED (LOIL)

LOIL was incorporated in Bermuda on August 24, 2007, and is registered as a Class 1 insurer under The Bermuda Insurance Act 1978 and Related Regulations. It received its license to operate in the territory in March 2008.

As Meralco's captive Reinsurer, LOIL serves as the vehicle to reinsure its parent's major catastrophic risk exposure. Together with RSIC, LOIL is part of Meralco's business risk management model.

This risk management model was tested in late 2009 when typhoon Ondoy wrought havoc on the Philippines. The devastation affected Meralco's assets but the ensuing loss was mitigated by the in-placed risk management program, where LOIL played a major role.



# Corporate Governance

The Company is now on its 107th year of being the largest electric distribution utility in the Philippines. Its past centenary years marked with consistent operational service excellence and sustained growth and profitability are inimitable testaments of how good corporate management and governance have resided in this Company. The Company takes a strong stand on fulfilling its public service mandate and regulatory accountabilities while continuing to create business value enrichments for all our stakeholders, especially the shareholders.

The Company's philosophy of "Service Excellence with Integrity" conveys its unwavering commitment to high standards of corporate governance principles and practices. Accountability, transparency and integrity are paramount considerations in the development and realization of the Company's strategies, plans and objectives. These, too, are in our evolving culture and tradition creating a mindset that cultivates esteemed values foremost of which is "malasakit."

On top of the Company's mechanism for corporate governance are the pertinent provisions in its Articles of Incorporation and By-Laws, embodying the fundamental structure of the Company, as well as the composition, qualifications, duties and responsibilities of its directors and officers. The adoption of a Manual of Corporate Governance approved by the Board of Directors ("the Board") in August 2002 reinforces the Company's vision towards long-term business opulence and ever-growing shareholder value. This Manual conforms with the requirements of the Code of Corporate Governance mandated by the Philippines' Securities and Exchange Commission (SEC). From its original version, it has undergone subsequent revisions to reflect improvements in the Company's governance structures, practices and programs, as well as include amendments in the SEC Governance Code for mandatory compliance by publiclylisted companies.

The succeeding sections briefly describe the key components in the Company's good corporate governance infrastructure.

Lately, the Company's Manual of Corporate Governance was revised pursuant to SEC Memorandum Circular No. 6, Series of 2009 (Revised Code of Corporate Governance), and in

accordance with the leading standards and best practices of good corporate governance. The Revised Manual was submitted to the SEC on April 14, 2010 and will take effect on May 1, 2010.

#### **BOARD OF DIRECTORS**

#### Key Responsibilities

The primary responsibility of compliance with corporate governance principles is lodged with the Board. The Board controls the affairs of the Company with utmost responsibility and effectiveness, to ensure long-term success and sustained value enhancements for the Company's stakeholders. It establishes the Company's purpose, vision and mission, and strategies to carry out its objectives. The directors are cognizant of their collective and individual responsibilities. Each director acts in good faith, with due diligence and care, and in the best interest of the Company and shareholders.

The Board also oversees the risk management function and the adequacy of internal control mechanisms in the Company to ensure the reliability of financial reporting, efficiency and effectiveness in operations, protection of assets, and compliance with applicable laws and regulations.

There are certain types of decisions which are reserved for approval at the Board level, including those relating to strategic directions, monitoring of Management's performance, operating and capital budgets, acquisitions and disposal of assets, major investments, contracts, and financing transactions.

#### **Board Composition**

The Board is composed of eleven (11) directors. As of the end of December 2009, three (3) are executive directors, two (2) are independent directors, and six (6) are non-executive directors. The Chairman of the Board and Chief Executive Officer is Manuel M. Lopez; while the President and Chief Operating Officer is Jose P. de Jesus. The existing Board structure and practices provide a clear division of responsibilities at the top of the corporation - between the Board exercising oversight function and the Management discharging its executive responsibilities for the business.

The Board represents a mix of expertise, professional competencies and experience necessary to thoroughly examine and deliberate on the various issues and matters affecting the Company. Each director provides value and contributing his own independent judgment to the formulation of sound corporate strategies and policies. The directors have substantially complied with ERC Resolution No. 1, Series of 2004, entitled: "Program to Promote Good Corporate Governance in Distribution Utility" which requires attendance in seminars on Corporate Governance.

The names and profiles of each director are found in the Board of Directors section of this Annual Report and in the Definitive Information Statement.

#### **Election of Directors**

In accordance with the provisions of the Company's By-Laws and Manual of Corporate Governance, the Corporation Code and the Securities Regulation Code (SRC), the nominees to the Board undergo a nomination and screening process through the Board's Nomination and Governance Committee. The directors are elected by stockholders entitled to vote during the Annual Stockholders Meeting. They hold office for one year and until their successors are elected and qualified.

Throughout 2009, the Company has complied with the requirement of the SRC on the number of independent directors - which is at least two (2) directors, or at least twenty percent (20%) of the members of the Board, whichever is the lesser. The independent directors in the Board provide the necessary balance among shareholders and ensure that the interests of minority shareholders are protected. The Company has adopted Rule 38 of the Implementing Rules of the SRC, as amended, on the requirements for the nomination and election of independent directors. The qualifications prescribed by the SRC include:

- (i) independent of Management;
- (ii) does not provide any other service, or receive compensation, income or privileges and benefits other than pertaining to a director;
- (iii) has sufficient knowledge of the Company's business activities and current performance to make informed decisions; and
- (iv) can provide independent judgment and outside experience and objectivity, not subordinated to operational considerations, on all issues which come before the Board.

#### Directors' Fees

The Board approved a reasonable per diem for directors' attendance in Board and Board Committee meetings. The per diem is intended to provide directors a reasonable allowance for attendance in meetings. The level of per diem was the result of a benchmark study among publicly-listed companies comparable with Meralco.

"The Company takes a strong stand on fulfilling its public service mandate and regulatory accountabilities while continuing to create business value enrichments for all our stakeholders, especially the shareholders."

#### **Board Performance**

The Board holds regular monthly meetings and special board meetings to deliberate on major issues affecting the Company. Ordinarily, the Board adopts a formal and sequential agenda for each regular meeting. The agenda include brief reports or updates by the Chairman and the Board Committees, reports on financial performance by the Chief Finance Officer, and operational performance by the President and Chief Operating Officer. The agenda also include items for the Board's deliberation and approval.

In 2009, the Board held twelve (12) regular meetings and one (1) special meeting. The details of attendance of each director in these meetings and in the annual stockholders' meeting and organizational meeting, including changes in membership in the Board are recorded below. The average attendance rate in 2009 was 92% and average duration of meetings was 1.80 hours.

The Corporate Secretary, or in his absence, the Assistant Corporate Secretary provides assistance and advisory services to the directors on their responsibilities and obligations. The Corporate Secretary supplies the directors with detailed reports and materials pertinent to the agenda in Board and Committee meetings, at least a day prior to the scheduled meeting. He also assists any director who may need to communicate with the Management to clarify certain matters submitted for the Board's consideration.

#### **BOARD COMMITTEES**

The Company's Board has five (5) standing committees. All committees have approved Charters which define and specify the scope of their responsibilities.

The functions, authority, and responsibilities of each Board committee, their accomplishments and Board committee members' attendance are as follows.

#### **Executive Committee**

The Executive Committee is composed of five (5) directors, one of whom is an independent director. This committee may act, by majority vote of all its members, on such specific matters within the competence of the Board, as may be delegated to it in the By-laws or on a majority vote of the Board, subject to the limitations provided by the Corporation Code of the Philippines.

In 2009, the Executive Committee met two (2) times. The members' performance attendance of this committee is as follows:

NUMBER OF MEETINGS ATTENDED		
	PRESENT	ABSENT
CHAIRMAN		
Manuel V. Pangilinan	1	1
MEMBERS		
Ramon S. Ang	-	1
Manuel M. Lopez	2	-
Artemio V. Panganiban*	2	1
Vicente L. Panlilio*	2	-
PAST DIRECTORS		
Cesar E.A. Virata	1	-
Felipe B. Alfonso	1	-
* Independent Directors		

#### Nomination and Governance Committee

The Nomination and Governance Committee is composed of at least three (3) directors, one of whom must be independent. This committee is responsible for screening qualified nominees for election as directors; assessing the independence of directors; introducing improvements on board organization and procedures; setting-up of mechanisms for performance evaluation of the Board and Management; and, providing programs for continuing education of the Board, including training for individual directors.

In 2009, the Nomination and Governance Committee held eight (8) meetings. Among the activities undertaken by the committee are the following: review and selection of the nominees for election as members of the Board; review of rules on nomination of candidates, validation of proxies, and appreciation of ballots; review of board committee charters and reorganization of board committees; propose amendment to the Company's By-Laws; and review of revisions to the Manual of Corporate Governance.

The members' performance attendance of this committee is as follows:

NUMBER OF MEETINGS ATTENDED			
	PRESENT	ABSENT	
CHAIRMAN			
Artemio V. Panganiban*	7	-	
MEMBERS			
Estelito P. Mendoza	6	1	
Napoleon L. Nazareno	3	2	
NON-DIRECTOR			
Elpidio L. Ibañez	3	2	
PAST MEMBER			
Vicente L. Panlilio*	1	-	
PAST DIRECTORS			
Christian S. Monsod	3	-	
Felipe B. Alfonso	1	-	
* Independent Directors			

#### Audit and Risk Management Committee

The Audit and Risk Management Committee is composed of at five (5) directors who possess accounting and financial backgrounds, two (2) of whom shall be an independent directors, and another with understanding of auditing concepts and basic auditing processes, or related audit experience or professional accreditation as an auditor. The Chairman is an independent director. This committee assists the Board in fulfilling its oversight responsibilities over the Company's internal and external auditors, the integrity and accuracy of financial statements and financial reporting process, as well as compliance with legal and regulatory matters. It also exercises oversight function on ensuring the effectiveness of the risk management systems in the Company.

The committee held seven (7) meetings in 2009. Among the matters taken-up by the committee are the following: review of the Company's 2008 audited financial statements and 2009 quarterly financial statements; financial performance of subsidiaries and affiliates; actuarial valuation of the Company's pension fund; review and approval of the 2008 Audit Committee report; nomination of the external auditor for 2009; review and approval of the 2009 internal audit plan, budget, and covenants; review of 2008 internal audit performance and report; review of external auditor's 2009 financial statement audit plan and audit fees; evaluation of the Company's risk profile and management structure, systems and processes, and approval of the risk management policy manual; review of the 2008 audited financial statements of the pension fund; and revisions to this committee's charter.

The detailed Audit and Risk Management Committee Report may be found on page 50 of this Annual Report.

The members' performance attendance of this committee is as follows:

NUMBER OF MEETINGS ATTENDED		
	PRESENT	ABSENT
CHAIRMAN		
Vicente L. Panlilio*	7	-
MEMBERS		
Napoleon L. Nazareno	4	-
Alan T. Ortiz	4	-
NON-DIRECTORS		
Aurora T. Calderon	5	2
Elpidio L. Ibañez	4	-
PAST MEMBERS		
Jose P. de Jesus	3	-
Estelito P. Mendoza	-	3
Artemio V. Panganiban*	3	-
* Independent Directors		

#### Compensation and Benefits Committee

The Compensation and Benefits Committee is composed of at least three (3) directors, one of whom shall be an independent director. It is responsible for formulating and developing the overall corporate philosophy and policy on total compensation package of the Board of Directors and officers of the Company. When used in reference to the functions of this committee, "compensation package" covers all types of remuneration including retirement benefits.

The Committee held six (6) meetings in 2009. Discussions and deliberations pertained to the Company's total compensation policy, philosophy and design, 2008 incentive program, 2008 performance evaluation results, and proposals for the 2009 performance management system and plans; performance evaluation of the Chairman and CEO; the Company's balanced scorecard results; promotion policy for officers; nomination and appointments to the pension fund board of trustees; actuarial studies on the pension fund and retirement plan; retirement policy and retirement pay options; granting of committee meeting fees for non-directors; and revision to this committee's charter and change in committee name.

The members' performance attendance of this committee is as follows:

NUMBER OF MEETINGS ATTENDED			
	PRESENT	ABSENT	
CHAIRMAN			
Napoleon L. Nazareno	3	-	
MEMBERS			
Manuel M. Lopez	3	-	
Alan T. Ortiz	3	-	
Vicente L. Panlilio*	3	-	
PAST DIRECTORS			
Cesar E.A. Virata	3	-	
Aurora T. Calderon	3	-	
Christian S. Monsod	2	1	
* Independent Director			

#### **Finance Committee**

The Finance Committee is composed of at least three (3) directors, with the Company's Chief Finance Officer as ex-officio member. Its primary responsibility is to review the financial operations of the Company and other matters pertaining to the acquisition, investments in companies, businesses or projects. It also advises and recommends approval or action on financial matters like establishment of changes in major financial and treasury policies, financing transactions, corporate plans and budgets; major contracts, acquisitions and divestitures, financing guarantees and indemnities, and mortgage of company assets.

This committee held twelve (12) meetings. Among the matters acted upon by the committee were: the approval of the corporate budget; review and approval of the medium-term financial plans; approval of cash dividend declaration for common and preferred shares; review of financial performance of subsidiaries and investment returns; review of quarterly cash projections and finance operations report; review of disbursement approval process; redemption on preferred shares; evaluation of debt refinancing; contribution to the pension fund; divestment of shareholdings in affiliate company; review of major purchases and contracts; and approval of bank accreditation and signing authorities.

The members' performance attendance of this committee is as follows:

NUMBER OF MEETINGS ATTENDED			
	PRESENT	ABSENT	
CHAIRMAN			
Ray C. Espinosa	6	-	
MEMBERS			
Jose P. de Jesus	6	-	
Alan T. Ortiz	4	1	
NON-DIRECTORS			
Anabelle L. Chua	4	2	
Ferdinand K. Constantino	10	1	
PAST MEMBERS			
Ramon S. Ang	-	5	
Estelito P. Mendoza	-	5	
Artemio V. Panganiban*	5	-	
PAST DIRECTORS			
Cesar E.A. Virata	6	-	
Daisy P. Arce	-	1	
Jesus P. Francisco	5	-	
Christian S. Monsod	1	-	
* Independent Director			

#### **MANAGEMENT**

Management's primary accountability is to the Board. It is in charge of the Company's successful implementation of the strategy and direction as approved by the Board.

Management is represented by a Management Committee (ManCom) composed of the corporate officers and executives formed and headed by the Chief Executive Officer, or in his absence, the President. ManCom meets regularly, at least once a week, to ensure the formulation and implementation of major policies and directions governing the Company and its subsidiaries. It reports to the Board during regular Board meetings or during special meetings through the Chief Executive Officer and/or the President. Management also formed various committees to focus on critical functions or processes, like power supply management, procurement and human resources.

Management's performance is annually assessed through the achievement of the Company's established Balanced Scorecard indicators.

The annual compensation of the Company's top officers composed of the Chairman and Chief Executive Officer, the President and Chief Operating Officer, and the heads of the ten (10) major groups of the Company is disclosed in the Definitive Information Statement distributed to the shareholders. This annual compensation includes basic salary, guaranteed

bonuses, fixed allowances, and performance-based pay dependent on the attainment of corporate goals and targets. In order to ensure continued success in managing the Company's operations, structured executive training and development, compensation and benefit plans and succession planning, programs for senior management and the executive levels were put in place.

Management, all employees and the Board of Directors are all subject to the Code of Ethics. This Code of Ethics embodies twelve (12) rules and norms manifesting the company's full commitment and dedication to uphold the fundamental principles of fairness, honesty and integrity. Ethical practices and prudent management of the Company's affairs by Management and the Board are further reinforced through the adoption of a Code on Employee Discipline, Conflict of Interest Policy, Full Business Interest Disclosure, Strategic Guidelines for Major Capital Investment, and Subsidiary Management Policy.

#### **CORPORATE THRUST FOR 2010**

As reaffirmation of its continued commitment to good corporate governance, the Company has taken a step further by making it a corporate thrust for the year 2010 – an integral component of sound strategic business management aimed at enhancing its value of the Company to all stakeholders.

The Company has defined its Corporate Governance framework, which is illustrative of the holistic approach by which a culture of sound moral and ethical values is embedded and observed in all its business processes, systems, and procedures. The fundamental principles of Integrity, Fairness, Accountability, and Transparency have been the Company's overall platform for the development and actual implementation of corporate governance programs and initiatives. As an implementation strategy, the Company has defined the 3 I's of Infrastructure, Information, and Implementation as enablers of corporate governance for the Company:

- Infrastructure all the policies, systems, and structure for setting up corporate governance initiatives in the organization
- Information education and communication through which corporate Governance awareness and appreciation/ understanding may be cascaded at all levels in the organization
- Implementation actual institutionalization and enforcement of the prescribed modes of organizational behavior manifesting good corporate governance

Further, a Corporate Governance Office was created to effectively manage and facilitate corporate governance initiatives. The new office highlights the importance and focus being given to good corporate governance.

#### **ENTERPRISE WIDE RISK MANAGEMENT**

As the Company fortifies its business, it likewise identifies, monitors and manages material risks associated with its business activities, such as regulatory risks. Risk management in the company is institutionalized with the creation of the Risk Management Committee at the Board level, the appointment of a Chief Risk Officer and the creation of an Enterprise Wide Risk Management Office in 2005 which functions as the arm in the development and implementation of a risk management framework and related tools. Since then, business risks at the corporate level are regularly identified, strategies are developed and implemented, and performance is monitored.

#### **ACCOUNTABILITY AND AUDIT**

The Audit and Risk Management Committee performs an oversight role over the performance of the independent and internal auditors. The Chairman of this committee is an independent director, in compliance with the pertinent provisions of the SEC Revised Code of Corporate Governance and the Company's Manual of Corporate Governance.

#### Independent Public Accountants

SyCip, Gorres, Velayo & Company (SGV&Co.) was reappointed as the principal accountant and independent auditor of the Company, through the approval of the shareholders in the annual stockholders' meeting. The engagement partner assigned to the Company since 2008 is Mr. Gemilo J. San Pedro who has extensive accounting and auditing experience. This appointment is in accordance with the SEC regulation that the audit partner principally handling the Company's account is rotated every five (5) years or sooner.

SGV&Co. has not been engaged by the Company to perform non-audit services.

The following fees (in Php million; exclusive of VAT) were incurred by the Company for SGV&Co.'s services.

Audit Fees	8.3
Audit-related Fees	3.4
TOTAL	11.7

Audit-related fees for 2009 pertain to SGV&Co.'s services to the Company's filing of the Business Separation and Unbundling Plan with the Energy Regulatory Commission, audit of the Meralco Pension Fund, and other services required by Management.

There has been no instance of disagreement with the independent auditors on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

#### Internal Auditor

The Company has an independent internal audit function which provides independent advisory and consulting services to help evaluate and improve effectiveness and compliance with the Company's organizational and procedural controls are effective, appropriate and complied with.

Internal Audit conducts its activities guided by The Institute of Internal Auditors' Professional Practices Framework primarily consisting of the International Standards for the Professional Practice of Internal Auditing (ISPPIA) and the Code of Ethics, and the Company's Code of Ethics.

The Head of Corporate Audits as the Chief Audit Executive (CAE) reports functionally to the Audit Committee and administratively to the Chairman and Chief Executive Officer.

#### Internal Control

The primary responsibility for the design, implementation and maintenance of internal controls rests on Management; while the Board and its Audit and Risk Management Committee oversee the actions of Management and monitor the effectiveness of the controls put in place.

#### FINANCIAL REPORTING

The Company's consolidated financial statements were prepared in accordance with the Philippine Financial Reporting Standards, which are aligned with the International Financial Reporting Standards. The year-end audited financial statements are reviewed by the Audit and Risk Management Committee to ensure that they fairly present, in all material respects, the financial position of the Company. In 2009, the review of the Company's financial statements was conducted by the independent auditor. The results of the review were discussed by the Audit and Risk Management Committee and presented to the Board; after which, the financial statements were filed with the SEC and released to the public.

#### **DEALINGS IN SECURITIES**

The Company has established an internal reporting system intended to guide the directors and principal officers when they trade the Company's securities. This is to control the handling and dissemination of price sensitive information and to comply with the disclosure requirements on direct and indirect ownership of the securities of the Company. The concerned directors and principal officers are required to report their trading transactions to the Compliance Officer not later than the following day after the required event or transaction.

In 2009, there has been no case of insider trading, involving directors and Management of the Company.

#### **DISCLOSURES ON OWNERSHIP STRUCTURE**

The Company ensures that it consistently complies with the required disclosure on shareholdings of its securities. It annually discloses the top 20 shareholders of its common shares. It also provides an annual disclosure of security ownership of certain record and beneficial owners who hold more than 5% of its equity shares. In compliance with the SEC requirements, a quarterly report of the Company's top 100 stockholders is disclosed in its website.

#### SHAREHOLDER RELATIONS

The Company recognizes the rights of its shareholders as well as the general investing public to obtain relevant information about the company in a timely and regular basis.

The Company's financial performance and prospects are contained in the regular or mandatory reports submitted to the SEC and PSE. These reports are immediately made available to the public upon confirmation by the SEC of the disclosure receipt, through public release and/or posting in the Company's website.

The Company conducts regular quarterly Investors' Briefings. Representatives of the local and foreign institutional investors, securities, brokerage firms and investment bankers are invited to these briefings. Through conference call, analysts of foreign-based institutional investors and investment banks are afforded the opportunity to participate in such sessions.

Shareholders and investors are provided with adequate means and facility to communicate with and inquire from the Company. The Investor Relations Office supervises the investors' briefings and attends to institutional investors needs; while the Stockholder Affairs attends to the other concerns of the shareholders. Inquiries are entertained by telephone, mail or electronic mail. The Company website (www.meralco.com. ph) also serves as a communication tool and a reference for pertinent information about the Company.

The Annual Stockholders' Meeting likewise provides an opportunity for shareholders to raise questions and clarify issues relevant to the Company. The Board, the Chairman and CEO, Management and the external auditors are present to respond to questions brought up in the meeting.

#### **EMPLOYEE RELATIONS**

The Company is committed to the development and welfare of its employees. All personnel and staff are properly informed, trained, and empowered to do their job well in the spirit of malasakit and teamwork. They are engaged and compensated based on qualification, merit and performance. Their professional growth and career advancement are ensured through the development and implementation of competency-based training, skills enrichment opportunities, and performance evaluation and job promotion plans and programs. Adequate provisions for medical and health support, essential benefits, and workplace safety are constantly provided and available for their protection and wellbeing. Uprightness and impartiality are observed and applied in the resolution of conflicts and disagreements. Management promotes openness and encourages employees to give suggestions and comments on corporate, administrative and operational improvements.

#### COMPLIANCE AND MONITORING

The Board has appointed a Compliance Officer for corporate governance. On a periodic basis, the Compliance Officer discusses with the Nomination and Governance Committee and the Chairman of the Board the status of the Company's compliance with the Manual of Corporate Governance and identifies areas for improvement. The Compliance Officer also seeks from the Nomination and Governance Committee direction and guidance to further elevate the Company's corporate governance practices to higher standards.

The Company considers regulatory compliance as one of the high-priority areas. A Regulatory Management organizational unit is in place to further strengthen and drive more focus in the overall orchestration and management of regulatory management initiatives. Specifically, this unit is responsible for the outcome of major regulatory management processes on regulatory agenda development, policy research, policy advocacy management, rate case management and compliance management. A Regulatory Compliance Officer is also appointed to execute plans and programs related to such regulatory matters.

#### **OBLIGATIONS TO OTHER STAKEHOLDERS**

The Company gives due regard on the impact of business decision on its shareholders and other key stakeholders. An explicit statement of such regard is contained in the Declaration of Corporate Principle of the Company's Revised Manual of Corporate Governance, thus: "The Company adheres to the principles of integrity, accountability, fairness, and transparency to develop and uphold an ethical culture that will protect and promote the best interest of the Company for the common benefit of the Company's stockholders and other stakeholders."

The Company also protects and maintains a cooperative relationship with its creditors who grant unwavering trust and confidence in the provision of financial facility, thus intensifying the company's leverage.

### CORPORATE GOVERNANCE APPLICABILITY TO SUBSIDIARIES

The Company recognizes the equally important contribution of its subsidiaries in boosting the shareholders value and pecuniary yield. To serve as a buttress of corporate governance application in its subsidiaries, a Subsidiary Management Policy has been developed and implemented. This policy institutionalizes a standard set of rules for creating and managing subsidiaries based on the criteria and principles embodied in the Company's Manual of Corporate Governance, Code of Ethics and existing laws, rules and regulations. For 2010, the Company introduced policy changes to strengthen the Company's resolve to improve good governance of subsidiaries. Specifically, a transparent process for the nomination and selection of board members in subsidiaries was defined, which would ensure that the criteria for board directorship is followed including qualifications, composition and conflict of interest situations.

# **Board of Directors**



Land Corporation. He is also Chairman of Rockwell Leisure Club and Indra Phils. Inc. (formerly Soluziona Phils. Inc.). He also holds the following positions: member of the Advisory Board of Philippine Long Distance Telephone Company; Director of First Philippine Holdings Corporation and First Private Power Corporation; Director of Benpres Holdings Corporation and Bauang Private Power Corporation. He also serves as Director of charitable foundations and organizations, in particular Meralco Millennium Foundation Inc. (MMFI), Meralco Management Leadership Development Center Foundation Inc. (MMLDCFI) and Eugenio Lopez Foundation Inc. Mr. Lopez previously served as Director of ABS-CBN Broadcasting Corporation until June 2005 and Chairman of Philippine Commercial Capital, Inc. from March 1986 to January 2006.

#### JOSE P. DE JESUS, 75 Director, President and Chief Operating Officer (since January 26, 2009)

Mr. De Jesus is currently the Chairman and Director of CIS Bayad Center, Meralco Industrial Engineering Services the Director of Republic Surety and Insurance Company, Inc., Lighthouse Overseas Insurance Limited, First Philippine Holdings Corporation, Manila North Tollways Corporation, First Philippine Balfour Corporation Rockwell Land Corporation, and Asian Eye Institute; a Trustee of Meralco Millineum Foundation, Inc., Benigno S. Foundation, Inc. He served as President and Chief Executive Officer of Manila North Tollways Corporation (MNTC) from January 2000 to December 2008.

#### RAMON S. ANG, 56 Director and Vice Chairman (since January 26, 2009)

Mr. Ang is the President and Chief Operating Officer of San Miguel Corporation. He is also the Chairman and Chief Executive Officer of Petron Corporation. He also holds, among others, the following positions: Chairman, President and Managing Director of San Miguel Brewery Inc., San Miguel Beverages, Inc., San Miguel Energy Corp., San Miguel International Ltd. (Bermuda), San Miguel Holdings Limited (BVI) and San Miguel Beverages Pte. Ltd. (Labuan, East Malaysia); Chairman and Managing Director of Liberty Telecoms Holdings Inc., The Purefoods-Hormel Company, Inc., San Miguel Yamamura Packaging Corporation, San Miguel Properties, Inc. and San Miguel Foods, Inc.



Mr. Cuna is presently a Consultant of San Miguel Corporation and INQ Radio; Vice President for Finance and member of the Board of Trustees of the International Association of Business Communicators (IABC) Philippines; and a member of the Presidents' Council and Board of Advisers of the Public Relations Society of the Philippines (PRSP). He is a Governor of the Manila Overseas Press Club (MOPC) and Trustee of Press Club (MOPC) and Trustee of the Philippine Christian Foundation. He was former company spokesman and Vice President for Corporate Communication of Meralco; and was Asia Pacific Regional Director of the IABC.

**RAY C. ESPINOSA, 54** Director (since May 26, 2009)

Atty. Espinosa is the General Counsel of Meralco. He is a Director of Philippine Long Distance Telephone Company (PLDT), Vice Chairman of the PLDT Beneficial Trust Fund, and Head of PLDT Regulatory Affairs and Policy. He is the President and Chief Executive Officer of Mediaquest Holdings, Inc., Associated Broadcasting Corporation, and Mediascape, Inc. He was a partner and member of the Executive Committee of the law firm Sycip Salazar Hernandez & Gatmaitan until June 2000. He has been cited as one of the leading capital market lawyers (1998 – 2002) and project finance lawyers (1996 and 1999) by Asia Law Leading Lawyers and Euromoney Guide to the World's Leading Project Finance Lawyers.

**ELENITA D. GO, 49** (since November 23, 2009)

Vice President of San Miguel

ESTELITO P. MENDOZA, 80 Director (since January 26, 2009)

Atty. Mendoza heads the law firm Estelito P. Mendoza and of San Miguel Corporation, Petron and Chairman of Prestige Travel, Inc. He was a former Solicitor General of the Republic of the Philippines, Minister of Justice and Governor of the Province of Pampanga. He is Chairman Association of the Philippines and of Harvard Alumni Clubs of Asia.

# **Board of Directors**



**NAPOLEON L. NAZARENO, 60** Director (since May 26, 2009)

Mr. Nazareno is the President and Chief Executive Officer of Philippine Long Distance Telephone Company (PLDT), Smart Communications, Inc., Pilipino Telephone Corporation and Connectivity Unlimited Resources Enterprise, Inc. He also serves as Chairman of the Board of Smart Broadband, Inc., Wolfpac Mobile, Inc., I-Contacts Corporation and Airborne Access, Inc. (subsidiaries of SMART). He is also non-executive director at First Pacific Company Limited. Mr. Nazareno is also Board Member of GSM Association Worldwide.

**ARTEMIO V. PANGANIBAN, 73** Independent Director (since May 27, 2008)

Justice Panganiban was formerly the Chief Justice, Supreme Court of the Philippines. Concurrently, he was Chairperson of the Presidential Electoral Tribunal (PET), Judicial and Bar Council, and Philippine Judicial Academy. He is also an Independent Director of First Philippine Holdings Corporation, Metro Pacific Investments Corporation and GMA Network, Inc.; and Robinsons Land Corporation, Manila North Tollways Corporation and Tollways Management Corporation. He is the Senior Adviser of Metropolitan Bank and Trust Company and a columnist of Philippine Daily Inquirer.

of Philippine Long Distance Telephone Company (PLDT), Chief Executive Officer and Managing Director of First Pacific Company Limited, Chairman of Metro Pacific Investments Corporation and Chairman of Smart Communications, Inc. He also holds the following positions: Chairman of Pilipino Telephone Corporation (Piltel) since 2005, Landco Pacific Corporation, Manila North Harbor Port, Inc., Colinas Verdes Corporation, Davao Doctors, Inc., Maynilad Water Services Corporation since 2007, Philex Mining Corporation and Manila North Tollways Corporation since 2008, Mediaquest, Inc., Associated Broadcasting Corporation (TV5), and Medical Doctors, Inc., Chairman of the Board of Trustees of San Beda College, President of Samahang Basketbol ng Pilipinas, Chairman of the Amateur Boxing Association of the Philippines and Philippine Disaster Recovery Foundation, Inc. in 2009, Chairman of Philippine Business for Social Progress, Vice Chairman of Foundation for Crime Prevention since 2001, Trustee of Caritas Manila and Radio Veritas Global Broadcasting Systems, Inc. He was Chairman of the Hong Kong Bayanihan Trust is a member of the Board of Overseers of the Wharton School,

University of Pennsylvania

VICENTE L. PANLILIO, 64 Independent Director (since May 27, 2008)

Mr. Panlilio is a Director of San Fernando Electric Light & Power Co., Inc. He is also a Director of the Philippine Stock Exchange (PSE).



From left: Simeon Ken R. Ferrer, Corporate Secretary and Compliance Officer; Former Directors Christian S. Monsod, Eduardo M. Cojuangco, Jr., Aurora T. Calderon, Alan T. Ortiz, Cesar E.A. Virata, and Jesus P. Francisco

Messrs. Ramon S. Ang, Eduardo M. Cojuangco Jr., Jose P. de Jesus, Estelito P. Mendoza and Ms. Aurora T. Calderon were elected by the Board on January 26, 2009 vice Messrs. Bernardino R. Abes, Felipe B. Alfonso, Winston F. Garcia, Jeremy Z. Parulan and Ms. Daisy P. Arce who resigned in January 2009.

Mr. Elpi O. Cuna and Ms. Elenita D. Go were elected by the Board on November 23, 2009 vice Messrs. Alan T. Ortiz and Mario K. Surio (not in photo) who resigned in November 2009.

Messrs. Eduardo M. Cojuangco, Jr., Jesus P. Francisco, Christian S. Monsod and Ms. Aurora T. Calderon ended their terms on May 26, 2009.

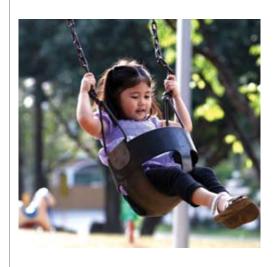
# **Corporate Officers**



Seated, from left: Anthony V. Rosete, Vice President, Assistant Corporate Secretary and Information Disclosure Officer; Leonisa C. de la Llana, Senior Vice President; Martin L. Lopez, Vice President; and Ivanna G. de la Peña, First Vice President

Standing, from left: Ruben B. Benosa, First Vice President; Betty C. Siy-Yap, Senior Vice President and Chief Finance Officer; Ricardo V. Buencamino, Executive Vice President; Roberto R. Almazora, Senior Vice President; Rafael L. Andrada, First Vice President, Treasurer and OIC Information Disclosure Officer; Ramon B. Segismundo, Senior Vice President; Miguel L. Lopez, Vice President





# **Foundations**

#### MERALCO MILLENNIUM FOUNDATION, INC. (MMFI)

Meralco's corporate foundation, MMFI, is registered with the Securities and Exchange Commission on May 8, 2002 as a non-stock, non-profit organization, primarily to initiate, develop, support, finance, undertake or manage programs and projects for socio-economic purposes in any of the four areas of corporate social responsibility, namely Social Investment, Community Sponsorship, Environment Management and Workplace Stewardship.

MMFI's initiatives were geared towards education through the Meralco Sibol Schools in Gawad Kalinga villages, along with other projects such as the Teacher Education Project, Brigada Eskwela, Martsa sa Eskwela and Lugao con Love Feeding Program.

# MERALCO MANAGEMENT AND LEADERSHIP DEVELOPMENT CENTER (MMLDC)

MMLDC, as a non-stock non-profit organization, continues to excel as a world-class training and development center and as an educational foundation duly accredited by the Philippine Council for NGO Certification. Aside from being recognized as the only training center in the country certified in the Integrated Management System (ISO 9001:2000, ISO 14001:2004 and OHSAS 18001:2007), MMLDC has been recognized since 2005 for achieving the Investors in People (IiP) standards by the UK Quality Centre. In December 2009, the Department of Tourism also certified its facilities and services as a recognized training center.

MMLDC, in 2009, provided training solutions and facilities, implemented mission programs and school-based management development programs; development projects, workshops and environment, safety and health assessments in selected schools in Cavite, Antipolo and Caloocan.





# Corporate Social Responsibility

A heritage of making a difference

Through the years, Meralco has built a solid heritage of giving and making a difference in the communities where it lives and works. To help employees make a great impact in these places, the company encouraged volunteerism – where employees share time and resources to causes that they are passionate about.

This corporate heart has captured accolades, the most recent of which was the recognition from regional business publication FinanceAsia magazine in June 2009, as one of the companies in Asia with a "Best in CSR Practice."

#### **EDUCATION AT THE CORE**

At the center of the company's CSR initiatives is education. In 2009, eight Meralco Sibol Schools in Gawad Kalinga (GK) villages, a pre-school for children of families residing in the GK villages, were constructed. Other projects implemented in schools included the Teacher Education Project, Brigada Eskwela, Martsa sa Eskwela and Lugao con Love Feeding Program.

Computer literacy in government and non-government organizations, police organizations and local government units is the aim of the e-Log On Mo na Project, a computer

donations program. A total of 102 organizations benefited from the program in 2009.

#### **BRIGHTENING UP LIVES**

The Dangal Program is Meralco's approach to electrification in depressed communities by espousing the GK principle of uplifting the dignity of communities through the provision and legalization of electric service. Seven GK communities were energized in 2009.

The much-vaunted Filipino values of malasakit and bayanihan came in full force towards the end of the year as typhoons Ondoy and Pepeng inflicted widespread and massive damage to lives and property. Through relief activities, Meralco reached out to 24 typhoon-stricken municipalities and provinces, even to those outside of the company's franchise area including Benguet, Pangasinan, Zambales and Tarlac.

Other outreach activities also benefited Meralco's own service personnel through Project Kasambahay, an annual in-reach activity held in December.





# **Environmental Initiatives**

Preserve and enhance nature's gifts

Meralco intensified its commitment to preserve and enhance the country's natural resources through a more vigorous impementation of sustainable development projects in communities within its franchise.

These projects include:

#### AIR POLLUTION CONTROL

Meralco piloted its Clean Fleet Management Program in its South Distribution Services Area and thereafter, spread the implementation to the other sectors of the company. The program involves shifting to cleaner fuel, re-fleeting, vehicle right-sizing and incorporation of eco-driving in the Company's defensive driving seminar (DDS).

A total of 1,563 vehicles have been subjected to emission testing in compliance to the Clean Air Act. Also, some 200 trees of different kinds have been planted in various Meralco compounds and in Cavite City.

#### WATER CONSERVATION

In response to the call for responsible handling of the country's water resources, Meralco implemented engineering solutions in its compounds to contribute to water conservation.

The company installed water meters in all its sectors and most of the business centers to ensure efficient monitoring of water consumption. Also, the company ensures regular discussion of water conservation tips in all its general environmental safety and health meetings in the sectors and the corporate headquarters.

#### **GREENING/TREE PLANTING**

In 2009, Meralco planted a total of 100 seedlings in support of Cavite City's tree planting project.

The company likewise participated in the Post Disaster Reforestation Project (PDRF) that aims to rehabilitate the Marikina watershed through tree planting and sustainable community programs. The launching was highlighted by the potting of almost 1,000 seedlings in the nursery area located in Boso-Boso, Antipolo City.

#### **BIO-INTENSIVE GARDEN**

In partnership with Haribon Foundation, Meralco implemented the Bio-Intensive Garden (BIG), a backyard farming project in Gawad Kalinga (GK) villages with Meralco Sibol Schools. Six GK villages benefited from the BIG project in 2009.

#### "BANTAY BATERYA" PROJECT

In line with Bantay Kalikasan's "Bantay Baterya" Project, Meralco again turned over junk lead acid batteries to Bantay Kalikasan last year.

#### **SOLID WASTE MANAGEMENT**

All 10 Meralco sectors including the corporate headquarters established ecology centers for effective waste segregation, composting and disposal of garbage throughout the Company.



# Glossary of Terms

#### MERALCO'S UNBUNBLED TARIFF COMPONENTS

#### **CURRENCY EXCHANGE RATE ADJUSTMENT (CERA)**

adjustments for fluctuations in the exchange rate of the Philippine Peso against the US Dollar.

**DISTRIBUTION CHARGE** cost of developing, building, operating and maintaining the distribution system of Meralco, which brings power from high-voltage transmission grids, to commercial and industrial establishments and to residential end-users.

**ENVIRONMENTAL CHARGE** mandated by EPIRA, for the rehabilitation and maintenance of watershed areas surrounding hydroelectric plants for sustained power generation.

**GENERATION CHARGE** cost of power generated and sold to Meralco by its suppliers, the National Power Corporation (NPC), the Independent Power Producers (IPPs), and the Wholesale Electricity Spot Market (WESM).

INTER-CLASS CROSS SUBSIDY CHARGE imposed on industrial and commercial end-users in order to reduce electricity rates of other customer sectors such as the residential end-users, hospitals and streetlights and charitable institutions. This subsidy was fully removed in November 2006.

pricing mechanism provided for by Section 73 of the EPIRA. In Meralco's case, as approved by the ERC, residential customers using up to 100 kWh in a given month will enjoy a Lifeline Discount to be applied to the total of the generation, transmission, system loss, distribution, supply and metering charges. The discount varies according to consumption and is funded by a Lifeline Subsidy Charge to be paid by all other customers.

**LOCAL FRANCHISE TAX** paid local to local government units in accordance with the provision of the Local Government Code.

**METERING CHARGE** cost of reading, operating and maintaining power metering facilities and associated equipment, as well as other costs attributed to the provision of metering service.

MISSIONARY ELECTRIFICATION CHARGE mandated by EPIRA to fund the electrification of remote and unviable areas, as well as areas not connected to the transmission system.

**SUPPLY CHARGE** cost of rendering service to customers, such as billing, collection, customer assistance and associated services.

SYSTEM LOSS CHARGE recovery of the cost of power lost due to technical and non-technical system losses. The maximum level of losses that may be recovered by private distribution utilities was set at 9.5%, by Republic Act 7832, but it was reduced to 8.5% starting 2010, as provided under ERC Resolution No. 17, Series of 2008.

**TRANSMISSION CHARGE** cost of delivery of electricity from generators, usually located in remote areas or provinces, to the distribution system of Meralco. This goes to the National Grid Corporation of the Philippines (NGCP).

#### UNIVERSAL CHARGE NON-BYPASSABLE CHARGE

remitted to the Power Sector Assets and Liabilities Management Corporation (PSALM), owned and controlled by the government, and created by Republic Act 9136. At present, this includes the missionary electrification and environmental charges.

VALUE ADDED TAX (VAT) percent tax (e.g. 12%) imposed on the value of the sale of electricity and related services through all the stages of generation, transmission, distribution and sale of electricity to the final consumer. It is a form of indirect sales tax because the totality of the VAT collected on each sale transaction in all the stages mentioned is charged to the final consumer as part of the purchased price with sellers acting merely as tax collectors.

#### **MERALCO'S TARIFF CATEGORIES**

FLAT STREETLIGHTING SERVICE (FS) rate class applicable to customers who wish to avail of public streetlighting at a fixed monthly rate. Streetlamps for this service are installed by Meralco on existing distribution poles in accordance with company specifications for equipment, installation, maintenance and operation.

#### **GOVERNMENT HOSPITALS AND METERED**

**STREETLIGHTING SERVICE (GHMS)** rate class applicable to government-owned metered streetlights; government hospitals and traffic lights; certain public parks; and, duly registered facilities of charitable institutions.

**INDUSTRIAL SERVICE (IS)** rate class applicable to industrial customers with demand of more than five kilowatts for general power, heating, and/or lighting purposes. This rate category has five sub-classifications:

- Small, for customers with demands greater than five kilowatts but less than 40 kilowatts
- Medium, for customers with demands of at least 40 kilowatts but not more than 200 kilowatts
- Large, for customers with demands greater than 200 kilowatts but less than 2,000 kilowatts

- Very large, for customers with demands of at least 2,000 kilowatts, but less than 10,000 kilowatts
- Extra large, for customers with demand of at least 10,000 kilowatts

NON-INDUSTRIAL SERVICE (NIS) rate class applicable to non-industrial customers with demands of more than five kilowatts for general power, heating and/or lighting purposes. This rate class has four sub-classifications: small, medium, large and very large depending on load, as similarly defined for industrial service, except that very large covers all non-industrial customers with demand of at least 2,000 kilowatts.

**RESIDENTIAL AND GENERAL SERVICE (RGS)** rate class applicable to all domestic customers for purposes such as lighting, heating, etc., in a single dwelling unit. This rate class is also applicable to non-residential customers with a connected load of not more than 5,000 watts.

#### OTHER ELECTRICITY RATE TERMS

AUTOMATIC ADJUSTMENT OF GENERATION AND SYSTEM LOSS CHARGES automatic recovery mechanism promulgated by the ERC that allows the Generation and System Loss Charges to change monthly, depending on the movement in generation costs and the losses per voltage level. This mechanism better reflects the true cost of electricity, since changes in the generation cost are immediately manifested on customers' bills. The automatic nature of the mechanism was suspended in September 2006 following the Supreme Court Decision on Meralco's Second GRAM. The automatic adjustment mechanism resumed in July 2007 upon the effectivity of amendments to EPIRA IRR Section 4(e) of Rule 3. The suspension was lifted by the ERC.

#### **GENERATION RATE ADJUSTMENT MECHANISM (GRAM)**

cost recovery mechanism implemented by the ERC, which allows distribution utilities to file with the ERC on a quarterly basis, for an adjustment in the Generation Charge to cover fluctuation in the price of electricity sourced from the NPC and IPPs. This has been replaced by a new mechanism, covered by the Guidelines for the Automatic Adjustment of the Generation and System Loss Rates by Distribution Utilities.

#### PERFORMANCE-BASED REGULATION (PBR)

internationally accepted ratemaking methodology allowed by Section 43 (f) of the Electric Power Industry Reform Act (R.A. 9136). Replacing the Return-on-Rate Base (RORB) or Cost-Plus regulation, the PBR entails the use of incentive and penalty mechanisms as determined by the performance of the public utility.

RATE BASE the value established by the ERC, on which a utility is allowed to earn a specified rate of return. The rate base represents the utility's appraised asset value — or investment in facilities, equipment and other property used and useful in the provision of electric service — and one-sixth of the utility's annual operations and maintenance expenses.

RETURN ON RATE BASE (RORB) the ratio of operating income to the utility's rate base expressed as a percentage. Meralco's current unbundled tariffs were based on an RORB equivalent to its weighted average cost of capital (WACC) for the year 2000, as determined by the ERC.

#### RULES FOR SETTING DISTRIBUTION WHEELING RATES

(RDWR) alternative form of rate setting methodology recently adopted by the ERC. The RDWR is based on performance-based regulation (PBR), as opposed to the traditional Return on Rate Base methodology. Under this new scheme, utilities are offered incentives to improve performance and reduce costs, which is expected to result in lower electricity rates in the long term. This is an update of the Distribution Wheeling Rates Guidelines (DWRG) considering specific entry points among private distribution utilities.

TIME-OF-USE RATES electricity prices that vary depending on the time periods in which energy is consumed. With time-of-use pricing, higher rates will be charged during hours when the demand for electricity is at its highest, and lower rates during off-peak hours. Demand for electricity peaks at about 11 am, 2 pm and 7 pm. Such rates provide an incentive for consumers to curb power use during peak times, thus reducing the peak system demand of the utility. This can avoid or defer the construction of new power plants, substations, transmission and distribution facilities, freeing much needed resources that can be redirected for other productive activities.

#### **ELECTRIC INDUSTRY PARTICIPANTS**

**DISTRIBUTION UTILITY** Refers to any electric cooperative, private corporation, government-owned utility or existing local government unit which has an exclusive franchise to operate a distribution system in accordance with EPIRA, including DUs operating in the economic zones.

**ENERGY REGULATORY COMMISSION (ERC)** independent regulatory body performing the combined quasi-judicial, quasi-legislative and administrative functions in the electric industry. The ERC was created by the EPIRA and replaced the Energy Regulatory Board (ERB), which previously carried out regulatory and adjudicatory functions pertaining to the energy sector.

**INDEPENDENT POWER PRODUCER (IPP)** non-utility power producers, entities that own and/or operate a generating facility primarily on a wholesale basis and whose facilities do not form any part of a local utility's rate base.

NATIONAL GRID CORPORATION OF THE PHILIPPINES (NGCP) is a privately owned corporation granted, through Republic Act No. 9511, a fifty-year franchise to operate and maintain the country's power transmission grid. NGCP took over the operation of the transmission grid of TransCo starting January 15, 2009.

NATIONAL POWER CORPORATION (NPC) The government corporation created under Republic Act No. 6395, as amended, whose generation assets, real estate, and other disposable assets, except for the assets of SPUG, and IPP contracts, shall be privatized, and whose transmission assets shall be transferred to the Power Sector Assets and Liabilities Management Corporation. -Based on amended PGC

#### PHILIPPINE ELECTRICITY MARKET CORPORATION

(PEMC) created by the Department of Energy (DOE) under Section 30 of the Electric Power Industry Reform Act (R.A. 9136) undertake the preparatory work and maintain, operate and govern the Wholesale Electricity Spot Market (WESM) during its initial operation.

POWER SECTOR ASSETS AND LIABILITY MANAGEMENT CORPORATION (PSALM) corporation owned and controlled by the government created by virtue of the EPIRA. Its principal function is to manage the orderly sale, disposition and privatization of NPC generation assets, real estate and other disposable assets, and IPP contracts.

#### NATIONAL TRANSMISSION CORPORATION (TransCo)

State-owned corporation created by EPIRA to acquire all the transmission assets of NPC and assume its electrical transmission function. Its transmission function was transferred to the private concessionaire NGCP in January 2009 through Republic Act No. 9511. TransCo remains to be the owner of all power transmission assets in the country.

**RETAIL ELECTRICITY SUPPLIER (RES)** is a person or entity authorized by ERC to sell, broker, market or aggregate electricity to end-users in a Contestable Market.

#### WHOLESALE ELECTRICITY SPOT MARKET (WESM)

venue for the trading of electricity as a commodity between generators and suppliers and large consumers. In the WESM, the price for electricity will be based on supply and demand, as the hourly offers submitted by bulk sellers of electricity are matched with submitted demand bids of wholesale buyers of electricity.

#### **OTHER ELECTRIC INDUSTRY TERMS**

**BUSINESS SEPARATION GUIDELINES** The rules and principles for the clear separation of accounts between regulated and non-regulated business activities; and, the structural and functional unbundling requirements that must be implemented and observed by electric power industry participants.

**BUSINESS SEPARATION PLAN** The plan submitted by a market participant pursuant to the Business Separation Guidelines.

#### MAGNA CARTA FOR RESIDENTIAL ELECTRICITY

**CONSUMERS** compilation of residential consumer rights and obligations under existing laws and rules. The Magna Carta balances the interests of both the distribution utilities and the consumers.

**OPEN ACCESS** system of allowing any qualified person the use of transmission and/or distribution system and associated facilities subject to the payment of transmission and/or retail wheeling rates duly approved by the ERC.

**PRIVATIZATION** sale, disposition, change and transfer of ownership and control of assets and IPP contracts from the government or a government corporation to a private person or entity.

**RESTRUCTURING** process of reorganizing the electric power industry in order to introduce higher efficiency, greater innovation and end-user choice. It shall be understood as covering a range of alternatives enhancing exposure of the industry to competitive market forces.

REVISED RULES, TERMS AND CONDITIONS FOR THE PROVISION OF OPEN ACCESS TRANSMISSION SERVICE (REVISED OATS RULES) approved by the ERC in December 2006, outlines the responsibilities of the Transmission Provider and the functions of the System Operator as specified in the Philippine Grid Code and the Wholesale Electricity Spot Market (WESM) Rules.

**TRANSITION SUPPLY CONTRACT (TSC)** a document, as provided in Section 67 of the Electric Power Industry Reform Act (R.A. 9136) that contains the agreement between the generator and distribution utility on the terms and conditions of the energy to be supplied and the corresponding schedule of rates to be applied.

#### **TECHNICAL TERMS**

**AUTOMATIC LOAD DROPPING (ALD)** The process of automatically and deliberately removing pre-selected Loads from a power System in response to an abnormal condition in order to maintain the integrity of the Power System. -Based on amended PGC

CUMULATIVE INTERRUPTION TIME (CIT) cumulative length of power interruption, in hours, that a customer connected to the Meralco distribution system experiences on the average, within a certain time period.

**DISTRIBUTION SYSTEM** The system of wires and associated facilities belonging to a franchised Distribution Utility, extending between the delivery points on the transmission, sub-transmission system, or generating plant connection and the point of connection to the premises of the end-user. -Based on amended PGC

**ELECTRIC POWER GENERATION** process of converting primary energy sources, e.g. flowing water, fossil fuels (oil,coal, and natural gas) and radioactive (uranium) materials, solar radiation, wind and geothermal, into electricity.

**ELECTRIC POWER PLANT** facilities for producing electricity thru electric power generation.

**ENERGY** amount of work done.

**GIGAWATTHOUR (GWh)** unit of electric energy equal to 1.000.000.000 watthours.

**GIGAWATT (GW)** unit of electric power equal to 1,000,000,000 watts.

GRID The high voltage backbone system of interconnected transmission lines, substations and related facilities, located in each of Luzon, Visayas and Mindanao, or as may be determined by the ERC in accordance with Section 45 of the EPIRA. -Based on amended PGC

INTERRUPTION FREQUENCY RATE (IFR) average number of times each customer connected to the Meralco distribution system experiences power interruption within a certain time period. IFR includes pre-arranged, forced and generation/transmission-related interruptions. Forced interruptions results from emergency conditions directly associated with a power system component requiring that it be taken out of service immediately, either automatically or through a switching operation. Examples of interruptions of this nature include those that are initiated by typhoons, fires, earthquakes, equipment failures, trees and other foreign objects touching the lines, and transient faults.

**KILOVOLT-AMPERE** (**kVA**) practical unit of apparent power, equivalent to 1,000 volt-amperes.

KILOWATT (kW) unit of electric power equal to 1,000 watts.

**KILOWATTHOUR** (kWh) unit of energy equal to 1,000 watthours.

LOAD An entity or electrical equipment that consumes or draws electrical energy.-Based on amended PGC

**LOAD FACTOR** The ratio of the total Energy delivered during a given period to the product of the maximum Demand and the number of hours during the same period. -Based on amended PGC

**LUZON GRID** electric power transmission network in the island of Luzon.

MAINTENANCE any activity intended to keep equipment in satisfactory working condition including tests, measurements, replacements, adjustments and repairs that are either corrective or preventive in nature.

MANUAL LOAD DROPPING (MLD) The process of manually and deliberately removing pre-selected Loads from a power System, in response to an abnormal condition, and in order to maintain the integrity of the Power System. -Based on amended PGC

# NATIONAL POWER CORPORATION (NPC) TRANSMISSION AND GENERATION TROUBLES those that arise out of the inability to meet the Meralco system demand due to power plant outage and/or transmission line outage.

due to power plant outage and/or transmission line outage resulting in the reduction of the available power supply. This situation causes the electric power demand to exceed the available supply necessitating instantaneous or scheduled interruption of electric service.

**POWER** time rate of transferring or transforming energy.

**SUBTRANSMISSION LINES** carry power from a bulk power source to distribution substations.

**SYSTEM LOSS** electrical energy lost through line and equipment losses (technical losses) and pilferages (nontechnical losses).

**SYSTEM TROUBLES** interruptions resulting from equipment failure, operating problems, construction troubles and design deficiencies.

**TRANSIENT FAULT** a fault that is self clearing or one that can be cleared by momentary interruptions of the circuit.

#### **OTHERS**

**CALL CENTER PERFORMANCE** This measures the time to answer telephone calls based on the proportion of telephone calls to a regulated entity that are answered within 30 seconds, with certain exclusions.

**CUSTOMER SATISFACTION INDEX** Weighted index that measures general and specific areas of customer satisfaction and priorities. Both satisfaction and level of importance by attribute are dictated by customers through an annual survey (quarterly reading starting 2009). This survey is conducted among residential core and non-core customers.

GSL Guaranteed Service Level, an incentive scheme that provides customers guarantees with regard to responsiveness and effectiveness. IF GSLs are not met, predetermined penalties will be paid by distribution utilities directly to customers.

PIS Performance Incentive Scheme, a mechanism for distribution utilities that rewards or penalizes it for achieving or failing to achieve performance target levels.

S-FACTOR A price-linked incentive scheme that through rewards or penalizes through rate adjustments, using weighted network and service performance measures based on levels achieved over the calendar year preceding each Regulatory Year.

TIME TO CONNECT PREMISES The average time for providing a connection to a Regulated Distribution Service after all government (local and national) approvals have been obtained and the Regulated Entity requirements have been met by the applicant for the service. (also limited to ordinary service applications only)

TIME TO PROCESS APPLICATION The average time between receiving an application for a Regulated Distribution Service (including, for the purpose of this measure, applications for Distribution Connection Services), processing and approving the application. (for the 2nd Regulatory Period, it comprises ordinary service applications or the installation of meter and service drop only.)

# Report of the Audit and Risk Management Committee to the Board of Directors

The Audit and Risk Management Committee's primary role and responsibility, as embodied in its Charter, is to assist the Board of Directors in fulfilling its oversight responsibilities to provide shareholders with timely, meaningful and reliable financial reports and to protect the interests of the shareholders, customers, employees and the public through effective identification, assessment, monitoring and management of risks.

To fulfill its responsibilities, the Audit and Risk Management Committee has focused on the following tasks in 2009:

- An independent director chaired the Committee.
- Held seven (7) meetings during the year.
- Reviewed and discussed the quarterly unaudited consolidated financial statements and the audited consolidated annual financial statements of the Company, including management's significant judgments and estimates that formed part of the financial statements, with the management, the internal auditors and the independent auditors of the Company. Responsibilities on the financial reporting are further defined as follows:
  - Management has the primary responsibility for preparing the financial statements and the financial reporting process; and
  - The independent external auditors are responsible for expressing an opinion on whether the Company's consolidated audited financial statements conform with Philippine Financial Reporting Standards.
- Endorsed the nomination of SGV & Co. as the independent auditors for 2009 to the Board of Directors.
- Discussed and approved the overall scope and respective audit plans of the internal auditors and the independent auditors.
- Discussed and reviewed the results of the audit findings and recommendations of the internal and independent auditors and their assessment of the Company's internal controls and the overall quality of the financial reporting process.
- Reviewed and approved all services provided by independent auditors to the Company and the related fees for such services.
- Reviewed the reports of the internal auditors and regulatory agencies, where applicable, ensuring that management
  is taking timely and appropriate corrective actions, including those addressing internal control and compliance
  issues.

Based on the reviews and discussions undertaken, and subject to the limitations on the roles and responsibilities referred to above, the Audit and Risk Management Committee recommended to the Board of Directors the approval of the audited consolidated financial statements for the year ended December 31, 2009 and their filing with the Securities and Exchange Commission and other regulatory bodies.

On behalf of the Audit and Risk Management Committee,

/ICENTE L. PANLILIO

Chairman, Audit and Risk Management Committee

February 18, 2010

# Statement of Management's Responsibility for Financial Statements

The management of MANILA ELECTRIC COMPANY is responsible for all information and representations contained in the consolidated statements of financial positions as at December 31, 2009 and 2008; the consolidated statements of comprehensive income, consolidated statements of changes in equity; consolidated statements of cash flows for each of the three years in the period ended December 31, 2009, and the summary of significant accounting policies and other explanatory notes. The consolidated financial statements have been prepared in accordance with Philippine Financial Reporting Standards and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition, and liabilities are recognized. The management likewise discloses to the Company's Audit and Risk Management Committee and to its external auditors: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls; and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

The Board of Directors reviews the consolidated financial statements before such statements are approved and submitted to the stockholders of the Company.

SyCip Gorres Velayo & Co., the independent auditors appointed by the Board of Directors and stockholders, have audited the consolidated financial statements of the Company and the major subsidiaries in accordance with auditing standards generally accepted in the Philippines and has expressed its opinion on the fairness of presentation upon completion of such audit, in its report to the Board of Directors and stockholders.

RAFAEL L. ANDRADA Treasurer

MANUEL M LOPEZ

President & COO

Chairman & CEO

#### Independent Auditors' Report

The Stockholders and the Board of Directors Manila Electric Company

We have audited the accompanying financial statements of Manila Electric Company and Subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2009 and 2008, 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, 2009, and a summary of significant accounting policies and other explanatory notes.

#### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Manila Electric Company and Subsidiaries as of December 31, 2009 and 2008, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2009 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Gemilo J. San Pedro

Partner

CPA Certificate No. 32614

SEC Accreditation No. 0094-AR-2 Tax Identification No. 102-096-610

PTR No. 2087569, January 4, 2010, Makati City

February 22, 2010

# Consolidated Statements of Financial Position

		mber 31
	2009	2008
	(Amount	's in Millions)
ASSETS		
Noncurrent Assets		
Jtility plant and others - net (Notes 8, 9, 11 and 19)	₽98,409	₽95,704
Construction in progress (Notes 8 and 9)	3,703	5,149
nvestments in associates and a joint venture (Note 10)	1,203	1,378
nvestment properties - net (Notes 8, 11, 19 and 21)	8,021	5,505
Deferred pass-through fuel costs (Notes 12 and 26)	3,161	3,792
Deferred tax assets - net (Notes 3 and 32)	17	7
Other noncurrent assets - net (Notes 2, 13, 18, 30, 31 and 33)	12,930	9,615
Total Noncurrent Assets	127,444	121,150
Current Assets		
Cash and cash equivalents (Notes 14 and 31)	17,068	5,402
Гrade and other receivables - net (Notes 2, 13, 15, 27, 29 and 31)	21,600	37,509
nventories - at lower of cost or net realizable value (Note 16)	1,857	1,648
and and development costs - net (Notes 11 and 17)	1,191	1,566
Other current assets (Notes 18, 24 and 31)	2,969	2,610
Total Current Assets	44,685	48,735
	₽172,129	₽169,885
EQUITY AND LIABILITIES		
Equity Attributable to Equity Holders of the Parent		
Common stock (Note 19)	₽11,273	₽11,038
Subscriptions receivable	(960)	- 1 11,000
Additional paid-in capital	4,112	2,932
Excess of acquisition cost over carrying value of non-controlling interest acquired	(328)	(328
Employee share-based payment plan (Note 20)	569	268
Unrealized fair value gains on available-for-sale investments (Note 13)	71	47
Share in revaluation increment of subsidiaries and an associate (Notes 10 and 19)	_	129
Share in cumulative translation adjustment of an associate (Note 10)	684	2
Retained earnings (Notes 3 and 19):		
Appropriated	4,198	4,198
Unappropriated	37,750	34,321
Equity Attributable to Equity Holders of the Parent	57,369	52,607
Non-controlling Interests	3,777	3,552
Total Equity	61,146	56,159
Noncurrent Liabilities		
nterest-bearing long-term financial liabilities - net of current portion (Notes 8, 11, 21, 29 and 31)	17,234	13,228
Customers' deposits - net of current portion (Notes 15, 22, 29 and 31)	25,063	23,443
Deposits from condominium units pre-sold (Note 17)	343	36
Deferred tax liabilities - net (Notes 3 and 32)	4,230	4,815
Pension liability (Note 30)	10,301	11,877
Provisions (Notes 23 and 33)	7,492	5,743
Customers' refund - net of current portion (Notes 2, 24 and 31)	_	2,680
Currency exchange rate adjustment (CERA) I and II over-recoveries, including carrying charges -		0.000
net of current portion (Notes 26 and 31)  Other noncurrent liabilities (Notes 26 and 31)	4 407	3,008
Total Noncurrent Liabilities	4,197	3,059
i otal Noncurrent Liabilities	68,860	67,889
Current Liabilities	540	0.000
Notes payable (Notes 25, 29 and 31)	513	9,828
Frade payables and accrued expenses (Notes 2, 12, 21, 22, 26, 27 and 31)	28,261	22,668
ncome tax payable	133	2,285
Customers' refund - current portion (Notes 2, 24 and 31)	9,147 4,069	7,925
nterest- bearing long-term financial liabilities - current portion (Notes 8, 11, 15, 21, 29, and 31)	4,069	3,131
Total Current Liabilities	42,123	45,837
Total Current Liabilities	440.000	440 700
Total Current Liabilities Total Liabilities	110,983	113,726

# Consolidated Statements of Income

	Y	ears Ended Decemi	oer 31
	2009	2008	2007
	(Amounts	in Millions, Except Pe	er Share Data)
REVENUES			
Sale of electricity (Notes 2, 5, 12, 26, 27 and 28)	₽178,686	₽186,999	₽196,171
Sale of real estate (Note 5)	2,877	2,213	2,122
Sale of contracts, services and others (Notes 5 and 11)	3,309	2,563	2,400
	184,872	191,775	200,693
EXPENSES (INCOME)			
Purchased power (Notes 27, 28 and 34)	150,928	156,872	172,837
Operations and maintenance (Notes 15, 20, 27, 29 and 30)	13,902	13,627	13,180
Depreciation and amortization (Notes 8 and 11)	5,064	4,426	4,492
Interest and other financial income (Notes 29 and 31)	(3,924)	(2,919)	(2,147)
Provision (reversal of provision) for probable losses from claims - net	(3,324)	(2,313)	(2,147)
(Notes 23 and 33)	3,351	318	(328)
	3,328		
Interest and other financial charges (Notes 21, 22, 25 and 29)	•	4,135	2,999
Cost of real estate sold (Note 5)	2,230	1,646	1,974
Cost of contracts and services (Note 29)	1,803	1,456	1,415
Provision (reversal of provision) for probable losses from refund - net			
(Notes 23 and 33)	(1,179)	6,617	(646)
Present value impact on customers' refund (Note 24)	555	846	1,096
Foreign exchange gains - net	(266)	(467)	(162)
Equity in net earnings of associates and a joint venture (Note 10)	(245)	(199)	(324)
Cost of guaranteed service level payout	216	_	( ·
Taxes other than income tax	130	217	214
Taxos other than moone tax	175,893	186,575	194,600
INCOME BEFORE INCOME TAX	8,979	5,200	6,093
	0,010	0,200	0,000
PROVISION FOR (BENEFIT FROM) INCOME TAX (Note 32)	0.040	F 400	0.700
Current	3,218	5,122	2,729
Deferred	(595)	(3,055)	(672)
	2,623	2,067	2,057
NET INCOME	₽6,356	₽3,133	₽4,036
Asserbinate by a To			
Attributable To Equity holders of the parent (Note 35)	₽6,005	₽2,800	₽3,759
Non-controlling interests	351	333	277
Non-controlling interests	₽6.356		
	F6,356	₽3,133	₽4,036
Earnings Per Share Attributable to the Equity Holders of the Parent			
(Note 35) Basic	₽5.42	₽2.54	₽3.55
	5.42	2.53	3.53
Diluted	0.42	2.53	ა.53

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Comprehensive Income

	Years Ended December 31		
	2009	2008	2007
		(Amounts in Millions	)
NET INCOME FOR THE YEAR	₽6,356	₽3,133	₽4,036
OTHER COMPREHENSIVE INCOME			
Unrealized fair value gains (losses) on available-for-sale investments	27	(23)	28
Income tax effect	(3)	2	(3)
	24	(21)	25
Share in cumulative translation adjustment of subsidiaries and an associate (Note 10)	682	_	1
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	706	(21)	26
TOTAL COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	₽7,062	₽3,112	₽4,062
Attributable To			
Equity holders of the parent	₽6,711	₽2,779	₽3,785
Non-controlling interests	351	333	277
	₽7,062	₽3,112	₽4,062

See accompanying Notes to Consolidated Financial Statements.

# MANILA ELECTRIC COMPANY AND SUBSIDIARIES

# Consolidated Statements of Changes in Equity

					Equity Attributable to Equity Holders of the Parent	e to Equity Hold	ers of the Parent						
	Common Stock	Subscriptions	Additional Paid in	Excess of Acquisition Cost Over Carrying Value of Non- Controlling	Employee Share-Based Payment Plan	Unrealized Fair Value Gains on Available for-Sale Investments	Share in Revaluation Increment of	Share in Cumulative Translation Adjustment of an Associate	Appropriated Retained Earnings	Unappro- priated Retained Earnings		Non- controlling	Total
	(el ajoni)	Receivable	Capital	naunhow	(INOIE ZU)	(CI AIONI)	(Amounts in Millions)	(NOIE 10)		(Notes 5 and 19)	10181	Sisalaili	Edulty
At January 1, 2009	P11,038	ď	₱2,932	(P328)	P268	P47	P129	<b>19</b>	P4,198	P34,321	P52,607	P3,552	P.56,159
Net income Other comprehensive income	1 1	1 1	1 1	1 1		24		- 682		6,005	6,005	351	6,356
Total comprehensive income	1	ı	ı	1	ı	24	ı	682	ı	6,005	6,711	351	7,062
Share on depreciation of revaluation increment of an associate transferred to unappropriated retained earnings	ı	1	1	ı	ı	ı	(129)	ı	ı	129	I.	ı	1
Issuance of shares	235	(096)	1,481	ı	1 20	1	` I	1	1	I	756	ı	156
Snare-based payments Dividends		, 1	(10c) -	1 1	- 10°		1 1		1 1	(2,705)	(2,705)	(126)	(2,831)
	235	(096)	1,180	1	301	1	(129)	ı	ı	(2,576)	(1,949)	(126)	(2,075)
At December 31, 2009	P11,273	(F960)	P4,112	(P328)	P569	P71	, H-	P684	P4,198	<b>P</b> 37,750	P57,369	P3,777	P61,146
At January 1, 2008	P11,033	aL	P2,931	( <b>P</b> 328)	P152	89 <b>e</b> J	P298	PP2	P200	P37,324	P51,680	P3,341	P55,021
Net income Other commencing income	1		1	1		- (54)		1	1	2,800	2,800	333	3,133
Total comprehensive income		ı		1		(21)		1	ı	2.800	2.779	333	3.112
Share on depreciation of revaluation increment													
of an associate transferred to unappropriated retained earnings	ı	I	I	I	I	I	(169)	I	I	169	I	ı	I
Issuance of shares	2	I	~	I	1	ı	I	ı	I	ı	9	ı	9
Share-based payments	1	1	1	1	116	1	ı	1	3 008	(3008)	116	1 1	116
Dividends	I	I	I	ı	I	I	ı	I	5	(1,974)	(1,974)	(122)	(5,096)
	2	1	-	1	116	1	(169)	1	3,998	(5,803)	(1,852)	(122)	(1,974)
At December 31, 2008	P11,038	aL	P2,932	( <b>P</b> 328)	P268	P47	P129	P2	P4,198	P34,321	P52,607	P3,552	₽56,159
At January 1, 2007	₽9,988	ם	<b>P</b> 2,918	( <b>P</b> 328)	P79	P43	P467	<b>GP</b>	P1,200	<b>P</b> 33,402	P47,770	P3,204	P50,974
Net income Other comprehensive income	1 1	1 1	1 1	1 1	1 1	25	1 1	ı <del>-</del>	1 1	3,759	3,759	277	4,036
Total comprehensive income	1	1	1	1	ı	25	ı	-	ı	3,759	3,785	277	4,062
Share on depreciation of revaluation increment of an associate transferred to													
unappropriated retained earnings	ı	I	ı	I	I	I	(169)	ı	I	169	I	ı	ı
Issuance of shares	1,045	I	13	I	1 g	I	I	I	I	ı	1,058	ı	1,058
Share-based payments Dividends	1 1	1 1	1 1	1 1	S 1	1 1	1 1	1 1	(1,000)	ı (9)	(1,006)	(140)	(1,146)
	1,045	1	13	1	73	1	(169)	1	(1,000)	163	125	(140)	(15)
At December 31, 2007	P11,033	aL	<b>P</b> 2,931	( <b>P</b> 328)	P152	<b>B</b> 98	<b>P</b> 298	<b>P</b> 2	P200	P37,324	P51,680	P3,341	P55,021

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Cash Flows

		Years Ended December 3	1
	2009	2008	2007
		(Amounts in Millions)	
CASH FLOWS FROM OPERATING ACTIVITIES Income before income tax	₽8,979	₽5,200	₽6,093
Adjustments for:	F0,979	F3,200	F0,093
Depreciation and amortization (Notes 8 and 11)	5,064	4,426	4,492
Interest and other financial income (Note 29)	(3,924)	(2,106)	(1,966)
Provision for probable losses from claims (Note 23)	3,351	5,729	5,075
Interest and other financial expenses (Note 29)	2,127	2,308	1,864
Provision (reversal of provision) for probable losses from refund - net	(4.470)	0.047	(0.4.0)
(Notes 6, 23, 26 and 36) Interest expense on bill deposits (Note 29)	(1,179) 1,120	6,617 925	(646) 864
Provision for doubtful accounts, net of recoveries (Note 29)	886	1,563	1.557
Present value impact on customers' refund (Note 24)	555	846	1,096
Equity in net earnings of associates and a joint venture (Note 10)	(245)	(199)	(324)
Employee share-based payment (Note 20)	301	116	73
Foreign exchange gain	(266)	(467)	(162)
Cost of guaranteed service levels payout	216	_	-
Taxes other than income tax	130	217	214
Interest expense on meter deposits (Note 29)  Loss from sale of investment	81 46	89	99
Denating income before working capital changes	17,242	25,264	18,329
Operating income before working capital changes Decrease (increase) in:	17,242	25,264	10,329
Trade and other receivables	15,601	(1,498)	(4,933)
Inventories	(209)	(110)	(502)
Land and development costs	(531)	`421 <sup>′</sup>	(1,349)
Deposits from condominium units pre-sold	307	2,375	(1,164)
Deferred pass-through fuel costs	_	1,104	(1,116)
Other current assets	(1,854)	(314)	386
Increase (decrease) in trade payables and accrued expenses	9,625	(8,568)	(5,666)
Net cash generated from operations	40,181 (1,654)	18,674 (2,093)	3,985 (2,561)
nterest paid ncome tax paid	(1,654) (3,797)	(2,093)	(2,583)
Franchise, realty and other taxes paid	(5,453)	(5,453)	(5,638)
Net cash flows generated from (used in) operating activities	29,277	8,240	(6,797)
CASH FLOWS FROM INVESTING ACTIVITIES	·		, , ,
Additions to:	(0.040)	(9.409)	(C 4CO)
Construction in progress (Note 9) Utility plant and others (Note 8)	(8,040) (187)	(8,498) (629)	(6,469) (326)
Investment properties (Note 11)	(662)	(48)	(74)
Decrease (increase) in:	(002)	(40)	(1-1)
Other noncurrent assets	(1,213)	2,187	(3,364)
Other receivables	` -	(603)	(1,122)
Interest and dividends received (Notes 10 and 29)	1,332	2,472	3,385
Net cash used in investing activities	(8,770)	(5,119)	(7,970)
CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from:			
Notes payable	2,936	9,650	12.180
Long-term debt	12,398	1,235	644
Issuance of subscription to common stock	445	5	_
Payments of:			
Notes payable	(12,251)	(10,570)	(1,742)
Long-term debt	(7,737)	(1,557)	(193)
Customers' refund ncrease (decrease) in:	(2,889)	(1,713)	(1,463)
Customers' deposits	2,913	4,468	1,515
Pension liability	(1,614)	536	522
Other noncurrent liabilities	336	(2,495)	2,430
Dividends paid	(2,820)	(1,960)	(1,006)
Redemption of preferred stock	(558)	(194)	(85)
Net cash flows generated from (used in) financing activities	(8,841)	(2,595)	12,802
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	11,666	526	(1,965)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	5,402	4,876	6,841
CASH AND CASH EQUIVALENTS AT END OF YEAR	₽17,068	₽5,402	₽4,876

#### Notes to Consolidated Financial Statements

#### 1. Corporate Information

In October 1902, the Second Philippine Commission, which had legislative powers to organize the new government, passed on Act No. 484. By virtue of Act No. 484, the franchise to construct, maintain and operate an electric street railway and to furnish electric current for light, heat and power in the city of Manila and its suburbs, was granted in March 1903, to a foreign company, which was later named Manila Electric Railroad and Light Company, now known as Manila Electric Company, or *MERALCO*, or the *Parent Company*.

Under its latest amended Articles of Incorporation, *MERALCO*'s corporate life was extended for another 50 years through 2019. Currently, *MERALCO* distributes and supplies electricity in its franchise area and is subject to the ratemaking regulations and rigid regulatory policies of the Energy Regulatory Commission or *ERC*.

On March 12, 2009, *MERALCO*'s then major shareholders, the *Lopez Group*, consisting of First Philippine Holdings Corporation or *First Holdings*, First Philippine Utilities Corporation or *FPUC* and Lopez, Inc. and, Philippine Long Distance Telephone Company or *PLDT*, entered into an investment and cooperation agreement pursuant to which: (a) *PLDT* agreed to acquire, through its designated affiliate, Pilipino Telephone Company or *Piltel*, 223 million shares in *MERALCO* representing approximately 20% of *MERALCO*'s outstanding shares of common stock, for a cash consideration of ₱20,070 million, or an equivalent ₱90 a share; and (b) *PLDT* and the *Lopez Group* agreed on certain governance matters, including the right of *PLDT* or its designee to nominate certain senior management officers and members of the board of directors or *BOD*, and board committees of *MERALCO*.

As part of the transaction, *Piltel* and *FPUC* also entered into an exchangeable note agreement pursuant to which *Piltel* purchased an exchangeable note dated April 20, 2009, issued by *FPUC*, exchangeable at *Piltel*'s option into approximately 22.2 million shares of common stock of *MERALCO*, which form part of the 223 million shares or approximately 20% of *MERALCO*'s voting common shares to be acquired by *Piltel* in this transaction. The exchange option is exercisable simultaneously with the acquisition of such shares by *Piltel*.

From July through October 2009, Metro Pacific Investments Corporation or *MPIC*, acquired a total of 164 million common shares of *MERALCO*. Such number of shares represents 14.5% of the issued and outstanding capital stock of *MERALCO* as of December 31, 2009. *MPIC* is a Philippine-based infrastructure investment company.

*PLDT* is an affiliate of First Pacific Company Ltd. or *First Pacific*, a Hong Kong-based investment and management company whose shares are listed in the Hong Kong Stock Exchange, while *MPIC* is an indirect subsidiary of *First Pacific*. Collectively, *PLDT* and *MPIC* own 34.5% of *MERALCO*.

In October 2008, San Miguel Corporation or *SMC*, a domestic conglomerate, entered into a sale and purchase agreement with the Government Service Insurance System or *GSIS* to acquire the latter's 27% ownership in *MERALCO*, under pre-agreed terms. The 27% holdings is being represented by nominees of *SMC*.

First Holdings owns 13.23% in MERALCO.

The *Parent Company* holds a congressional franchise under Republic Act or *RA*, No. 9209, which took effect on June 28, 2003, granting the *Parent Company* a 25-year franchise to construct, operate, and maintain an 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 *ERC* granted the *Parent Company* a consolidated Certificate of Public Convenience and Necessity for the operation of electric service within its franchise coverage, effective until June 28, 2028, to coincide with the *Parent Company*'s congressional franchise.

MERALCO is the largest distribution utility or DU, in the Philippines. The electric operating segment consists of operations of the *Parent Company* and its subsidiary, Clark Electric Distribution Corporation or CEDC. Through its other operating segments, it develops and sells real estate properties and provides engineering, construction and consulting, information systems and technology services, among others.

CEDC was organized on February 19, 1997 under a joint venture agreement entered into between Clark Development Corporation or CDC and Meralco Industrial Engineering Services Corporation or MIESCOR. CEDC, which is also subject to extensive regulation by the CDC, a government-owned corporation created as the implementing arm of the Bases Conversion Development Authority to manage and develop the Clark Economic Zone, in so far as these are consistent with RA No. 9136, otherwise known as the Electric Power Industry Reform Act or EPIRA. The franchise of CEDC is co-terminus with the agreement between CEDC and CDC.

The common shares of the Parent Company are listed and traded on the Philippine Stock Exchange or PSE.

The registered office address of the Parent Company is Lopez Building, Ortigas Avenue, Pasig City, Philippines.

The accompanying consolidated financial statements as at December 31, 2009 and 2008, and for each of the three years ended December 31, 2009 were reviewed and recommended for approval by the Audit and Risk Management Committee on February 18, 2010. The same consolidated financial statements were approved and authorized for issue by the *BOD* on February 22, 2010.

#### 2. Rate Regulations

As *DU*s, *MERALCO* and *CEDC* are subject to the rate-making regulations and regulatory policies of the *ERC*. Billings to customers of the *Parent Company* are itemized or "unbundled" into a number of bill components that reflect the various units incurred in providing electric service. The adjustment of 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 in the following bill components: generation charge, transmission charge, system loss charge, lifeline rate subsidies, local franchise and business taxes; and (ii) the "Rules for the Setting of Distribution Wheeling Rates or *RDWR*," as modified by *ERC* Resolution No. 20, Series of 2008, which govern the determination of the *Parent Company's* distribution, supply, and metering charges.

The rate-setting mechanism of *CEDC* is likewise in compliance with *ERC* regulations. After the unbundling of its rates in accordance with *ERC* guidelines, *CEDC* shall also become an entrant to the Performance-Based Regulation, or *PBR*. However, the effective date when *CEDC* shall be under the *PBR* scheme depends on when the *ERC* decides and approves so.

The following is a discussion of matters related to rate-setting of the *Parent Company*:

Rate Applications

PBR Application

The *Parent Company* is among the first entrants to the *PBR*, together with Dagupan Electric Corporation or *DECORP*, and Cagayan Electric and Power Company, or *CEPALCO*.

Rate-setting under *PBR* is governed by the *RDWR*. Unlike the previous Return on Rate Base, or *RORB*, methodology where utility tariffs were based on historical costs plus a reasonable rate of return, the *PBR* scheme sets tariffs according to forecasts of capital and operating expenditures to meet a predetermined level of operational performance. The *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

Rate filings and setting are done on a regulatory period basis, where one regulatory period or *RP* consists of four regulatory years. A regulatory year or *RY*, begins in July and ends in June of the following year. As of December 31, 2009, the *Parent Company* is in the third *RY* of the second *RP*. The second *RP* is from July 1, 2007 to June 30, 2011.

On August 31, 2007, the *ERC* issued its Final Determination setting forth its evaluation of the *Parent Company*'s annual revenue requirement and approved the performance incentive scheme and price control arrangements that will apply to the *Parent Company* during the second regulatory period. The approved Maximum Average Prices or *MAP*s, were \$1.167 per kWh, \$1.260 per kWh, \$1.361 per kWh, and \$1.471 per kWh for the regulatory years 2008, 2009, 2010 and 2011, respectively.

A Motion for Reconsideration and Clarification was filed, with a series of appeals and discussions ensuing, which dealt primarily with the components of the *MAP* determination. Thereafter, on January 11 and April 1, 2008, the *Parent Company* filed separate applications for the approval of its proposed translation of the *MAP* for *RY* 2008 and *RY* 2009 into different rate schedules for the *Parent Company*'s various customer segments. Distribution charge under-recoveries as a result of the delay in the implementation of *PBR* were partly incorporated in the proposed *MAP* of \$\mathbb{P}1.3607\$ per kWh for *RY* 2009.

On October 17, 2008, the *ERC* released its Decision on the *Parent Company*'s rate translation applications. To avoid price shocks and mitigate the rate impact on end-users, the *ERC* subjected the proposed rate to side constraints and approved a *MAP* for *RY* 2009 of ₱1.2280 per kWh. The *ERC*'s Decision also directed the *Parent Company* to implement its approved distribution, supply and metering charges starting July 1, 2008.

#### Notes to Consolidated Financial Statements

However, the *ERC*, acting on a Motion for Reconsideration and Clarification filed by the National Association of Electricity Consumers for Reforms, Inc. or *NASECORE*, a group of electricity consumers, deferred the implementation of the approved charges until such time that the *ERC* can resolve the Motion for Reconsideration and Clarification filed by the group. *MERALCO* eventually received a copy of the consumer group's Motion for Reconsideration and Clarification, to which *MERALCO* filed an opposition on November 19, 2008.

On February 16, 2009, the *ERC* approved the Guidelines for the *RY* 2010 rate reset to guide the first entrants to *PBR* in their next rate application, which was due on March 20, 2009.

In April 2009, the *ERC* approved the implementation of the increase in the *Parent Company*'s average distribution rate for *RY* 2009 of ₱1.2227 per kWh effective for billing periods starting May 2009. This rate is inclusive of ₱0.1285 per kWh representing the recovery of under-recoveries for the calendar year 2007. Under-recoveries for the period 2008 onwards will be considered in future rate petitions.

On May 28, 2009, the *NASECORE* and other consumer groups filed a Petition with the Court of Appeals, or *CA*, questioning the Decision and Order of the *ERC* on the *Parent Company*'s rate translation application. The parties submitted their respective memoranda, after which the case will be deemed submitted for decision. As of February 22, 2010, the case is still pending with the *CA*.

As part of the *PBR*, the *Parent Company* implemented payouts to customers for whom the *Parent Company* failed to meet certain guaranteed service levels or *GSL*, of performance. See *Note 26 – Trade Payables and Accrued Expenses*.

On August 7, 2009, the *Parent Company* filed a petition for the verification of the *MAP* for *RY* 2010 and its translation into tariffs by customer category. In accordance with the *ERC*'s Guidelines for *RY* 2010 Rate Reset for First Entrant Distribution Utilities, the constrained *MAP* for *RY* 2010 was computed to be ₱1.4917 per kWh.

On December 14, 2009, the *ERC* approved the *Parent Company*'s application for approval of: a) *MAP* for the *RY* 2010; and b) translation of the *MAP* for *RY* 2010 into a distribution rate structure for its various customer classes. However, because of a Motion for Reconsideration and Clarification filed by a consumer group against the said *ERC* decision on January 26, 2010, the *Parent Company* filed a manifestation with the *ERC* voluntarily suspending the implementation of the *ERC*'s December 14, 2009 Decision. The suspension will be until such time that the regulator resolves the pending Motion for Reconsideration and Clarification and addresses all other issues other intervenors may raise.

Supreme Court, or SC, Decision on Unbundling Rate Case

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

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 the *ERC*'s authority in rate-fixing, the *SC* also recognized the potential social impact of the matter. Thus, the *SC* directed the *ERC* to request the *COA* to undertake a complete audit of the books, records and accounts of the *Parent Company*. On January 15, 2007, in compliance with the *SC*'s directive, the *ERC* requested the *COA* to conduct an audit of the books, records and accounts of the *Parent Company*. The test periods were calendar years 2004 and 2007.

The status of the COA audit is discussed in Note 33 – Contingencies.

Applications for Recoveries

The Parent Company filed applications with the ERC for recoveries of advances for pass-through costs. These advances consist mainly of unrecovered or differential generation and transmission charges technically referred to as under-recoveries, which are recoverable from the customers, as allowed by law.

#### 10 Applications for the Recovery of Generation Costs

During the period in which the Automatic Generation Rate Adjustment or *AGRA* mechanism was suspended by the *ERC*, the *Parent Company* filed 10 separate applications (*ERC* Case Nos. 2006-052RC, 2006-062RC, 2006-076RC, 2007-001RC, 2007-038RC, 2007-078RC, 2007-101RC, 2007-120RC, 2007-123RC and 2007-135RC) for the full recovery of generation costs, including value-added tax, or *VAT*, incurred for the supply months of August 2006 to May 2007, which resulted in under-recoveries totaling of ₱12,679 million for generation charges and ₱1,295 million for system loss charges.

On January 18, 2008, the *ERC* issued an Order allowing the *Parent Company* to collect the amount of \$\mathbb{P}8,829\$ million through a \$\mathbb{P}0.1662\$ per kWh charge to customers for the generation cost under-recoveries of \$\mathbb{P}12,679\$ million. The charge was implemented beginning February 2008 and has been fully collected as of January 2010.

On September 3, 2008, the *ERC* released a Decision dated June 4, 2008 on the remaining \$\mathbb{P}3,850\$ million, representing the balance of the *Parent Company*'s generation charge under-recoveries. In the said Decision, the *ERC* directed the *Parent Company* to recover \$\mathbb{P}1,149\$ million in generation cost under-recoveries, plus \$\mathbb{P}813\$ million in carrying costs. The balance of \$\mathbb{P}2,701\$ million, which represents the *Parent Company*'s incremental generation cost for energy purchases from the Wholesale Electricity Spot Market or *WESM*, in excess of 10% of the *Parent Company*'s total requirement (for the period from December 2006 to May 2007) was disallowed. It is the *Parent Company*'s position that its purchases from the *WESM* are prudent and mandated by law. As such, these costs are just and reasonable pass-through costs recoverable from its customers. On September 18, 2008, the *Parent Company* filed a Motion for Partial Reconsideration questioning the disallowance of \$\mathbb{P}2,701\$ million. The *ERC* has yet to decide on the *Parent Company*'s motion.

Of the P10,791 million approved for recovery, the *Parent Company* has billed a total of P9,458 million and P4,312 million as of December 31, 2009 and 2008, respectively. The remaining balance of P1,333 million will be billed in 2010 and is shown as part of "Trade and other receivables - Unbilled" account. See *Note 15 – Trade and Other Receivables*.

With respect to the system loss charge under-recoveries of P1,295 million, the *ERC* also ordered the *Parent Company* to file a separate application for the recovery of system loss adjustments after the *ERC* confirms the transmission rate to be used in the calculation of the system loss rate in accordance with the system loss rate formula of the *AGRA* Guidelines. As of February 22, 2010, the *Parent Company* is yet to file the application of recovery of the P1,295 million system loss charge under-recoveries with the *ERC*.

#### Generation Rate Adjustment Mechanism or GRAM, Case

In the March 2003 Decision on the *Parent Company*'s rate unbundling application, the *ERC* directed the *Parent Company* to discontinue implementing the Purchased Power Adjustment or *PPA*, clause with respect to its tariffs. Instead, subsequent changes in the *Parent Company*'s generation charge would be covered by the *ERC*'s *GRAM* rules.

In accordance with the *GRAM* rules, the *Parent Company* made three filings related to its deferred generation cost accounting beginning November 2004 as well as a final *GRAM* filing to account for all generation costs prior to November 2004.

The approval by the *ERC* of the second *GRAM* filing was questioned before the *SC* by a group of electricity consumers on grounds that the *Parent Company* and the *ERC* failed to comply with Section 4(e), Rule 3 of the *EPIRA* Implementing Rules and Regulations or *IRR*, which required publication, notice, and hearing of application prior to issuance of the second *GRAM* Order.

The *GRAM* rules, however, neither require the publication of the application prior to its filing with the *ERC*, nor the conduct of formal hearings thereon.

On February 2, 2006, the *SC* ruled that strict compliance with Section 4(e), Rule 3 of the *EPIRA IRR* is jurisdictional and applies to the *GRAM*. Accordingly, the *ERC*'s second *GRAM* Order was declared void and set aside. On February 20, 2006, the *ERC* and the *Parent Company* filed separate Motions for Reconsideration or *MR*s with the *SC*.

As of December 31, 2009 and 2008, the *Parent Company* has refunded ₱746 million with the balance of ₱34 million as of such dates included as part of other current liabilities under "Trade payables and accrued expenses" account in the consolidated statements of financial position. See *Note 26 – Trade Payables and Accrued Expenses*.

#### Notes to Consolidated Financial Statements

The *Parent Company* will be filing an application with the *ERC* for the recovery of the total generation costs refunded under the second *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.

Application for Recovery of Transmission Costs

In September 2005, the ERC promulgated the rules related to Transmission Rate Adjustment Mechanism or TRAM.

On September 26, 2007, the *Parent Company* filed an application to recover \$\mathbb{P}\$5,554 million in transmission costs advanced by the *Parent Company* over the period June 2003 to July 2007, along with a corresponding carrying cost.

On October 12, 2009, the *ERC* authorized the *Parent Company* to collect transmission under-recoveries of \$\mathbb{P}\$5,348 million inclusive of \$\mathbb{P}\$1,026 million in carrying costs from its customers. The approved amount is net of certain disallowances by the *ERC*, which it claimed the *Parent Company* failed to fully substantiate. The *Parent Company* subsequently filed a Motion for Partial Reconsideration on October 30, 2009, and presented evidence to provide additional explanation and substantiation of the amounts disallowed by the *ERC*.

Also, on October 12, 2009, the *ERC* released an Order on a separate application of the *Parent Company* to offset transmission cost over-recoveries of P4,528 million covering the period August 2007 to April 2009 against the under-recoveries being claimed. The *ERC* provisionally approved the offsetting proposal and directed the *Parent Company* to refund over-recoveries amounting to P4,917 million and carrying costs of P257 million. When offset against the P5,348 million approved for collection by the *ERC*, the net amount to be collected from customers is P174 million. The *Parent Company* has filed a manifestation of its intention to implement the Order, without prejudice to the outcome of the October 30, 2009 Motion for Partial Reconsideration and the hearing on the merits for this offsetting.

The foregoing Decision of the *ERC* with respect to the offsetting arrangement was implemented by the *Parent Company* starting with the November 2009 billing.

Thereafter, on December 29, 2009, the *Parent Company* received an Order dated December 14, 2009 granting with modification, its Motion for Partial Reconsideration of the Decision dated October 12, 2009. The *ERC* reconsidered its earlier Decision and confirmed the revised total under-recoveries of *MERALCO* in the transmission charges for the period from June 2003 to July 2007 to be P6,925 million, with P5,418 million in transmission costs and P1,507 million in carrying costs. Collection of such amounts shall start in January 2010 until such time that the full amount shall have been collected.

Applications for Recovery of Advances for Other Pass-through Costs

Inter-class Cross Subsidy

On November 14, 2007, the *Parent Company* filed a petition for authority to recover \$1,054 million of under-recoveries and a corresponding carrying charge incurred in implementing the inter-class cross subsidy system.

On November 27, 2009, the *Parent Company* received a Decision of the *ERC* dated November 16, 2009, approving, with modification, the subject Application. The *ERC* authorized the *Parent Company* to collect the total inter-class cross subsidy under-recoveries covering the period June 2003 to October 2006 amounting to \$\mathbb{P}\$1,049 million equivalent to \$\mathbb{P}\$0.0103 per kWh until such time that the said amount shall have been fully recovered.

In December 2009, the *Parent Company* filed a Motion for Partial Reconsideration praying that it be allowed to incorporate the inter-class cross subsidy charge under-recoveries as a line item under the "Subsidies" instead of a line item under "Universal Charge." As of February 22, 2010, said Motion is pending before the *ERC*. In the meantime, billing for inter-class cross subsidy is presented as a separate line item in the customers' monthly statements.

Lifeline Subsidy

On February 19, 2008, the *Parent Company* filed an application with the *ERC* for the collection of the under-recoveries incurred in the implementation of the lifeline subsidy amounting to P864 million, with a corresponding carrying cost.

On November 27, 2009, the *Parent Company* received a Decision dated November 16, 2009 approving with modification, the subject application. The *ERC* authorized the *Parent Company* to recover the total lifeline subsidy under-recoveries covering the period June 2003 to December 2007 amounting to ₱856 million, equivalent to ₱0.0068 per kWh, until such time that the said amount shall have been fully recovered.

The decisions with respect to inter-class cross subsidy and lifeline subsidy were implemented beginning with the December 2009 billing cycle. As of December 31, 2009, the total amount recovered for the inter-class cross subsidy and lifeline subsidy is P25 million and P16 million, respectively. The balances of P1,024 million for inter-class cross subsidy and P840 million for lifeline subsidy are expected to be recovered in the next 41 and 51 months, respectively. The current and noncurrent portions of the balances are presented under "Other current assets" and "Other noncurrent assets" accounts, respectively, in the consolidated statements of financial position.

Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities

On August 12, 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 over- or under-recoveries in the following bill components: generation charge, transmission charge, system loss charge, lifeline rate subsidies, local franchise and business taxes.

The rules synchronize the various confirmation and verification processes by the *ERC* for the foregoing charges. In its decision, the *ERC* required *DU*s in Luzon to which the *Parent Company* belongs, to file their consolidated applications to resolve under- or over-recoveries accumulated from the start of their rate unbundling until December 2008, not later than October 30, 2009. Subsequent filings will be every three years thereafter. On October 12, 2009, through Resolution No. 23, series of 2009 dated October 12, 2009, such application was deferred indefinitely. The *ERC* has yet to set the new deadline for the consolidated application.

Meanwhile, on October 8, 2009, the *Parent Company* filed a petition with the *ERC*, seeking the amendment to the *ERC*'s Resolution No. 16, series of 2009. Specifically, the *Parent Company* proposed a modification to the formula used in confirming the system loss charges of *DU*s, from a monthly to an annual reckoning to fairly reflect the actual system loss performance of *DU*s. Up to the present, the reckoning of system loss charges by the *ERC* has been on an annual basis. The petition is currently pending with the *ERC*.

Others

Bureau of Trade Regulation and Consumer Protection of the Department of Trade and Industry, or BTRCP-DTI Petition

On December 10, 2008, the *ERC* denied a Petition filed by the *BTRCP-DTI* with respect to certain charges billed by *MERALCO* as well as proposal on energy sourcing, except with respect to the increase in discounts under the lifeline rate to be given to those using 20kWh or less each month, from 50% to 100%, subject only to the payment of metering charge of \$\mathbb{P}\$5 a month. The modification in the lifeline subsidy system, which is revenue neutral to the *Parent Company*, commenced in February 2009.

An *MR* filed by certain intervenors with respect to the Decision was also denied by the *ERC*. A Petition for Mandamus filed with the *SC* praying that the *ERC* and the *Parent Company* be ordered to stop charging customers the cost of system loss and administrative or company use was also denied on April 15, 2009 for being a wrong remedy and a violation of hierarchy of courts.

Thereafter, on May 21, 2009, a similar Petition for Mandamus was filed before the *CA*, which the *CA* issued a Resolution dated September 1, 2009 directing the *ERC* and the *Parent Company* to file their comment within 10 days from notice. The *Parent Company* and the *ERC* have filed their respective comments to the Petition. The matter is currently pending final decision of the *SC*.

SC Decision on the ₱0.167 per kWh Refund

Following the *SC*'s final ruling that directed the *Parent Company* to refund affected customers ₱0.167 per kWh covering the billing period from February 1994 to April 30, 2003, the *ERC* approved the release of the refund in four phases. The refund is still ongoing. See *Note 24 – Customers' Refund*.

#### 3. Basis of Preparation and Statement of Compliance

The accompanying consolidated financial statements have been prepared on a historical cost basis, except for Parent Company's utility plant and others, and investment properties, which are carried at deemed cost and for derivative financial instruments and available-for-sale or *AFS* financial assets, which are measured at fair value. Derivative financial instruments are shown as part of "Other current assets," "Other noncurrent assets," "Trade payables and accrued expenses" and "Other noncurrent liabilities" accounts in the consolidated statement of financial position. *AFS* 

#### Notes to Consolidated Financial Statements

financial assets are included as part of "Other noncurrent assets" account in the consolidated statement of financial position.

The consolidated financial statements are presented in Philippine peso, the *Company*'s functional and presentation currency, and all values are rounded to the nearest millions (P000,000), except when otherwise indicated.

#### Statement of Compliance

The consolidated financial statements of the *Parent Company* and subsidiaries (collectively referred to as "the *Company*" or "*MERALCO Group*," have been prepared in compliance with Philippine Financial Reporting Standards or *PFRS*. *PFRS* include statements named *PFRS* and Philippine Accounting Standards or *PAS*, including Interpretations issued by the Philippine Financial Reporting Standards Council.

#### Basis of Consolidation

The consolidated financial statements comprise the financial statements of *MERALCO* and its subsidiaries as at December 31 of each year, except for *MIESCOR* and its subsidiaries, whose financial reporting date ends at September 30. Adjustments and disclosures are made for the effects of significant transactions or events that occurred between the date of *MIESCOR*'s financial statements and the date of the consolidated financial statements.

The consolidated financial statements include the financial statements of the *Parent Company* and the following directly and indirectly-owned subsidiaries as of December 31:

			Pe	ercentage of	f Ownersh	ip
	Place of	_	20	09	20	08
Subsidiary	Incorporation	Principal Business Activity	Direct	Indirect	Direct	Indirect
Corporate Information Solutions, Inc. or CIS	Philippines	e-Transactions	100	_	100	
CIS Bayad Center, Inc.	Philippines	Bills payment collection	_	100	_	100
Outsourced Telleserve Corporation or OTC	Philippines	Tellering services	-	100	_	100
Meralco Energy, Inc. or MEI	Philippines	Energy systems				
		management	100	_	100	_
eMERALCO Ventures, Inc. or eMVI	Philippines	e-Business development	100	_	100	_
Asian Center for Energy Management*	Philippines	Research and development	100	_	100	_
Meralco Financial Services Corporation						
or <i>Finserve</i>	Philippines	Financial services provider	100	_	100	_
Republic Surety and Insurance Company Inc.						
or RSIC	Philippines	Insurance	100	_	100	_
Lighthouse Overseas Insurance Company,						
Limited or LOIL	Bermuda	Insurance	100	_	100	_
MIESCOR	Philippines	Engineering, construction				
		and consulting services	99	_	99	_
MIESCOR Builders Inc. or MBI	Philippines	Electric transmission and				
		distribution operation				
		and maintenance	_	99	_	99
Landbees Corporation or Landbees	Philippines	General services,				
		manpower/maintenance	_	99	_	99
Miescorrail, Inc. or Miescorrail**	Philippines	Engineering and construction	_	59	_	_
CEDC	Philippines	Power distribution	65	_	65	_
Rockwell Land Corporation or Rockwell Land	Philippines	Real estate	51	-	51	-

<sup>\*</sup> In the process of dissolution

#### Basis of Consolidation from January 1, 2009

Subsidiaries are fully consolidated from the date of acquisition, being the date at which the MERALCO Group obtains control, and continue to be consolidated until the date that such control ceases.

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.

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

Non-controlling interest (previously referred to as "minority interest") shares in losses even if the losses exceed the non-controlling equity interest in the subsidiary.

<sup>\*\*</sup> Miescorrail was incorporated in June 2009 to engage in the mass transit business. As of December 31, 2009, it has contract for the construction of the LRT Line North Extension Project through April 24, 2010.

If the control over a subsidiary is lost, the *Company*: (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 differences recorded 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 the parent's share of components previously recognized in the consolidated statement of comprehensive income to the consolidated statement of income.

#### Basis of Consolidation Prior to January 1, 2009

In comparison to the foregoing policies, which are applied on a prospective basis, the following differences applied:
(a) acquisition of non-controlling interests was accounted for using the entity concept method, whereby, the difference between the fair value of the consideration transferred and the net book value of the share in the net assets acquired is treated as an equity transaction and recognized as "Excess of acquisition cost over carrying value of non-controlling interest acquired" in the equity section of the consolidated statement of financial position.

Non-controlling interests represent the portion of profit or loss and net assets in *MIESCOR* and its subsidiaries, *CEDC* and *Rockwell Land* not held by the *Company* and are presented separately in the consolidated statements of income and within equity in the consolidated statement of financial position, separately from parent equity, respectively.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions that are recognized in the consolidated financial statements, are eliminated in full.

In 2009, certain accounts in the 2008 consolidated statement of financial position have been reclassified to conform with the current financial statements presentation. An amount from advances for construction was reclassified from trade payables and accrued expenses to other noncurrent liabilities, which resulted in decrease in current liabilities and increase in noncurrent liabilities by \$2,220 million. Deferred tax assets and liabilities were offset on a per entity basis, which resulted in decrease in consolidated deferred tax assets and liabilities by \$8,526 million as of December 31, 2008. The balance of revaluation increment in utility plant and others as of December 31, 2008 was transferred to and increased unappropriated retained earnings by \$19,926 million. The retrospective restatement has no material impact on the comparative statements of financial position.

#### 4. Changes in Accounting Policies

New Standards and Interpretations Issued and Effective as of January 1, 2009

The accounting policies adopted are consistent with those of the previous financial year except with respect to the adoption of the following new and amended *PFRS* that became effective beginning January 1, 2009. Adoption of these changes in *PFRS* did not have any significant effect on the *Company*'s consolidated financial statements, unless otherwise indicated.

#### PAS 1, Presentation of Financial Statements

The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity. In addition, the standard introduces the statement of comprehensive income: it presents all items of recognized income and expense, either in one single statement, or in two linked statements. The *Company* has elected to present two linked statements.

#### PAS 23, Borrowing Costs (Revised)

The revised *PAS* 23 requires capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. The adoption of this standard did not have any impact on the financial position or the performance of the *Company* as it has been the policy of the *Company* to capitalize borrowing costs attributable to qualifying assets.

#### PFRS 8, Operating Segments

*PFRS 8* replaced *PAS* 14, *Segment Reporting*. This standard is only applicable to an entity with debt or equity instruments that are traded in a public market or that files (or is in the process of filing) its financial statements with a securities commission or similar party. The *Company* concluded that the operating segments determined in accordance with *PFRS 8* are the same as the business segments previously identified under *PAS* 14. See *Note 7 – Segment Information*.

#### Notes to Consolidated Financial Statements

Philippine Interpretation IFRIC 13, Customer Loyalty Programmes

Philippine Interpretation *IFRIC 13* requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to the award credits and deferred. This is then recognized as revenue over the period that the award credits are redeemed. The adoption of this interpretation did not have any impact on the financial position or the performance of the *Company*.

Philippine Interpretation IFRIC 16, Hedges of a Net Investment in a Foreign Operation

This Interpretation is to be applied prospectively. Philippine Interpretation *IFRIC 16* provides guidance on the accounting for a hedge of a net investment. As such, it provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of a net investment, where within the group the hedging instruments can be held in the hedge of a net investment and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment.

Philippine Interpretation IFRIC 18, Transfers of Assets from Customers

This Interpretation is to be applied prospectively to transfers of assets from customers received on or after July 1, 2009. The Interpretation provides guidance on how to account for items of property, plant and equipment received from customers or cash that is received and used to acquire or construct assets that are used to connect the customer to a network or to provide ongoing access to a supply of goods or services or both. When the transferred item meets the definition of an asset, the asset is measured at fair value on initial recognition as part of an exchange transaction. The services delivered are identified and the consideration received (the fair value of the asset) is allocated to each identifiable service. Revenue is recognized as each service is delivered by the entity. Adoption of this standard did not have any material impact on the financial position or the performance of the *Company*.

PAS 32 and PAS 1 Amendments –Puttable Financial Instruments and Obligations Arising on Liquidation

The standards have been amended to allow a limited scope exception for puttable financial instruments to be classified as equity if they fulfill a number of specified criteria. The adoption of these amendments did not have any impact on the financial position or the performance of the *Company* as the *Company* has not issued such instruments.

PFRS 1 and PAS 27 Amendments –Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate

The amendments to *PFRS 1, First-time Adoption of Philippine Financial Reporting Standards*, allowed an entity to determine the "cost" of investments in subsidiaries, jointly controlled entities or associates in its opening *PFRS* financial statements in accordance with *PAS 27, Consolidated and Separate Financial Statements*, or using a deemed cost method. The amendment to *PAS 27* required all dividends from a subsidiary, jointly controlled entity or associate to be recognized in the statement of income in the separate financial statements. The revision to *PAS 27* was applied prospectively.

PFRS 2 Amendment - Vesting Conditions and Cancellations

The amendment to *PFRS 2, Share-based Payment*, clarifies the definition of vesting conditions and prescribes the treatment for an award that is cancelled. The adoption of this amendment did not have any impact on the financial position or the performance of the *Company* as the *Company* has not entered into share-based payment schemes with non-vesting conditions attached.

PFRS 7 Amendments – Improving Disclosures about Financial Instruments

The amendments to *PFRS 7*, *Financial Instruments: Disclosures*, require additional disclosures about fair value measurement and liquidity risk. Fair value measurements related to items recorded at fair value are to be disclosed by source of inputs using a three-level fair value hierarchy, by class, for all financial instruments recognized at fair value. In addition, a reconciliation between the beginning and ending balances for level 3 fair value measurements is now required, as well as significant transfers between levels in the fair value hierarchy. The amendments also clarify the requirements for liquidity risk disclosures with respect to derivative transactions and financial assets used for liquidity management. The liquidity risk disclosures are not significantly impacted by the amendments. See *Note 31 – Financial Assets and Liabilities*.

#### Philippine Interpretation IFRIC 9 and PAS 39 Amendments - Embedded Derivatives

This amendment to Philippine Interpretation *IFRIC 9, Reassessment of Embedded Derivatives*, requires an entity to assess whether an embedded derivative must be separated from a host contract when the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significantly change the cash flows of the contract. *PAS 39, Financial Instruments: Recognition and Measurement*, now states that if an embedded derivative cannot be reliably measured, the entire hybrid instrument must remain classified as at fair value through profit or loss. The adoption of these amendments did not have any impact on the financial position or the performance of the *Company*.

The omnibus amendments to *PFRS* issued in 2008 (and 2009) were issued primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes in accounting policies but did not have any impact on the financial position or the performance of the *Company*.

#### PAS 40, Investment Properties

The amendment to PAS 40 raises the scope (and the scope of PAS 16, Property, Plant and Equipment) to include property that is being constructed or developed for future use as an investment property. Where an entity is unable to determine the fair value of an investment property under construction, but expects to be able to determine its fair value on completion, the investment under construction will be measured at cost until such time as fair value can be determined or construction is complete. Adoption of this amendment resulted to change in accounting policies on investment properties and construction in progress.

#### PAS 18. Revenue

The amendment adds guidance (which accompanies the standard) to determine whether an entity is acting as a principal or as an agent. The features to consider are whether the entity: (a) has primary responsibility for providing the goods or services; (b) has inventory risk; (c) has discretion in establishing prices; and (d) bears the credit risk.

The *Company* has assessed its revenue arrangements against these criteria and concluded that it is acting as principal in all arrangements. The revenue recognition policy has been updated accordingly.

Revisions and Amendments to Existing Standards Early Adopted

PFRS 3, Business Combinations (Revised), and PAS 27, Consolidated and Separate Financial Statements (Amended)

The revised standards are effective for annual periods beginning on or after July 1, 2009. *PFRS 3 (Revised)* introduces significant changes in the accounting for business combinations occurring after this date. Changes affect the valuation of non-controlling interest, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration and business combinations achieved in stages. These changes will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs and future reported results. *PAS 27 (Amended)* requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes by *PFRS 3 (Revised)* and *PAS 27 (Amended)* will affect future acquisitions or loss of control of subsidiaries and transactions with non-controlling interests. *PFRS 3 (Revised)* will be applied prospectively while *PAS 27 (Amended)* will be applied retrospectively with a few exceptions. The early adoption of these revisions and amendments has no impact on the financial position or the performance of the *Company*.

New Accounting Standards, Interpretations and Amendments to Existing Standards Effective Subsequent to December 31, 2009

The *Company* will adopt the following standards and interpretations enumerated below when these become effective. Except as otherwise indicated, the *Company* does not expect the adoption of these new or amended *PFRS* and Philippine Interpretations to have significant impact on its consolidated financial statements.

Philippine Interpretation IFRIC 15, Agreement for the Construction of Real Estate

This Philippine Interpretation, effective for annual periods beginning on or after January 1, 2012, covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through

#### Notes to Consolidated Financial Statements

subcontractors. The Interpretation requires that revenue on construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under *PAS 11*, *Construction Contracts*, or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the construction materials and where the risks and rewards of ownership are transferred to the buyer on a continuous basis will also be accounted for based on stage of completion. The *Company* will apply this interpretation in 2012. Adoption of this interpretation will result in a change in the revenue recognized on sale of condominium units.

Philippine Interpretation IFRIC 17, Distributions of Non-cash Assets to Owners

This Philippine Interpretation is effective for annual periods beginning on or after July 1, 2009 with early application permitted. It provides guidance on how to account for non-cash distributions to owners. The interpretation clarifies when to recognize a liability, how to measure it and the associated assets, and when to derecognize the asset and liability. The *Company* will apply this in 2010. The *Company* is in the process of assessing the impact of the adoption of the interpretation in the consolidated financial statements.

PAS 39 Amendment - Eligible Hedged Items

The amendment to *PAS 39, Financial Instruments: Recognition and Measurement,* effective for annual periods beginning on or after July 1, 2009, clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item. This also covers the designation of inflation as a hedged risk or portion in particular situations. The *Company* has concluded that the amendment will have no impact on the financial position or the performance of the *Company*, as the *Company* has not entered into any such hedges.

PFRS 2 Amendments - Group Cash-settled Share-based Payment Transactions

The amendments to *PFRS 2, Share-based Payment*, effective for annual periods beginning on or after January 1, 2010, clarify the scope and the accounting for group cash-settled share-based payment transactions. The *Company* has concluded that the amendment will have no impact on the financial position or the performance of the *Company* as the *Company* has not entered into any cash-settled share-based payment transactions.

The omnibus amendments to *PFRS* issued in 2009 were issued primarily with a view to removing inconsistencies and clarifying wording. The amendments are effective for annual periods beginning on or after January 1, 2010, except when otherwise stated. The *Company* has not yet adopted the following amendments and anticipates that these changes will have no material effect on the consolidated financial statements.

PFRS 2, Share-based Payment, clarifies that the contribution of a business on formation of a joint venture and combinations under common control are not within the scope of PFRS 2 even though they are out of scope of PFRS 3, Business Combinations (Revised). The amendment is effective for annual periods beginning on or after July 1, 2009.

PFRS 5, Noncurrent Assets Held for Sale and Discontinued Operations, clarifies that the disclosures required in respect of noncurrent assets and disposal groups classified as held for sale or discontinued operations are only those set out in PFRS 5. The disclosure requirements of other PFRS only apply if specifically required for such noncurrent assets or discontinued operations.

PFRS 8, Operating Segments, clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision-maker.

PAS 1, Presentation of Financial Statements, clarifies that the terms of a liability that could result, at anytime, in its settlement by the issuance of equity instruments at the option of the counterparty do not affect its classification.

PAS 7, Statement of Cash Flows, explicitly states that only expenditure that results in a recognized asset can be classified as a cash flow from investing activities.

*PAS 17, Leases*, removes the specific guidance on classifying land as a lease. Prior to the amendment, leases of land were classified as operating leases. The amendment now requires that leases of land are classified as either "finance" or "operating" in accordance with the general principles of *PAS 17*. The amendments will be applied retrospectively.

*PAS 36, Impairment of Assets*, clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in *PFRS 8* before aggregation for reporting purposes.

PAS 38, Intangible Assets, clarifies that if an intangible asset acquired in a business combination is identifiable only with another intangible asset, the acquirer may recognize the group of intangible assets as a single asset provided the individual assets have similar useful lives. Also clarifies that the valuation techniques presented for determining the fair value of intangible assets acquired in a business combination that are not traded in active markets are only examples and are not restrictive on the methods that can be used.

PAS 39, Financial Instruments: Recognition and Measurement, clarifies the following:

- that a prepayment option is considered closely related to the host contract when the exercise price of a
  prepayment option reimburses the lender up to the approximate present value of lost interest for the remaining
  term of the host contract.
- that the scope exemption for contracts between an acquirer and a vendor in a business combination to buy or sell
  an acquiree at a future date applies only to binding forward contracts, and not derivative contracts where further
  actions by either party are still to be taken.
- that gains or losses on cash flow hedges of a forecast transaction that subsequently results in the recognition of a financial instrument or on cash flow hedges of recognized financial instruments should be reclassified in the period that the hedged forecast cash flows affect profit or loss.

Philippine Interpretation IFRIC 9, Reassessment of Embedded Derivatives, clarifies that it does not apply to possible reassessment at the date of acquisition, to embedded derivatives in contracts acquired in a business combination between entities or businesses under common control or the formation of joint venture.

Philippine Interpretation IFRIC 16, Hedge of a Net Investment in a Foreign Operation, states that, in a hedge of a net investment in a foreign operation, qualifying hedging instruments may be held by any entity or entities within the group, including the foreign operation itself, as long as the designation, documentation and effectiveness requirements of PAS 39 that relate to a net investment hedge are satisfied.

#### 5. Summary of Significant Accounting Policies

The principal accounting policies adopted in preparing the consolidated financial statements of the *Company* are as follows:

Utility Plant and Others

Utility plant and others, except land, are stated at cost, excluding amounts related to day-to-day servicing, less accumulated depreciation and any impairment loss. Such costs include the cost of replacing part of such utility plant and other properties when that cost is incurred, if the recognition criteria are met. The cost of each major inspection performed is recognized in the carrying amount of utility plant and others as a replacement if the recognition criteria are satisfied. 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 its 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 Parent Company's utility plant and others acquired up to January 1, 2004 are stated at deemed cost. The recorded revalued amount as of 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 19 – Equity* for the related discussion.

Depreciation and amortization of utility plant and others of the *Company* is computed using the straight-line method (except for certain subtransmission and distribution assets, which use straight-line functional group method) over the following estimated useful lives:

Asset Type	Estimated Useful Lives
Subtransmission and distribution	10–50 years, depending on the life of the significant parts
Others:	
Buildings and improvements	15–40 years
Communication equipment	10 years
Office furniture, fixtures and other equipment	5 years
Transportation equipment	5–10 years
Others	5–20 years

#### Notes to Consolidated Financial Statements

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 on 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 financial year-end to ensure that the period and method 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 of subtransmission and distribution substations and buildings and others is stated at cost, which includes cost of construction, plant and equipment 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 use.

#### **Borrowing Costs**

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of the respective asset. A qualifying asset is an item of utility plant and others 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 to prepare the asset are in progress and expenditures and borrowing costs are being incurred, and ceases when the assets are substantially ready for their intended use.

If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized. Borrowing costs consist of 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 these projects, to the extent that they are regarded as an adjustment to interest costs.

All other borrowing costs are expensed in the period these are incurred.

#### Investment Properties

Investment properties, except land, are measured at cost, including transaction costs less accumulated depreciation and any impairment in value. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property. Depreciation is calculated on a straight-line basis over the useful lives of investment properties.

Land is carried at cost less any impairment in value.

The Parent Company's investment properties acquired up to January 1, 2004 are stated at deemed cost. See Note 19 – Equity for the related discussion.

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

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

#### Asset Retirement Obligations

Under the terms of certain of the *Company*'s lease contracts, the *Company* is required to dismantle the installation in leased sites and restore such sites to their original condition at the end of the lease contract term. The *Company* recognizes 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. The amount of asset retirement obligations is accreted and such accretion is recognized as interest expense.

### Investments in Associates

Investments in associates are accounted for using the equity method in the consolidated financial statements. An associate is an entity over which the *Company* has significant influence and which is neither a subsidiary nor a joint venture

Under the equity method, the investment in an associate is carried in the consolidated statement of financial position at cost plus post-acquisition changes in the *Company*'s share of net assets of the associate, less any impairment in value. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized nor individually tested for impairment. The consolidated statement of income reflects the *Company*'s share of the results of operations of the associates. Where there has been a change recognized directly in comprehensive income and in the equity of the associate, the *Company* recognizes its share in any changes and discloses this, when applicable, in the consolidated statements of comprehensive income and changes in equity. Unrealized gains and losses resulting from transactions between and among the *Company* and the associates are eliminated to the extent of the interest in those associates.

The share in profits and losses of associates is shown on the face of the consolidated statement of income. This is the profit or loss attributable to equity holders of the associate and therefore is profit or loss after tax and non-controlling interest in the subsidiaries of the associates. The interest in the associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the net investment in the associate. Losses recognized under the equity method in excess of the investor's investment in ordinary shares are applied to the other components of the interest in an associate in the reverse order such was contracted (e.g., priority in liquidation). After the interest in associate is reduced to zero, additional losses are provided for, and a liability is recognized only to the extent that the *Company* has incurred legal or constructive obligations or will make payments on behalf of the associate. If the associate subsequently reports profits, recognition of share of profits resume only after the share of the profits equals the share of losses not previously recognized.

The reporting dates of the associates and the *Company* are identical and the associates' accounting policies conform with those used by the *Company* for like transactions and events in similar circumstances.

### Interest in a Joint Venture

The *Company*'s interest in Indra Philippines, Inc., or *Indra Philippines*, (formerly Soluziona Philippines, Inc.), a joint venture, is accounted for using the equity method of accounting in the consolidated financial statements. The interest in a joint venture is carried at cost plus post-acquisition changes in the *Company*'s share of the net assets of the joint venture, less any impairment in value. The *Company*'s share of the results of operations of the joint venture is recognized in the consolidated statement of income.

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control, and a jointly controlled entity is a joint venture that involves the establishment of a separate entity in which each venturer has an interest. The financial statements of the joint venture are prepared for the same reporting year as the *Company*, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

When the *Company* contributes or sells assets to the joint venture, any share in the gain or loss from the transaction is recognized based on the substance of the transaction. When the *Company* purchases assets from the joint venture, the *Company* does not recognize its share of the profits of the joint venture from the transaction until it resells the assets to an independent party.

### Deferred Pass-through Fuel Costs

Deferred pass-through fuel costs are accounted as prepayments and are initially recorded based on the billings received. The account is reduced for fuel consumption above the required annual volume based on historical costs and is tested for impairment at each reporting date. Key factors in the impairment test of the deferred pass-through costs are the ability of the First Gas Power Corporation or *FGPC* and FGP Corp. or *FGP'*s power plants to consume the banked gas within the prescriptive period and bill its customers for the power generated from the withdrawn banked gas on the basis of the amounts paid for such gas.

Business Combinations and Goodwill

Business Combinations from January 1, 2009

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

When a business is acquired, an assessment of the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and 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 acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit and 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 the consolidated statement of income or as a charge to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill acquired in a business combination is initially measured at cost, such cost being the excess of the cost of the business combination over the *Company*'s interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in the consolidated statement of income.

Following initial recognition, goodwill is measured at cost less any accumulated impairment loss. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the *Company*'s cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether the other assets or liabilities of the *Company* are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated represents the lowest level within the *Company* at which the goodwill is monitored for internal management purposes; and, is not larger than a segment based on either the primary or secondary reporting format determined in accordance with *PFRS 8*.

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 of and the portion of the cash-generating unit retained.

Business Combination Prior to January 1, 2009

In comparison to the foregoing policy on business combination, the following differences apply:

Business combinations were accounted for using the purchase method. Transaction costs directly attributable to the acquisition formed part of the acquisition costs. The non-controlling interest was measured at the proportionate share of the acquiree's identifiable net assets.

Business combination achieved in stages was accounted for as separate steps. Any acquired share of interest did not affect previously recognized goodwill.

When a business is acquired, embedded derivatives separated from the host contract by the acquiree are not reassessed on acquisition unless the business combination resulted in a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.

Contingent consideration was recognized if, and only if, there are present obligation, the economic outflow of which was more likely than not and a reliable estimate was determinable. Subsequent adjustments to the contingent consideration are charged to goodwill except for accretion of interest, which is recognized in the consolidated statement of income.

### Impairment of Nonfinancial Assets

The Company assesses at each reporting date whether there is an indication that an asset may be impaired.

If any such indication exists (such as obsolescence, physical damage, significant changes to the manner in which the asset is used, worse than expected economic performance, a drop in revenues or other external indicators), or when annual impairment testing for an asset is required (in the case of goodwill), the *Company* makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. 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 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. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded securities or other available fair value indicators.

Impairment losses of continuing operations are recognized in the consolidated statement of income in those expense categories consistent with the function of the impaired asset, except for assets previously revalued where the revaluation was taken to equity. In this case, the impairment is also recognized in equity up to the amount of any previous revaluation.

For assets, excluding goodwill, 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 such indication exists, the *Company* estimates the 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 that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation (in case of utility plant and others and investment properties), had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income. After such a reversal, the depreciation and amortization expense is 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

The following criteria are also applied in assessing impairment of specific assets:

### Associates and a Joint Venture

After application of equity method, the *Company* determines whether it is necessary to recognize an impairment loss on the *Company*'s investments in its associates and a joint venture. The *Company* determines at each reporting date whether there is any objective evidence that the investments in associates and a joint venture are impaired. The entire carrying amount of the investment is tested for impairment, by comparing its recoverable amount, which is the higher of value in use and fair value less costs to sell, with its carrying amount. In determining the value in use of the investment, the *Company* estimates its share of the present value of the estimated future cash flows expected to be generated by the associates and a joint venture, including the cash flows from the operations of the associates and a joint venture and the proceeds on the ultimate disposal of the investments; or the present value of the estimated future cash flows expected to arise from dividends to be received from the investments and from its ultimate disposal. The recoverable amount of an investment in an associate or a joint venture is assessed for each associate or joint venture, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

### Inventories

Materials and supplies are stated at the lower of cost or net realizable value. Costs incurred in bringing materials and supplies to their present location and condition are determined on the moving average method. Net realizable value is the current replacement cost of the asset.

Condominium units for sale are stated at the lower of cost or net realizable value. Cost includes the cost of the land, expenditures for the construction of the condominium units and borrowing costs incurred during construction of the units. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

### Land and Development Costs

Real estate properties for development, subdivided or otherwise, are stated at the lower of cost or net realizable value. Expenditures for development are capitalized as part of the cost of the land. Borrowing costs are capitalized while development is in progress. Net realizable value is the estimated selling price in the ordinary course of business less estimated costs to complete. A valuation allowance is provided for land development costs that are no longer recoverable.

Financial Assets

### Initial Recognition

Financial assets are classified as financial assets at fair value through profit or loss, or *FVPL*, loans and receivables, held-to-maturity, or *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, reevaluated at each reporting date.

Financial assets are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets and liabilities, 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, i.e., the date that the *Company* commits to purchase or sell the asset.

The *Company*'s financial assets include cash and cash equivalents, trade and other receivables, quoted and unquoted equity securities, unbilled receivables, *SC GRAM* refund, installment contracts receivables and embedded derivatives that are not accounted for as accounting hedges.

### 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 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 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" for derivative instruments and for non-derivative financial assets. Interest earned and dividends received from investment at *FVPL* are recognized in the consolidated statement of income under "Interest and other financial income" and "Other income" accounts, respectively.

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 and liabilities or recognizing gains or losses on them on a different bases; (ii) the assets and liabilities 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 and liabilities contain one or more embedded derivatives that would need to be separately recorded.

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 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.

### 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 exactly 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 through

the amortized process. Interest earned or incurred is recorded in "Interest and other financial income" or "Interest and other financial charges" account, respectively, in the consolidated statement of income. Assets in this category are included in the current assets except for maturities greater than 12 months after the end of the reporting period, 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 *Company* has the positive intention and ability to hold it 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 greater than 12 months after the end of the reporting period, which are classified as noncurrent assets. The *Company* has no *HTM* investments as of reporting date.

### 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 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 until the investment is derecognized, at which time the cumulative gain or loss recorded in other comprehensive income is recognized in the consolidated statement of income, or determined to be impaired, at which time the cumulative loss recorded in other comprehensive income is recognized in the consolidated statement of income. Interest earned on holding AFS debt securities are included under "Interest and other financial income" account using the effective interest method 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 end of the reporting period.

### 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 and in the case of other financial liabilities, inclusive of directly attributable transaction costs.

The *Company*'s financial liabilities include notes payable, interest-bearing long-term financial liabilities, trade payables and accrued expenses, customers' deposits, customers' refund, other noncurrent liabilities and derivative financial instruments.

### Subsequent Measurement

The 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 at *FVPL*. Financial liabilities are classified as held-for-trading if they are acquired 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" account, respectively, for derivative instruments and "Other income or expense" account for non-derivative financial liabilities.

Financial liabilities 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 and liabilities or recognizing gains or losses on them on a different bases; (ii) the assets and liabilities 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 and liabilities contain one or

more embedded derivatives that would need to be separately recorded. The *Company* does not have financial liabilities at *FVPL* as of reporting date.

### 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 through the effective interest amortization process. 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.

### Offsetting of Financial Instruments

Financial assets and 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.

### Fair Value of Financial Instruments

The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business at the reporting date. When current bid and asking prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's-length market transactions, reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis and option pricing models.

### Amortized Cost of Financial Instruments

Amortized cost is computed using the effective interest method less any allowance for impairment and principal repayment or reduction. 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 *Company* recognizes the difference between the transaction price and fair value (a Day 1 profit or loss) in the consolidated statement of income, unless it qualifies for recognition as some other type of asset or liability. In cases where data used are not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the *Company* determines the appropriate method of recognizing the Day 1 profit or loss amount.

### Impairment of Financial Assets

The *Company* 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 debtors 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 assets carried at amortized cost, the *Company* first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. 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. The *Parent Company* considers termination or disconnection of service and significant financial difficulties of debtors as objective evidence that a financial asset is impaired. For *Rockwell Land*, consideration is given to breach of contract, such as default or delinquency in interest on principal payments as objective evidence that a financial asset or group of assets is impaired. For both specific and collective assessment, any collateral and credit enhancement is 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 shall be 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 are 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 *Company*.

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 a write-off is subsequently recovered, the recovery is recognized in the consolidated statement of income. Any subsequent 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

For AFS financial assets, the *Company* assesses at each reporting period whether there is an objective evidence that an investment or a group of investments is impaired.

In the case of equity investments 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 other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment 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 an investment in an equity instrument are not reversed in profit or loss. Subsequent increases in fair value after impairment are recognized directly in other comprehensive income amount.

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 profit or loss.

### Assets Carried at Cost

If there is objective evidence that an impairment loss 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 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 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 rights to receive cash flows from the asset have expired;
- the Company has transferred its right to receive cash flows from the asset or has assumed an obligation to received cash flows in full without material delay to a third party under a "pass-through" arrangement; and either the Company (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 *Company* has transferred its rights 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 *Company*'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 *Company* 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.

### Derivative Financial Instruments

Initial Recognition and Subsequent Measurement

MERALCO has bifurcated embedded foreign currency forwards and currency options while Rockwell Land has foreign currency contracts which are derivative financial instruments used to hedge risks associated with foreign currency fluctuations.

Derivative instruments, including bifurcated embedded derivatives are initially recognized at fair value on the date in which a derivative transaction is entered into or bifurcated, and are subsequently re-measured at fair value. Changes in fair value of derivative instruments not accounted as hedges are recognized immediately in the consolidated statement of income. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Derivative financial instruments also include bifurcated embedded derivatives. 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 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, in which case reassessment is required. 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 and whether the change is significant relative to the previously expected cash flows on the contract.

The fair values of freestanding forward currency transactions of *Rockwell Land* are calculated by reference to current forward exchange rates for contracts with similar maturity profiles. See *Note 31 – Financial Assets and Liabilities*.

### Redeemable Preferred Stock

The *Company*'s peso-denominated redeemable preferred stock exhibits characteristics of a liability and is thus recognized as a liability in the consolidated statement of financial position, net of transaction costs. The corresponding dividends on those shares are charged as part of "Interest and other financial charges" account in the consolidated statement of income.

### **Provisions**

Provisions are recognized when the *Company* 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 *Company* expects some or all of a provision 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 liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as part of "Interest and other financial charges" account.

### Pension and Other Post-employment Benefits

MERALCO and substantially all of its subsidiaries have distinct, funded, noncontributory defined benefit retirement plans covering all permanent employees. In addition, MERALCO has a pension plan covering employees hired up to 2003, which provides for post-retirement benefits. MIESCOR, on the other hand has a defined contribution retirement plan in addition to its noncontributory defined benefit plan.

The costs of providing benefits under the distinct defined benefit plan are separately determined using the projected unit credit actuarial valuation method. This method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement costs include current service cost plus amortization of past service cost, experience adjustments and changes in actuarial assumptions. Past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits vest immediately following the introduction of, or changes to, a pension plan, past service cost is recognized immediately. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plans.

The defined benefit asset or liability is the aggregate of the present value of the defined benefit obligation (using a discount rate based on government bonds) and any actuarial gains not recognized reduced by past service cost and actuarial losses not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. Plan assets are assets that are held by a long-term employee benefit fund. Fair value is based on market price information and in the case of quoted securities, it is the published bid price. The value of any defined benefit asset recognized is restricted to the sum of any past service cost and actuarial gains or losses not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plans.

### Share-based Payment Transactions

MERALCO has a share-based payment plan covering its employees, active and retired, to purchase fixed number of shares of stock at a stated price. The plan features include vesting requirements and payment terms.

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which the options are granted. The fair value is determined using the Black-Scholes Option Pricing Model. 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 period in which the performance and/or service conditions are fulfilled, ending on the date on 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 the *MERALCO*'s best estimate of the number of equity instruments that will ultimately vest. The consolidated statement of income charge or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of that year.

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 due 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.

The dilutive effect of outstanding awards is reflected as additional share dilution in the computation of earnings per share. See *Note 34 – Earnings Per Share Attributable to Equity Holders of the Parent*.

### Revenue

Revenues are stated at amounts invoiced to customers, net of discounts, rebates, value-added tax and duty, where applicable. Revenue is recognized to the extent that it is probable that the economic benefits will flow to the *Company*, the revenue can be reliably measured, evidenced by an arrangement, collectibility is reasonably assured and the delivery of the goods or rendering of the service has occurred. The *Company* assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The *Company* 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. The Uniform Filing Requirements, or *UFR*, on the rate unbundling released by the *ERC* on October 30, 2001 specified the following bill components: generation charge, transmission charge, system loss charge, distribution charge, supply charge, metering charge, *CERA* I and II and interclass and lifeline subsidies. National and local franchise taxes, the Power Act Reduction (for Residential Customers) and the universal charge are also separately presented in the customer's billing statement. National and local franchise taxes and universal charges, which are billed and merely collected on behalf of the national and local governments, do not form part of the *Company*'s revenue.

### Sale of Real Estate

Sale of real estate, which includes the sale of land and condominium units, is accounted for using the full accrual method. The percentage-of-completion method is used to recognize income from sale of projects where the *Company* has material obligations under the sales contracts to complete the projects after the properties are sold. Under this method, revenue is recognized as the related obligations are fulfilled, measured principally on the basis of the estimated completion of a physical proportion of the contract work.

The *Company* accounts for cash received as "Deposits from condominium units pre-sold" account when the construction is not beyond a preliminary stage. Construction is not beyond a preliminary stage if engineering and design work, execution of construction contracts, site clearance and preparation, excavation, and completion of the building foundation are incomplete. Proceeds shall be accounted for as deposits until the criteria for percentage-of-completion method are met. Collections received in excess of receivables recognized under the percentage-of-completion method are shown separately as part of "Trade payables and accrued expenses" account in the consolidated statement of financial position.

Cost of condominium units sold before completion of the project is determined based on actual costs and project estimates of building contractors and technical staff.

### Sale of Contracts and 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 contract 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 from contract penalty provisions, and final contract settlements, which may result in revisions to estimated costs and gross margins are recognized in the period in which the changes are determined.

Service fees are recognized when the services are rendered.

Consulting fees are recognized when services are rendered.

Interest Income

Revenue is recognized as interest accrues, using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

Dividends

Dividend from AFS investment is recognized when the Company's right to receive the payment is established.

Lease Income

Lease income is generated from investment properties, poles, condominium units held for lease and retail outlet as part of the *Company*'s mall operations. Lease contracts are with third parties and are accounted for on a straight-line basis over the lease terms on ongoing leases.

Lease income is shown as part of the "Revenue – Sale of contracts, services and others" account in the consolidated statement of income.

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.

For arrangements entered into prior to January 1, 2005, the date of inception is deemed to be January 1, 2005 in accordance with the transitional requirements of *IFRIC 4*, *Determining whether an Arrangement contains a Lease*.

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 *Company* does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating lease. Initial direct cost 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 bases as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

Foreign Currency-denominated Transactions and Translation

The financial statements are presented in Philippine peso, which is the *Company*'s functional and presentation currency. Each entity in the *Company* determines its functional currency. Except for *LOIL*, whose functional currency is the United States or U.S. dollar, the functional currency of all other entities within the *MERALCO Group* is the Philippine peso.

Transactions in foreign currencies are initially recorded by the *Company* at its respective functional currency rates prevailing at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate as of the reporting date.

Differences are taken to the consolidated statement of income with the exception of all monetary items that provide an effective hedge for a net investment in a foreign operation. These are recognized in other comprehensive income until the disposal of the net investment, at which time they are recognized in the consolidated statement of income. Tax charges and credits attributable to exchange differences on those monetary items are also recorded in equity.

Nonmonetary items that are measured at historical cost in a currency other than the Philippine peso are translated using the exchange rates as at the dates of the initial transactions. Nonmonetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

As at the reporting date, the statement of financial position of an associate (whose functional currency is other than the Philippine peso) is translated into the presentation currency of the *Company* (the Philippine peso) at the rate of exchange at the reporting date and, the statement of income is translated at the monthly average exchange rates for the year. The exchange differences arising on the translation recognized in other comprehensive income. Upon disposal of such associate, the component of other comprehensive income relating to that particular foreign operation will be recognized in the consolidated statement of income.

Income Tax

### Current Tax

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

### Deferred Tax

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

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

- where the deferred 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 subsidiaries, 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 tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits from excess minimum corporate income tax or *MCIT*, over regular corporate income tax or *RCIT*, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward benefits of *MCIT* can be utilized except:

- when the deferred 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 nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and
  interests in joint ventures, deferred 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 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 asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

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

Deferred tax relating to items recognized outside profit or loss is recognized in correlation to the underlying transaction either in other comprehensive income 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 all dilutive potential common shares.

### Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. They 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. They are disclosed in the notes to consolidated financial statements when an inflow of economic benefits is probable.

### Events After the Reporting Date

Post year-end events that provide additional information about the *Company*'s financial position at the reporting date (adjusting events) are reflected in the consolidated financial statements. Post year-end events that are not adjusting events are disclosed in the notes to consolidated financial statements, when material.

### 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 in equity as a deduction from proceeds, net of tax. Proceeds and/or fair value of consideration received in excess of par value are recognized as additional paid-in capital.

Stock options issued represent the cumulative compensation expense recognized from the *Company*'s share-based payment plan, net of cumulative compensation expense related to exercised and expired stock options.

Treasury stocks are the *Company*'s own equity instruments, which are reacquired and recognized at acquisition cost and presented as reduction in equity. No gain or loss is recognized in the consolidated statement of income on the purchase, sale, reissuance or cancellation of the *Company*'s equity instruments. Any difference between the carrying amount and the consideration upon reissuance or cancellation of shares is recognized as an adjustment to additional paid-in capital.

Retained earnings represent the Company's accumulated earnings, net of dividends declared.

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.

Other comprehensive income comprise items of income and expense, including reclassification adjustments, that are not recognized in profit or loss as required or permitted by other *PFRS*.

Non-controlling interests represent the equity interests in *Rockwell Land, CEDC* and *MIESCOR*, which are not held by the *Parent Company*.

### 6. Significant Accounting Judgments and Estimates

The preparation of the *Company*'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 liabilities, at the end of the reporting period. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

### Judgments

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

### Operating Lease Commitments

### As Lessor

As a lessor, the *Company* has several lease arrangement covering its investment property portfolio. Based on the terms and conditions of the arrangement, the *Company* has evaluated that the significant risks and rewards of ownership of such properties are retained by the *Company*. None of the lease agreement transfer ownership of the assets to the lessee at the end of the lease term and do not give the lessee a bargain purchase option over the assets. Consequently, the lease agreements are accounted for as operating lease, as applicable to a lessor.

### As Lessee

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

### Functional Currency

The functional currencies of the entities under the *MERALCO Group* are the currency 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 relevant, the functional and presentation currency of *MERALCO* and its subsidiaries, except *LOIL*, is the Philippine peso. The functional and presentation currency of *LOIL* is the U.S. dollar.

### Arrangement that Contains a Lease

The *Company's PPA*s and transmission line agreements or *TLA*s, with Independent Power Producers, or *IPP*s, qualify as leases on the basis that the *Company* and the *IPP*s have take or pay arrangements where payments for purchased power are made on the basis of the availability of the power plant and not on actual consumption. In determining the lease classification, it is judged that substantially all the risks and rewards incident to the ownership of the *IPPs*' power plants are with the *IPPs*. Thus, the *PPAs* and *TLAs* are classified as operating leases. Accordingly, capacity fees, fixed operating fees and transmission line fees that form part of purchased power expense, are accounted for similar to a lease.

Components of purchased power expense, which have been accounted for similar to a lease amounted to \$\mathbb{P}20,900\$ million, \$\mathbb{P}21,592\$ million and \$\mathbb{P}17,107\$ million in 2009, 2008 and 2007, respectively. See *Note 28 - Revenues and Purchased Power*.

### Contingencies

The *Company* 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 the control of the *Company*. 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 33 – Contingencies*.

### Estimates and Assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty 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 year are discussed in the following.

### Estimating Useful Lives of Utility Plant and Others and Investment Properties

The *Company* estimates the useful lives of utility plant and others as well as 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 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 of the utility plant and others as well as investment properties are reviewed at least at each financial year-end 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 the *Company*'s utility plant and other assets and investment properties would increase recorded operating expenses and decrease noncurrent assets.

The total depreciation and amortization of utility plant and others amounted to \$\mathbb{P}4,901\$ million, \$\mathbb{P}4,305\$ million and \$\mathbb{P}4,336\$ million for the years ended December 31, 2009, 2008 and 2007, respectively. Total carrying values of utility plant and others, net of accumulated depreciation and amortization amounted to \$\mathbb{P}98,409\$ million and \$\mathbb{P}95,704\$ million as at December 31, 2009 and 2008, respectively.

Total depreciation for investment properties amounted to P163 million, P121 million, and P156 million for the years ended December 31, 2009, 2008 and 2007, respectively. Total carrying value of investment properties, net of accumulated depreciation and amortization amounted P8,021 million and P5,505 million as at December 31, 2009 and 2008, respectively.

See Note 8 – Utility Plant and Others and Note 11 – Investment Properties.

### Asset Impairment

*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 units 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 a suitable discount rate in order to calculate the present value of those cash flows.

Determining the recoverable amount of utility plant and others, construction in progress, investment properties, investments in associates and a joint venture, deferred pass-through fuel costs, goodwill and other noncurrent assets, requires the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires making estimates and assumptions that can materially affect the consolidated financial statements. Future events could cause management to conclude that utility plant and others, investment properties, deferred pass-through fuel costs and other noncurrent assets associated with an acquisition are impaired. Any resulting impairment loss could have a material adverse impact on the *Company*'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 additional impairment charges under *PFRS*.

The carrying values of noncurrent and current assets subject to impairment review are as follows:

	2009	2008
	(Amount	s in Millions)
Utility plant and others - net	₽98,409	₽95,704
Investment properties - net	8,021	5,505
Construction in progress	3,703	5,149
Deferred pass-through fuel costs	3,161	3,792
Investments in associates and a joint venture	1,203	1,378
Other noncurrent assets	6,091	5,937

See Note 8 – Utility Plant and Others, Note 9 – Construction in Progress, Note 10 – Investments in Associates and a Joint Venture, Note 11 – Investment Properties, Note 12 – Deferred Pass-through Fuel Costs and Note 13 – Other Noncurrent Assets.

### Goodwill

The *Company*'s consolidated financial statements and results of operations reflect acquired businesses after the completion of the respective acquisition. The *Company* accounts for the acquisition of businesses using the purchase 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 our consolidated statement of financial position. Thus, the number of items, which involve judgments made in estimating the fair market value to be assigned to the acquiree's assets and liabilities can materially affect our results of operations.

### Realizability of Deferred Tax Assets

The *Company* reviews the carrying amounts of deferred tax assets at the end of each reporting period and reduces these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred income tax assets to be utilized. Assessment on the recognition of deferred income tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income for the subsequent reporting periods. This forecast is based on past results and future expectations on revenues and expenses as well as future tax planning strategies. However, there is no assurance that the *Company* will generate sufficient taxable income to allow all or part of the recorded deferred income tax assets to be utilized.

Based on the foregoing assessment, following are the relevant consolidated information with respect to deferred tax assets:

	2009	2008
	(Amounts	in Millions)
Recognized deferred tax assets	₽7,531	₽7,390
Unrecognized deferred tax assets	41	65

See Note 32 – Income and Franchise Taxes.

### Determination of Fair Values of Financial Assets and 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 value of financial instruments.

Total fair values of financial assets and liabilities as at December 31, 2009 amounted to P45,652 million and P83,484 million, respectively, while the total fair values of financial assets and liabilities as at December 31, 2008 amounted to P46,580 million and P81,436 million, respectively.

See Note 31 - Financial Assets and Liabilities.

### Estimating Allowance for Doubtful Accounts

If there is objective evidence that an impairment loss has been incurred in the balance of trade and other receivables, 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 collectibility of the accounts. In these cases, use judgment based on the best available facts and circumstances, including but not limited to, the length of our 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 our receivables to amounts that we expect to collect is applied. These specific reserves are reevaluated 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 characteristic, 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 recognized in the consolidated statement of income amounted to P886 million, P1,566 million and P576 million for the years ended December 31, 2009, 2008 and 2007, respectively. Trade and other receivables, net of asset impairment, amounted to P21,600 million and P37,509 million as at December 31, 2009 and 2008, respectively.

See Note 15 - Trade and Other Receivables and Note 29 - Expenses and Income.

### Estimating Net Realizable Value of Inventories and Materials and Supplies

Inventories consist of condominium units for sale and, materials and supplies used in the distribution and services operating segments of the *Company*. The excess of cost over net realizable value relating to inventories consists of collective and specific provisions. The cost of inventories is written down whenever the net realizable value of inventories becomes lower than cost due to damage, physical deterioration, obsolescence, change in price levels or other causes. The lower of cost and 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 income statement.

The carrying values of inventories amounted to ₱1,857 million and ₱1,648 million as at December 31, 2009 and 2008, respectively.

See Note 16 - Inventories.

### Estimation of Pension Benefit Costs and Other Retirement Benefits

The cost of defined benefit plans and present value of the pension obligation are actuarially determined. Actuarial valuation includes making variance assumptions, which consists, among other things, discount rates, expected rates of return on plan assets, rates of compensation increases and mortality rates. Actual results that differ from our assumptions are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. Due to complexity of valuation, the underlying assumptions and its long-term nature, a defined benefit obligation is highly sensitive to changes in assumptions. While management believes that the assumptions are reasonable and appropriate, significant differences in the actual experience or significant changes in the assumptions may materially affect cost for pension and other retirement obligations. All assumptions are reviewed at each reporting date.

Total consolidated pension benefit costs amounted to ₱1,886 million, ₱1,889 million and ₱2,858 million for the years ended December 31, 2009, 2008 and 2007, respectively. Unrecognized actuarial gains as at December 31, 2009 amounted to ₱1,362 million while actuarial losses as at December 31, 2008 amounted to ₱425 million. Except for *Rockwell Land*, pension liability as at December 31, 2009 and 2008 amounted to ₱10,301 million and ₱11,877 million, respectively. The net pension asset of *Rockwell Land* as at December 31, 2009 and 2008 amounted to ₱66 million and ₱28 million, respectively.

See Note 29 – Expenses and Income and Note 30 – Retirement Plan.

### Share-based Payment Transactions

The *Company*'s Employee Stock Purchase Plan, or *ESPP*, grants qualified participants the right purchase common shares of the *Company* at a grant price. The *ESPP* recognizes the services received from the eligible employees and an equivalent adjustment to the equity account over the vesting period. The *Company* measures the cost of equity-settled transactions with the participants by reference to the fair value of the equity instrument at the date when such right to purchase is granted. Estimating the fair value requires the determination of the most appropriate valuation model for a grant of equity instrument depending on the terms and conditions of the grant. This also requires determining the most appropriate inputs to the valuation model and making certain assumptions. The estimates and assumptions are described in *Note 20 – Share-based Payment Plan* and include, among other things, annual stock volatility, risk-free interest rate, dividends yield, and the remaining life of options. While management believes that the estimates and assumptions used are reasonable and appropriate, significant differences in our actual experience or significant changes in the estimates and assumptions may materially affect the stock compensation costs charged to operations.

The stock compensation recognized as expense for the years ended December 31, 2009, 2008 and 2007, with a corresponding charge to the equity account amounted to P302 million, P116 million and P73 million, respectively. As at December 31, 2009 and 2008, the balances of employee share-based payment plan amount in the equity section of the consolidated statement of financial position amounted to P569 million and P268 million, respectively.

See Note 20 - Share-based Payment Plan and Note 29 - Expenses and Income.

### Provision for Asset Retirement Obligations

Provision for asset retirement obligations are recognized in the period in which they are incurred if a reasonable estimate of fair value can be made. This requires an estimation of the cost to restore/dismantle on a per square meter 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 obligations were recognized since the amount is immaterial.

### Revenue Recognition

The Company's revenue recognition policies require the use of estimates and assumptions that may affect the reported amounts of our revenues and receivables.

Revenues from sale of electricity by the *Parent Company* and *CEDC* are billed under different cycles with different cycle cut-off dates, while take-up of related power purchase cost in the accounts is based on calendar month. The recognition of unbilled revenues for billing cycles that have earlier than month-end cut-off dates requires the use of estimates.

The difference between the amount initially recognized and the actual settlement or actual billing is taken up in the subsequent period. Management believes that such use of estimates will not result in material adjustments in future periods.

Revenue from real estate transactions of *Rockwell Land* and 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. There is no assurance that such use of estimates may not result in material adjustments in future periods.

### 7. Segment Information

Each operating segment of the *Company* 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 *Company*). The operating results of each of the operating segment are regularly reviewed by the enterprise's chief operating decision-maker to make decisions about how resources are to be allocated to the operating segment and to assess their performances, and for which discrete financial information is available.

For management purposes, the *Company*'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. Each operating business is a distinct reportable operating segment.

- Power Distribution The power distribution segment is involved in the distribution and supply of electricity covering franchise areas in the Luzon islands representing 54% of the requirements of the country. This is primarily provided by *MERALCO* and *CEDC*, the latter covering the Clark Economic Zone.
- Real Estate This segment, which is provided by Rockwell Land, is involved in luxury residential and commercial real estate development and leasing.
- Services The services segment is involved principally in engineering, construction and consulting services, etransaction services and insurance. These services are provided by MIESCOR, MBI, Landbees and Miescorrail (collectively known as "MIESCOR Group"), MEI, eMVI, RSIC, LOIL, Finserve, CIS, CIS Bayad Center and OTC.

The chief operating decision-maker or management monitors the operating results of each business units separately for purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on consolidated net income for the year, earnings before interest, taxes and depreciation and amortization, or *EBITDA*; *EBITDA* margin; and core net income. Net income for the year is measured consistent with consolidated net income in the consolidated financial statements.

*EBITDA* is measured as consolidated net income excluding depreciation and amortization, impairment of noncurrent assets, financing cost, carrying charges, interest income, equity in net earnings of associates, foreign exchange gains (losses) – net, gains (losses) on derivative financial instruments – net, provision for (benefit from) income tax and other non-recurring gains (losses) – net, if any.

*EBITDA* margin pertains to *EBITDA* divided by revenues. Separately, *EBITDA* from power distribution is calculated by dividing *EBITDA* from the power distribution segment by distribution revenues.

Core net income for the year is measured as consolidated net income attributable to equity holders of parent of *MERALCO* excluding core net income adjustments in equity in net earnings of associates, foreign exchange gains or losses – net, gains or losses on derivative financial instruments – net, asset impairment on noncurrent assets, one-time approvals by the *ERC* for under- or over-recoveries for of prior regulatory years including related carrying costs, and other non-recurring gains or losses, net of tax effect of the foregoing adjustments.

Transfer prices between business segments are set on 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 in the consolidation.

The *Company* mainly operates and generates substantially all of its revenues from the Philippines (i.e., one geographical location). Thus, geographical segment information is not presented.

### MANILA ELECTRIC COMPANY AND SUBSIDIARIES

# Notes to Consolidated Financial Statements

	<u>A</u>	Power Distribution	tion		Real Estate		Contre	Contracts and Services	ices	Inter-seç	Inter-segment Transactions	ctions		Total	
	2009	2008	2007	2009	2008	2007	2009	2008	2007	2009	2008	2007	2009	2008	2007
Results							(Amou	(Amounts in Millions)	s)						
Segment results	P13,787	P14,792	<b>P</b> 8,560	P1,211	P555	<b>P</b> 358	P376	P2,231	P1,221	۵Ļ	q	aL	P15,374	P17,578	P10,139
Depreciation and amortization	(4,822)	(4,218)	(4,256)	(197)	(118)	(223)	(45)	(06)	(13)	ı	1	I	(5,064)	(4,426)	(4,492)
Provisions	(2,172)	(6,935)	974	1 ;	I	I	1	I	1	I	I	I	(2,172)	(6,935)	974
Interest and other financial income (Note 29)	3,837	2,159	1,993	19	264	746	<b>L</b>	196	(265)	I	I	I	3,924	2,919	2,147
joint venture (Note 10)	953	910	831	ı	ı	ı	ı	ı		(208)	(711)	(201)	242	199	324
Interest and other financial charges															
(Note 29)	(3,243)	(3,007)	(2,866)	(79)	(69)	(77)	(21)	(839)	(26)	15	(220)	I	(3,328)	(4,135)	(2,999)
Provision for (benefit from) income tax  Non controlling interests	(2,216)	(1,615)	(1,630)	(291)	(329)	(328)	(116)	(123)	(66)	(351)	(333)	(277)	(2,623)	(2,067)	(2,057)
Net income	₽6,124	<b>₽</b> 2,086	₽3,606	₽654	<b>₽</b> 603	<b>P</b> 476	P271	P1,375	P461	(P1,044)	(P1,264)	( <b>P</b> 784)	P6,005	<b>P</b> 2,800	P3,759
EBITDA													P13,264	P11,021	P12,047
EBITDA margin Core net income													7.17% P7,003	5.75% <b>P</b> 2,605	6.00% <b>P</b> 3,532
Assets and Liabilities															
Segment assets	P55,584	P53,530	P55,887	P9,599	P11,838	P11,872	<b>P4</b> ,156	P3,636	<b>P</b> 2,090	od.	<b>o</b> L	OL.	P69,339	P69,004	P69,849
Investments in associates and a joint venture		0.76,06	32,230	•	000	<u>†</u>	8	<u>,</u>	2		I	ı	6,00	100.00	00,4
(Note 10)	6,730	5,604	5,086	2,024	I	I	I	1	153	(7,551)	(4,226)	(3,604)	1,203	1,378	1,635
Deferred tax assets - net (Note 32)	1 ;	1	1	I	I	I	17	7	2	I	I	I	17	7	7
Deferred pass-through fuel costs	3,161	3,792	4,986	ı	I	I	ı	ı	I	ı	I	ı	3,161	3,792	4,986
Total assets	P162,980	P156,896	P158,249	P12,027	P12,228	P12,286	<b>P</b> 4,673	P4,987	P2,994	(P7,551)	( <b>P</b> 4,226)	( <b>P</b> 3,604)	P172,129	P169,885	P169,925
:::::::::::::::::::::::::::::::::::::::				:			:			,	,	1			
Segment liabilities Deferred tax liabilities - net (Note 32)	P100,831 4.046	P102,372 4 630	<b>P</b> 106,690 7,719	<b>P</b> 4,410	<b>P</b> 5,140	P5,591 65	₽1,512 1	<b>P</b> 1,399	<b>P</b> 501	od I	<b>or</b> 5	or 8	P106,753 4,230	P108,911 4.815	P112,782 7,870
Total liabilities	P104,877	P107,002	P114,409	P4,593	P5,246	P5,656	P1,513	P1,399	P502	αĹ	P79	P85	P110,983	P113,726	P120,652
Other Segment Information										ı	l				
Capital expenditures	<b>F</b> 8,040	P7,545	<b>₽</b> 6,469	<b>P</b> 726	P1,562	<b>P</b> 184	P123	P143	<b>P</b> 216	ai.	ar	or	<b>B</b> 8,889	<b>P</b> 9,250	<b>₽</b> 6,869

The operating profit for each segment does not include interest and other charges, equity in net earnings of associates and a joint venture and income tax expense.

The following table presents additional information on the power distribution business segment of the *Company* for 2009, 2008 and 2007:

	Generation		
	and		
	Transmission	Distribution	Total
	(Ai	mounts in Millions)	
Year Ended December 31, 2009:			
Revenues	₽146,993	₽31,693	<b>₽</b> 178,686
Purchased power/cost and expenses	150,928	20,425	171,353
Segment results	(3,935)	11,268	7,333
Year Ended December 31, 2008:			
Revenues	₽160,794	₽26,205	₽186,999
Purchased power/cost and expenses	156,872	17,261	174,133
Segment results	3,922	8,944	12,866
Year Ended December 31, 2007:			
Revenues	₽170,352	₽25,819	₽196,171
Purchased power/cost and expenses	172,837	16,974	189,811
Segment results	(2,485)	8,845	6,360

Revenues from generation and transmission do not include revenue accrual for pass-through charges during the periods that do not have an *ERC*-approved recovery mechanism. This portion of pass-through charges becomes part of contingent assets. See *Note 33 – Contingencies*.

# MANILA ELECTRIC COMPANY AND SUBSIDIARIES Notes to Consolidated Financial Statements

### 8. Utility Plant and Others

The movements of utility plant and others as of December 31, 2009 and 2008 are as follows:

					Office Furniture, Fixtures			
	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	and Other Equipment	Transportation Equipment	Others	Total
Cost				(Amounts in Millions)	Millions)		:	
Reginning of year	B112 102	B15 622	BA 511	B5 22/	DA 660	B1 056	<b>9</b> 2 110	B146 213
Transfers from construction in progress (see Note 9)	6 597	2,0,01	145	73,334	7,003	126	243	2,013
	3.5		2	. 5	2 4	071	£ %	187
Additions Disposals/rotiromonts	(1.766)	1	7	(432)	30	1 60	8 (	(2 17.4)
	(00/1)	1 (60)	I	(201)	(00)	(661)	(+7)	(4,1,4)
Transfer to investment properties (see Note 11)	1 1	(179)	1 5	ı	I	I	I	(129)
I ransier from Investment properties (see Note 11)	/ L	ı	77	1 4	1 3	ı (	1 (5	44 7
Reclassification and others	/9/	I	47	91	(14)	(2)	(40)	99/
End of year	117,752	15,001	4,727	5,647	5,171	1,922	2,336	152,556
Less accumulated depreciation and amortization:								
Beginning of year	40,044	ı	1,695	3,280	3,498	1,087	1,005	50,609
Charge for the year	3,746	ı	112	457	366	42	178	4,901
Disposals/retirements	(1,466)	1	ı	(132)	(25)	(66)	(23)	(1,772)
Reclassification and others	(80)	ı	(2)	277	(32)	75	171	409
End of year	42,244	ı	1,802	3,882	3,777	1,105	1,337	54,147
Net book value	<b>P</b> 75,508	P15,001	P2,925	P1,765	₽1,394	<b>P</b> 817	<b>P</b> 999	₱98,409
					2008			
					Furniture, Fixtures			
	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	and Other Equipment	Transportation Equipment	Others	Total
				(Amounts in Millions)	Millions)			
Cost:	247 746	100	000	100 10	030	070	1 0 5 7	977
Degining of year	101,719	120,021	#4,509	10,001	74,002 200,4	7. 010,10	/CO,1 L	141,030
I ransiers from construction in progress (see Note 9)	4,000	I	204	143	200	90	± 5	0,100
Discools (actions and	771	ı	1 €	102	20 (06)	7 (	55	(500 )
Disposais/Tetri errents Roclessification and others	(38)	۱ 🕶	ΞΞ	(204)	(30)	(70)	(19)	(1,227)
End of year	112 102	15 622	4 511	5 334	4 669	1 956	2 119	146 313
Less accumulated depreciation and amortization:								
Beginning of vear	36.973	ı	1.588	3.336	3.341	1.120	982	47.340
Charge for the year	3,503	ı	107	448	172	68	36	4,305
Disposals/retirements	(432)	I	· ·	(504)	(15)	(72)	(13)	(1,036)
End of year	40,044	ı	1,695	3,280	3,498	1,087	1,005	50,609
Nat book value	970 050	B1E 600	B2 946	BO OEA	D4 474	0000	777	DOF 704

A significant portion of the *Company*'s utility plant and others are purchased from foreign suppliers. Such transactions are concluded in currencies, other than the Philippine peso, principally in U.S. dollar. The *Company* records the liabilities in Philippine peso using the exchange rate at the date of the transaction. The outstanding amount of foreign currency liabilities is restated at each reporting period. See *Note 26 – Trade Payables and Accrued Expenses* and *Note 31 – Financial Assets and Liabilities*.

Interest capitalized to utility plant and others that qualified as borrowing costs for the years ended December 31, 2009 and 2008 amounted to P77 million and P33 million, respectively.

Average rates of interest capitalized were 8.6% to 8.8% and 7.7% to 8.5% for the years ended December 31, 2009 and 2008, respectively.

### 9. Construction in Progress

	2009	2008
	(Amounts	in Millions)
Balance at beginning of year	₽5,149	₽2,811
Net additions	8,040	8,498
Transfers to utility plant and others (see Note 8)	(8,041)	(6, 160)
Transfer to investment properties (see Note 11)	(1,445)	_
Balance at end of year	₽3,703	₽5,149

In 2009, the major items of construction in progress pertain to electric capital projects, or *ECPs*. *ECPs* consist of the expansions of Balintawak 230kv Substation, CBP1-A Substation and Paco Substation, among others, have been approved for construction by the *ERC* under the Final Determination - *ERC* Case No. 2006-045 RC. There is no carryforward provision for unconstructed projects. Under the provisions of the *RDWR*, any committed capital expenditures not incurred are to be re-applied for approval in the subsequent regulatory period.

Total interest capitalized and included in "Construction in progress" account amounted to P99 million and P55 million as of December 31, 2009 and 2008, respectively.

Consolidated average rates of interest capitalized in 2009 and 2008 ranges from 8.6% to 8.8% and 7.7% to 8.5%, respectively.

### 10. Investments in Associates and a Joint Venture

This account consists of:

			F	ercentage o	of Ownersh	ip
	Country of		20	009	20	08
	Incorporation	Principal Activities	Direct	Indirect	Indirect	Indirect
Associates						
First Private Power Corporation						
or <i>FPPC</i>	Philippines	Power Generation	40	_	40	_
Bauang Private Power Corporation						
or <i>BPPC</i> *	Philippines	Power Generation	_	40	_	40
Batangas Cogeneration Corporation						
or Batangas Cogen**	Philippines	Power Generation	_	_	38	_
General Electric Philippines Meter and Instrument Company, Inc. or GEPMICI						
	Philippines	Sale of metering products and services	35	_	35	_
Joint Venture						
Indra Philippines	Philippines	Management and information technology,				
		or <i>IT</i> , consultancy	50	_	50	_

<sup>\*</sup> Through FPPC. BPPC is a wholly owned subsidiary of FPPC.

<sup>\*\*</sup> Ceased operations in 2004 and ceased to be an associate in 2009.

The movements in the investments in associates and a joint venture account follow:

	2009	2008
	(Amounts	in Millions)
Acquisition costs:		
Balance at beginning of year	₽465	₽465
Return of capital	(6)	_
Balance at end of year	459	465
Accumulated equity in net earnings:		
Balance at beginning of year	782	870
Adjustments and reclassification	(657)	_
Equity in net earnings for the year	245	199
Depreciation on share in revaluation increment	129	169
Return of capital	6	_
Dividends received	(445)	(456)
Balance at end of year	60	782
Share in revaluation increment of an associate:		
Balance at beginning of year	129	298
Depreciation on share in revaluation increment	(129)	(169)
Balance at end of year	_	129
Share in cumulative translation adjustment of an associate	"	
Balance at beginning of year	2	2
Movement and reclassification	682	-
Balance at end of year	684	2
	₽1,203	₽1,378

### Investment in FPPC

FPPC was incorporated in October 1992 for the sole purpose of engaging in power generation as an IPP. The construction of a 195-MW generating plant under a Build-Operate-Transfer, or BOT Agreement was part of the government's program to fast track stabilization of the power industry, as sponsored by NPC. The BOT Agreement between FPPC and NPC was signed on January 11, 1993.

Under the *BOT* Agreement, *FPPC* shall design, build, and operate the plant for 15-year Cooperation Period and sell electricity to *NPC*. At the end of the Cooperation Period, *FPPC* shall transfer ownership of the power plant at no cost to *NPC*. *FPPC* then incorporated *BPPC* as its subsidiary for the purpose of constructing and operating the power plant. *BPPC* assumed *FPPC*'s rights and obligations under the *BOT* Agreement pursuant to an Accession Agreement dated March 15, 1993. In January 1994, *NPC*, *FPPC*, and *BPPC* signed a Memorandum of Understanding revising some of the terms of the *BOT* Agreement which includes the increase of Contracted Capacity to 215 MW from 195 MW.

In July 1994, construction of the Bauang Plant was completed and formally launched the entry of the plant into the Luzon grid. The start of the Cooperation Period was established on July 25, 1995 with turnover of the plant to *NPC* set on July 25, 2010, the end of the Cooperation Period.

### Investment in GEPMICI

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

### Investment in 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 supports MERALCO's system in the area of system development, outsourcing of IS and IT operations and management consulting. To date, the bulk of its business is sourced from unrelated parties.

See Note 27 – Related Party Transactions for details of transactions.

In 2009, *Batangas Cogen* returned ₱6 million representing the capital of *MERALCO*. The Company's investment in *Batangas Cogen* has been written down to zero since 2007.

The carrying values of investments in associates and a joint venture follow:

	2009	2008
	(Amounts	in Millions)
FPPC	₽989	₽1,180
GEPMICI	63	66
Indra Philippines	151	132
	₽1,203	₽1,378

The condensed financial information of FPPC and GEPMICI follow:

	200	)9	200	)8
	FPPC	GEPMICI	FPPC	GEPMICI
		(Amounts in Mi	illions)	
Current assets	₽2,686	₽199	₽1,379	₽230
Noncurrent assets	2,242	13	4,617	15
Current liabilities	(193)	(31)	(447)	(58)
Noncurrent liabilities	(2,264)	=	(2,530)	· -
Net assets	₽2,471	₽181	₽3,019	₽187

	20	009	20	800	20	007
	FPPC	GEPMICI	FPPC	GEPMICI	FPPC	GEPMICI
			(Amount	s in Millions)		
Revenues	₽973	₽377	₽1,210	₽396	₽2,458	₽518
Costs and expenses	(436)	(335)	(786)	(359)	(1,357)	(489)
Net income	₽537	₽42	₽424	₽37	₽1,101	₽29

The aggregate amounts of the *Parent Company*'s interest in the assets, liabilities, income and expenses related to its 50% interest in *Indra Philippines* are as follows:

	2009	2008
	(Amounts ii	n Millions)
	₽236	₽275
	67	38
	(142)	(161)
	`(10 <b>)</b>	(20)
	₽151	₽132
2009	2008	2007
	(Amounts in Millions)	
₽461	₽416	₽162
(417)	(389)	(153)
<b>P</b> 44	<b>₽</b> 27	₽9
	P461 (417)	(Amounts in P236 67 (142) (10) P151  2009 2008 (Amounts in Millions) P461 P416 (417) (389)

### 11. Investment Properties

Movements in investment properties are as follows:

	2009 Buildings and			
	Land In	nprovements	Total	
	(Am			
Cost:				
Balance at beginning of year	₽2,551	₽3,943	₽6,494	
Additions	_	662	662	
Transfer from utility plant and others (see Note 8)	621	_	621	
Transfer to utility plant and others (see Note 8)	(17)	(27)	(44)	
Transfer from construction in progress (see Note 9)		1,445	1,445	
Transfer to land and development costs	_	(5)	(5)	
Balance at end of year	3,155	6,018	9,173	
Accumulated depreciation:	"			
Balance at beginning of year	_	989	989	
Charge for the year	_	163	163	
Balance at end of year	_	1,152	1,152	
Net book value	₽3,155	₽4,866	₽8,021	

	2008			
	Buildings and			
	Land	Land Improvements		
		(Amounts in Millions)		
Cost:				
Balance at beginning of year	₽2,551	₽3,895	₽6,446	
Additions	_	48	48	
Balance at end of year	2,551	3,943	6,494	
Accumulated depreciation:				
Balance at beginning of year	_	868	868	
Charge for the year	_	121	121	
Balance at end of year	-	989	989	
Net book value	₽2,551	₽2,954	₽5,505	

2000

Investment properties are stated at cost. These consist of real properties held for capital appreciation and real properties, mainly the Rockwell Power Plant Mall at the Rockwell Center, Makati City and BPO buildings at the *MERALCO* compound, which are being leased out.

Generally, charges for leases to related parties are made at market rates. Lease income (included as part of other revenues) earned from investment properties amounted to ₱566 million, ₱542 million and ₱516 million in 2009, 2008 and 2007, respectively. Direct operating expenses incurred amounted to ₱231 million, ₱357 million and ₱195 million in 2009, 2008 and 2007, respectively.

As of December 31, 2009 and 2008, unamortized borrowing costs capitalized as part of investments properties amounted to P14 million and P281 million, respectively.

As of December 31, 2009, investment properties of the *Parent Company* with carrying values of ₱1,498 million, have fair values of ₱1,689 million. This includes the land and structures where the BPO buildings are situated.

The aggregate fair value of the Rockwell Power Plant Mall amounted to \$\mathbb{P}\$5,159 million and \$\mathbb{P}\$5,115 million as of December 31, 2009 and 2008, respectively. The aggregate fair value of investment properties held for lease other than the Rockwell Power Plant mall within the Rockwell Center and land held for appreciation amounted to \$\mathbb{P}\$1,797 million and \$\mathbb{P}\$1,775 million as of December 31, 2009 and 2008, respectively. The fair value of the BPO buildings amounted to \$\mathbb{P}\$2,247 million as of December 31, 2009.

The fair values of investment properties were determined by Asian Appraisal Company, Inc. for the *Parent Company* and Vitale Valuation Services, Inc. for *Rockwell Land*, independent professionally qualified appraisers at December 31, 2009 and 2008. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's-length transaction at the date of valuation.

The value of the property was arrived at through the use of the "Income Approach." The Income Approach considers the resulting net income of the lease business operations of the mall including the parking fees that is then capitalized in accordance with commensurate return on investment plus due allowance rate for depreciation to indicate the value of which the property can be duly offered under open market conditions. The value of other investment property held for lease within the Rockwell Center and land held for appreciation was arrived at through the use of the "Market Data Approach." The market data approach is based on the assumption that no prudent purchaser will buy more than what it will cost to acquire an equally desirable substitute parcel or site. This approach is primarily based on sales and listings, which are adjusted for the time of sale, location, and general characteristics of comparable lots in the neighborhood where the subject lot is situated.

### 12. Deferred Pass-through Fuel Costs

Deferred pass-through fuel costs represent amounts paid for the quantity and the cost of natural gas that was contracted for but not yet consumed by the *Parent Company*'s major *IPPs*, *FGPC* and *FGP Corp.*, collectively referred to as "First Gas." See Notes 26 – Trade Payables and Accrued Expenses, Note 27 – Related Party Transactions and Note 33 – Contingencies. Any unconsumed gas is the result of the First Gas plants' dispatch being lower than their stipulated capacity factors.

In 2005, *First Gas* billed the *Parent Company* for a total of US\$231 million (equivalent to 44 million giga joules in gross calorific value), representing unconsumed gas for the years 2002 to 2004. The *Parent Company*'s obligations to pay for unconsumed gas were deferred until the resolution of the dispute between *First Gas* and the *Gas Sellers* (Shell Philippines Exploration B.V., Shell Philippines LLC, Texaco Philippines, Inc., and PNOC Exploration Corporation) under the Gas Sale and Purchase Agreements or *GSPA*. *FGP* and *FGPC* each have an existing *GSPA* with the *Gas Sellers* for the supply of natural gas in connection with the operations of the power plants. The *GSPA*, now on its 8<sup>th</sup> contract year, is for a total period of 22 years up to 2020.

Under the *GSPA*, *First Gas* is obligated to consume (or pay for, if not consumed) a minimum quantity of gas for each contract year (which runs from December 26 of a particular year up to December 25 of the immediately succeeding year), called the *Take-or-Pay Quantity* or *TOPQ*. Thus, if the *TOPQ* is not consumed within a particular contract year, *FGP* and *FGPC* will incur an "annual deficiency" for that contract year equivalent to the total volume of unused gas. *FGP* and *FGPC* are required to make payments to the *Gas Sellers* for such annual deficiency after the end of the contract year. After paying for annual deficiency, *First Gas* can, subject to the terms of the *GSPA*, "make-up" such annual deficiency by consuming the unused-but-paid-for gas (without further charge) within 10-contract years after the contract year for which the annual deficiency was incurred, in the order that it arose.

For contract year 2006, the *Gas Sellers* issued the Annual Reconciliation Statements or *ARS*, of *FGP* and *FGPC* on December 29, 2006. The *Gas Sellers* then claimed annual deficiency payments for contract year 2006 amounting to \$3.9 million for *FGP* and \$5.4 million for *FGPC*. Both *FGP* and *FGPC* disagreed that such Annual Deficiency payments are due and each claimed for among others, relief due to events of force majeure or *EFM* that affected the San Lorenzo and Santa Rita plants, respectively. *FGP* and *FGPC*'s position is that the power plants actually consumed more than their respective *TOPQs* and are entitled to make-up its outstanding balance of annual deficiency.

Pursuant to the terms of the *GSPA*, the dispute on the foregoing matter is now under arbitration in Hong Kong, SAR under the *International Chamber of Commerce* or *ICC* Rules of Arbitration. The arbitral tribunal or *Tribunal* rendered a Partial Final Award on August 11, 2009, which was received by *FGP* and *FGPC* on August 18, 2009. The Tribunal determined that the transmission related events claimed by *FGP* and *FGPC* constitute *EFM* under the *GSPA*s, and therefore, the companies can claim relief for those events that have actually occurred subject to adjustments stipulated in the *GSPA*s. The *Tribunal* was not persuaded, however, that the government-related events claimed by *FGP* and *FGPC* for contract year 2006 constitute *EFM* under the *GSPA*s based on the evidence presented.

The calculation of adjustments to the *ARS* for contract year 2006 based on the Partial Final Award of the *Tribunal*, as well as entitlement to and the amount of costs, damages, and interest, are yet to be agreed upon by the parties. This will be decided upon by the Tribunal should the parties fail to reach agreement on the quantum.

Deferred pass-through fuel costs, representing the remaining unconsumed gas, amounted to \$\mathbb{P}3,161\$ million and \$\mathbb{P}3,792\$ million as of December 31, 2009 and 2008, respectively.

The liability for unconsumed gas amounting to ₱433 million and ₱1,242 million as of December 31, 2009 and 2008, respectively, is shown as part of "Trade payables and accrued expenses" account in the consolidated statements of financial position. See *Note 26 – Trade Payables and Accrued Expenses*.

### 13. Other Noncurrent Assets

	2009	2008
	(Amounts in Millions)	
Unbilled receivables - net of current portion (see Note 15)	₽5,406	₽2,250
Deferred input valued added tax or VAT (see Note 26)	4,467	4,789
SC GRAM case refund (see Note 2)	780	780
Receivable from Bureau of Internal Revenue or BIR - net		
of current portion (see Note 33)	577	577
AFS investments (see Note 31)	361	403
Derivative assets - net of current portion of ₱11 million in 2009		
and ₱19 million in 2008 (see Notes 18 and 31)	172	102
Deferred reinsurance premium	165	111
Pension asset (see Note 30)	66	28
Installment contracts receivable - net of current portion		
(see Note 15)	54	115
Goodwill	36	36
Others - net	846	424
	₽12,930	₽9,615

### Unbilled Receivables

Unbilled receivables represent unbilled generation and other pass-through costs incurred by the *Company*. It includes unbilled charges covered by an approved recovery mechanism but is expected to be collected beyond one year and other unbilled generation and pass through charges of prior years, which is the subject of application for recovery with the *ERC*.

### Deferred Input VAT

The amount represents portion of input VAT incurred and paid in connection with purchase of capital assets in excess of P1 million per month. As provided for in RA No. 9337 as implemented by Revenue Regulation 11-2005, said portion of input VAT shall be deferred and depreciated over the shorter of the expected useful lives of said capital projects or five years.

### SC GRAM Case Refund

Based on a Petition of an electricity consumer group, Implementing Rules and Regulations for the collection by *MERALCO* of the rate adjustment under the second *GRAM* was not published nor was it subject to a public hearing. In response, the *SC* issued a decision directing *MERALCO* to refund ₱780 million at the rate of ₱0.1327 per kWh until full collection. *MERALCO* has refunded ₱746 million up to December 31, 2008. Thereafter, *MERALCO* will file an application to recover the amount previously refunded including any additional amount still to be refunded and corresponding carrying charges. See *Note 2 – Rate Regulations* for the related discussions.

### AFS Investments

AFS investments consist mainly of proprietary club shares, the significant accounts of which, stated in their fair market values, are as follows:

	2009	2008
	(Amounts in Million	
Rockwell Leisure Club, Inc.	₽242	₽241
Manila Golf and Country Club	46	40
Wack-Wack Golf Club	19	19
Others	54	103
	₽361	₽403

### 14. Cash and Cash Equivalents

	2009	2008
	(Amounts	s in Millions)
Cash on hand and in banks	₽6,399	₽3,601
Cash equivalents	10,669	1,801
	₽17,068	₽5,402

Cash in banks earns interest at prevailing bank deposit rates. Cash equivalents are temporary cash investments, which are made for varying periods up to three months depending on the *Company*'s immediate cash requirements, and earn interest at the prevailing short-term investment rates. Due to the short-term nature of such transactions, the carrying value approximates the fair value of the temporary cash investments. See *Note 31 – Financial Assets and Liabilities*.

### 15. Trade and Other Receivables

This account consists of receivables from:

	2009	2008
	(Amounts in Millions	
Trade:		
Electricity:		
Billed	<b>₽</b> 15,362	₽16,870
Unbilled (see Notes 2 and 13)	5,537	20,078
Current portion of installment contracts receivable		
(see Note 13)	367	642
Service contracts and others	1,278	734
Nontrade (see Note 27)	1,378	1,204
·	23,922	39,528
Less allowance for doubtful accounts	2,322	2,019
	₽21,600	₽37,509

Billed receivables from sale of electricity of the Parent Company and CEDC consist of the following:

	2009	2008
	(Amounts in Millions)	
Residential	₽5,338	₽5,780
Commercial	6,988	7,179
Industrial	2,584	3,490
Flat streetlights	452	421
	15,362	16,870
Less allowance for doubtful accounts	2,088	1,927
	₽13,274	₽14,943

Movements of allowance for doubtful accounts for trade receivables are as follows:

		2009			
	Balance at Beginning of Year	Provisions (see Note 29)	Recoveries (see Note 29)	Write-off	Balance at End of Year
		(A	mounts in Millions)	)	
Billed trade receivables: Residential Commercial Industrial Flat streetlights	₽774 608 267 278	₽319 478 22 26	( <b>P</b> 84) (8) (8) (1)	( <b>P</b> 480) (71) (22) (10)	₽529 1,007 259 293
Other receivables	1,927 92 <b>P</b> 2,019	845 148 ₱993	(101) (6) (₽107)	(583) - (₱583)	2,088 234 P2,322

7	n	n	a
4	v	u	J

				Flat		
	Residential	Commercial	Industrial	Streetlight	Others	Total
			(Amounts	in Millions)		
Individually impaired	₽452	₽303	₽187	₽87	₽185	₽1,214
Collectively impaired	77	704	72	206	49	1,108
Total	₽529	₽1,007	₽259	₽293	₽234	₽2,322
			2008			
		Balance			10	Balance
		at Beginning	Provisions	Recoveries		at End
		of Year	(see Note 29)	(see Note 29)	Write-off	of Year
			(A	mounts In Millions)		
Billed trade receivables:						
Residential		₽317	₽1,061	(₽75)	(₽529)	₽774
Commercial		635	110	(13)	(124)	608
Industrial		161	197	(4)	(87)	267
Flat streetlights		9	277	(1)	(7)	278
		1,122	1,645	(93)	(747)	1,927
Other receivables		254	14	` _	(176)	92
		₽1,376	₽1,659	(₱93)	(₱923)	₽2,019
			2008			
				Flat		
	Residential	Commercial	Industrial	Streetlight	Others	Total
			(Amounts	in Millions)		
Individually impaired	₽661	₽183	₽193	₽83	₽_	₽1,120
Collectively impaired	113	425	74	195	92	899

### Trade Receivables - Electricity

₽774

Total

Trade receivables of the *Parent Company* and *CEDC* include charges for pass-through costs. Pass-through costs consist of generation and transmission charges, which constitute 59% and 13%, respectively, of the total billed amount in 2009. Billed receivables are generally due 10 days after bill date.

₽267

₽278

₽92

₽2,019

₽608

Unbilled receivables represent electricity consumed after the meter reading cut-off dates that will be billed to customers in the succeeding billing period. This also includes the current portion of pass through cost underrecoveries. The *Parent Company* and *CEDC*'s trade receivables are noninterest-bearing and are substantially secured by bill deposits. See *Note 22 – Customers' Deposits*.

### Installment Contracts Receivable

Installment contracts receivable represent receivables from sale of condominium units with credit terms ranging from one to five years. As of December 31, 2009 and 2008, the gross undiscounted trade receivables (both recognized and future receivables) from sale of the "Number One Rockwell" or *One Rockwell* and "Joya Lofts and Towers" or *Joya*, condominium project amounting to P912 million and P364 million, respectively, have been assigned as security for interest-bearing long-term financial liabilities. See *Note 21 – Interest Bearing Long-term Financial Liabilities*.

### Service Contracts and Others

Service contracts receivable arise from contracts entered into by subsidiaries for provision of services such as construction, engineering, consulting, insurance underwriting, bill payment collection, tellering, data transport and e-business development.

Receivables from service contracts and others are noninterest-bearing and are generally on 30 to 60-day terms.

### 16. Inventories

	2009	2008
	(Amounts in Millions	
Materials and supplies:		
At net realizable value	₽1,801	₽1,563
At cost	1,862	1,638
Condominium units for sale:	·	
At net realizable value	56	85
At cost	56	85
Total inventories at the lower of cost or		
net realizable value	₽1,857	₽1,648

No write-down of inventories and supplies was recognized for the years ended December 31, 2009, 2008 and 2007. While the aggregate cost of inventories is less than the aggregate net realizable value, the difference of each inventory line items have been adjusted to the lower of cost or net realizable value.

See Note 6 - Significant Accounting Judgments and Estimates, and Note 29 - Expenses and Income.

### 17. Land and Development Costs

This account represents land and development costs of Rockwell Land, consisting of the following:

	2009	2008
	(Amounts in Millions)	
Land held for future development	₽_	₽475
Development costs (see Note 11)	1,200	1,100
Less allowance for probable losses on development costs	9	9
	1,191	1,091
	₽1,191	₽1,566

In 2008, land held for future development represents the remaining 9,026 square meters of land within the Rockwell Center used as parking space. In 2009, such property is being developed for the Edades Tower and Garden Villas and the cost of the land has been reclassified to development costs.

Other development costs pertain to residential and commercial projects, which *Rockwell Land* shall implement and complete in the following years.

### 18. Other Current Assets

	2009	2008
	(Amounts	s in Millions)
Advances to suppliers	₽1,197	₽957
Creditable withholding tax	515	652
Prepaid expenses	497	383
Prepaid taxes and tax credit certificates	390	90
Input VAT	177	75
Current portion of derivative assets (see Notes 13 and 31)	11	19
Prepaid creditable withholding taxes (see Note 24)	_	431
Others	182	3
	₽2,969	₽2,610

Advances to Suppliers

This represents advances made to suppliers and contractors of Rockwell Land for various construction projects.

Prepaid Creditable Withholding Taxes from Refund Claims

This represents advance remittances to the BIR of withholding taxes related to Phase IV refund claims. Such amounts are applied against actual taxes withheld upon payment to the claimant.

### 19. Equity

### Common Stock

The movements of the Company's common stock as at December 31, 2009 and 2008 are as follows:

	Number	
	of Shares	Amount
		(In Millions)
Authorized – ₱10 par value a share	1,250,000,000	₽12,500
lacuado		
Issued:		
Balance as at January 1, 2008	1,103,342,882	₽11,034
Issuances	425,130	4
Balance as at December 31, 2008	1,103,768,012	₽11,038
Balance as at January 1, 2009	1,103,768,012	₽11,038
Issuances	23,502,808	235
Balance as at December 31, 2009	1,127,270,820	₽11,273

See Note 20 - Share-based Payment Plan for discussion of common stock issuances.

### Unappropriated Retained Earnings

Unappropriated retained earnings balance as of December 31, 2009 and 2008 includes the balance of revaluation increment in utility plant and others and investment properties carried at deemed cost amounting to P19,232 million and P19,926 million, respectively. Such amounts are restricted for dividend declaration purposes in the respective periods, until such are realized through depreciation or disposal.

The following are cash dividends declared on common shares in 2009 and 2008:

			Dividend	
<b>Declaration Date</b>	Record Date	Payment Date	Per Share	Amount
				(In Millions)
October 29, 2009	November 13, 2009	December 11, 2009	₽1.50	₽1,617
May 26, 2009	June 9, 2009	June 30, 2009	1.00	1,078
August 26, 2008	September 25, 2008	October 21, 2008	0.50	559
March 17, 2008	April 16, 2008	May 13, 2008	0.50	557

On February 22, 2010, the *BOD* approved a dividend policy, which called for payment of regular dividends equivalent to 50% of core earnings, supplemented by special dividends on a "look-back" basis.

### Appropriated Retained Earnings

On February 22, 2010, the *BOD* approved the reversal of the retained earnings appropriated in 2008 for under-recoveries as a result of the *ERC*'s approval of *MERALCO*'s over- and under-recoveries in October 2009. On the same date, the *BOD* approved the appropriation of \$\mathbb{P}6,000\$ million out of the unappropriated retained earnings balance for the *Company*'s planned business expansion.

### 20. Share-based Payment Plan

The *Parent Company* has a Share-based Payment Plan, which entitles participants to purchase common shares of the *Company* subject to certain terms and conditions, during the designated offer period. Following are the salient features of the Share-based Payment Plan:

Participants	•	Qualified regular employees of the Parent Company and subsidiaries
	•	Retirees of the Parent Company
Purchase Price	•	No less than 80% of the weighted average daily closing market price at the <i>PSE</i> during a 30-day calendar period that ends two weeks before the start of the offer period.

Holding Period	•	Maximum of three years (as approved by the Board of Administrators in each offering)
Cancellation	•	Cancellation option at anytime prior to full payment of the purchase price with refund of net amount paid by the grantee

The outstanding grants as of December 31, 2009 under the *Parent Company*'s share-based payment plan consist of grants under from the 13<sup>th</sup>, 13<sup>th</sup>A and 14<sup>th</sup> options.

Movements in the number of option shares outstanding under the share-based payment plan are as follows:

			2009		
	12 <sup>th</sup>	13 <sup>th</sup>	13 <sup>th</sup> A	14 <sup>th</sup>	Total
Balance as at January 1, 2009	2,789,031	6,978,620	_	_	9,767,651
Availed/Issued	(2,789,031)	(5,008,902)	_	_	(7,797,933)
Subscribed shares during the offering period			419,453	12,448,838	12,868,291
Cancelled	_	(58,399)	(12,316)	(31,844)	(102,559)
Balance as at December 31, 2009	-	1,911,319	407,137	12,416,994	14,735,450
			2008		
	12 <sup>th</sup>	13 <sup>th</sup>	13 <sup>th</sup> A	14 <sup>th</sup>	Total
Balance as at January 1, 2008	3,170,060	7,212,477	_	_	10,382,537
Availed/Issued	(381,029)	(1,594)	_	_	(382,623)
Cancelled	_	(232,263)	_	_	(232,263)
Balance as at December 31, 2008	2,789,031	6,978,620	_	_	9,767,651

As at December 31, 2009, a total of 1,466,780 shares were acquired by the officers and executives who exercised their options, at exercise prices ranging from P13.00 to P74.00 a share, depending on the option to which the shares apply.

The fair value of the offerings was estimated at the dates of the grant using the Black-Scholes Option Pricing Model, which considered annual stock volatility, risk-free interest rate, expected life of the offering, exercise price of \$\mathbb{P}\$51.00 to \$\mathbb{P}\$74.00 a share for the 13<sup>th</sup> to the 14<sup>th</sup> offerings. Share options become fully vested upon final settlement. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome.

In July 2009, the *BOD* ratified the resolution of the Board of Administrators of the *ESPP* to shorten the vesting period of the 13<sup>th</sup> offering from three years to two years. This resulted in the acceleration of the recognition of the cost of the grant. Total expense arising from the share-based payment plan amounted to P301 million in 2009, P116 million in 2008 and P73 million in 2007. See *Note 29 – Expenses and Income*.

### 21. Interest-bearing Long-term Financial Liabilities

This account consists of the following:

	2009	2008
	(Amount	ts in Millions)
Long-term portion of interest-bearing financial liabilities:		
Long-term debt	₽16,909	₽12,029
Redeemable preferred stock	325	1,199
	17,234	13,228
Current portion of interest-bearing financial liabilities:		
Long-term debt	2,285	1,666
Redeemable preferred stock	1,784	1,465
	4,069	3,131
	₽21,303	₽16,359

The current portion of preferred shares redeemed includes P1,149 million and P866 million as of December 31, 2009 and 2008, respectively, which have matured and have been called for redemption by the Company. Interest is no longer accrued for the portion of the preferred shares, which has been called for redemption.

The details are as follows:

Description	2009	2008
	(Amounts in Millions)	
Peso-denominated Debt		
Parent Company		
₽12 Billion Note Facility Agreement*:		
Fixed rate notes	₽5,127	₽5,633
Floating rate notes	<del>-</del>	5,520
₽5.5 Billion Note Facility Agreement:		
Fixed rate notes	1,600	_
Floating rate notes	3,900	_
₽3 Billion Term Loan Facility	3,000	_
₽5 Billion Note Facility Agreement	2,715	_
Loans payable to government entities in quarterly		
installments	1	2
Rockwell Land		
₽2 Billion Note Facility Agreement	1,860	2,000
Bridge Facilities and Term Loan	1,060	398
U.S. Dollar-denominated Debt		
Parent Company		
Availment under the Master Credit Agreement		
payable in semi-annual installments	_	22
Rockwell Land		
Floating rate corporate notes payable in quarterly		
installments	_	91
Euro-denominated Debt		
Parent Company		
Availment under the Master Credit Agreement		
payable in equal semi-annual installments	35	71
CHF-denominated Debt		
Parent Company		
Availment under the Master Credit Agreement	40	20
payable in equal semi-annual installments	19	38
Total long-term debt	19,317	13,775
Less unamortized debt issue costs	123	80
	19,194	13,695
Redeemable Preferred Stock	2,109	2,664
	21,303	16,359
Less portion maturing within one year	4,069	3,131
Long-term portion of interest-bearing financial liabilities	₽17,234	₽13,228

<sup>\*</sup> Includes value of embedded call option. See Note 31 – Financial Assets and Liabilities.

The scheduled maturities of the *Company*'s outstanding long-term debt at nominal values as at December 31, 2009 and 2008 are as follows:

			Decem	nber 31, 2009				
		U.S. Dollar	r Debt	Euro De	ebt	Swiss Fran	c Debt	
Year	Peso Debt -	In \$	In ₽	In €	In P	In CHF	In P	Total
				(Amounts in N	Millions)			
2010	₽2,230	\$-	₽_	€0.54	₽35	CHF0.44	₽19	₽2,284
2011	2,233	_	_	_	_	_	_	2,233
2012	1,779	_	_	_	_	_	_	1,779
2013	4,902	_	_	_	_	_	_	4,902
2014	4,718	_	_	_	_	_	_	4,718
After 2014	3,315	_	_	_	_	_	_	3,315
Total	₽19,177	\$-	₽-	€0.54	₽35	CHF0.44	₽19	₽19,231

December 31 2008

		U.S. Dolla	r Debt	Euro De	ebt	Swiss France	c Debt	
Year	Peso Debt	In \$	In ₽	In €	In ₽	In CHF	In ₽	Total
				(Amounts in N	Millions)			
2009	₽1,498	\$2.37	₽113	€0.54	₽36	CHF0.44	₽19	₽1,666
2010	1,240	_	_	0.54	35	0.44	19	1,294
2011	1,240	_	_	_	_	_	_	1,240
2012	1,240	_	_	_	_	_	_	1,240
2013	7,480	_	_	_	_	_	_	7,480
After 2013	740	_	_	_	_	_	_	740
Total	₽13,438	\$2.37	₽113	€1.08	₽71	CHF0.88	₽38	₽13,660

Peso-denominated Debt

### ₱12 Billion Note Facility Agreement

In December 2006, *MERALCO* raised ₱12,000 million from the local banking system consisting of ₱6,000 million in fixed-rate notes and ₱6,000 million in floating rate corporate notes. The proceeds were utilized to prepay all of the *Company*'s secured loans. In December 2009, the *Company* prepaid the balance of its floating rate notes. The fixed rate notes are payable in 24 quarterly installments until December 2013 inclusive of a one-year grace period. The amortization schedule is back-ended with the first 20 quarterly installments representing 2% of the original principal amount while the last four quarterly installments represent 15% of the original principal amount.

The fixed rate note has an embedded call option (prepayment option), which gives the *Parent Company* the right to redeem all or a part of any of the outstanding notes at an amount equivalent to 105% of the outstanding principal amount on any interest payment starting at the end of the second year from issue date.

### ₽5.5 Billion Note Facility Agreement

On December 9, 2009, *MERALCO* signed a ₱5,500 million Note Facility Agreement for the issuance of fixed and floating rate notes. The ₱1,600 million fixed rate notes mature in 2014 while the ₱3,900 million floating rate notes mature in 2015. The fixed rate notes are repaid at maturity while the floating rate notes are payable in annual installments of 3% of the original principal amount from 2010 to 2014 and the remaining balance payable in 2015.

### ₽3 Billion Term Loan Facility

On October 2, 2009, *MERALCO* signed a ₱3,000 million, 5-year bilateral term agreement with Unionbank of the Philippines. The loan was fully drawn on October 5, 2009 and matures in October 2014.

### ₽5 Billion Note Facility Agreement

In January 2009, *MERALCO* entered into a Note Facility Agreement for the issuance of \$\mathbb{P}2,715\$ million fixed rate notes with final maturity in January 2014 and \$\mathbb{P}2,285\$ million floating rate due in January 2010. The floating rate notes were prepaid in October 2009. The fixed rate notes are payable in annual installments of 1% of the original principal amount for the years 2010 to 2013 and the remaining balance payable in 2014.

### ₽2 Billion Note Facility Agreement

On July 19, 2007, *Rockwell Land* signed a Fixed Rate Corporate Notes Facility Agreement with First Metro Investment and Philippine Commercial Capital, Inc. (Joint Issue Managers and Lead Underwriters), Metropolitan Bank and Trust Company - Trust Banking Group (Facility Agent and Collateral Trustee), and Philippine Commercial Capital, Inc. - Trust and Investment Group (Paying Agent) for a ₱2,000 million fixed rate corporate notes or *Notes* to finance the development of the BPO buildings located in the *MERALCO* compound. The *Notes* were issued in two tranches, Tranche 1 and Tranche 2, each amounting to ₱1,000 million. Tranche 1 has been availed of in August 2007. Tranche 2 was availed of on February 28, 2008 and July 30, 2008, each amounting to ₱500 million. Of the total, ₱1,400 million is payable in 20 quarterly installments starting August 2009 and the balance of ₱600 million is payable in lumpsum in August 2014.

See Note 11 - Investment Properties.

### Peso Bridge Facilities and Term Loan

As of December 31, 2009, *Rockwell Land's* loans from various banks and financial institutions consist of bridge facilities payable in 2011 and a term loan payable in December 2014.

### U.S. Dollar-denominated Debt

In 2002, MERALCO availed of a \$4.668 million loan under the Master Credit Agreement with Credit Agricole (formerly Calyon) to finance the supply and installation of a distribution automation system. This loan was fully paid in May 2009.

Rockwell Land's dollar-denominated term loans from various local bank and institutions amounting to \$1.9 million as of December 31, 2008 were fully paid in April 2009.

### Euro-denominated Debt

In 2002, *MERALCO* availed of a €3.764 million loan under the Master Credit Agreement with Credit Agricole to finance the supply and installation of a 115 kV gas-insulated substation at the Central Business Park. This loan bears interest at 5.56% and is payable in equal semi-annual installments until November 2010.

### CHF-denominated Debt

In 2002, *MERALCO* availed of a CHF3.055 million loan under the Master Credit Agreement with Credit Agricole to finance the supply and installation of another 115 kV gas-insulated substation at the Central Business Park. This loan was priced at 6-month CHF LIBOR plus 0.7% and is payable in equal semi-annual installments in November 2010.

### Fixed Rate Loans

Principal Amount	Interest Rate	Maturity Date	2009	2008
			(Amounts	in Millions)
₽6 Billion Notes	9%	2013	₽5,127	₽5,633
₽2.715 Billion Notes	8.78650%	2014	2,715	· –
₽2 Billion Notes				
	8.8% fixed and 8.50%			
	fixed in 2009 and 2008,			
	respectively	2014	1,860	2,000
₽1.6 Billion Notes	7.46830%	2014	1,600	_
€3.764 Million Availment under the Master				
Credit Agreement	5.56%	2010	35	71
₽200 Million Term Loan	7.2632%	2010	149	_
₽150 Million Term Loan	8.5%	2014	148	_
Loans payable to government entities	3.5%	2011	1	2
Total			₽11,635	₽7,706

### Floating Rate Loans

Principal Amount	Interest Rate	Maturity Date	2009	2008
			(Amounts	in Millions)
₽3.9 Billion Notes	3-month PDST-F plus 1.1%	2015	₽3,900	₽_
₽3 Billion Term Loan	6-month PDST-F plus 1.5%	2014	3,000	_
Bridge Facilities and Term Loan	1-yr PDST-F plus 1.5%, 3 month PDST-F plus 2% in 2009 and			
	3 month PDST-F plus 2%; 1 year	r		
	PDST-F plus 2.25%		763	398
₽6 Billion Notes	3-month PDST-F plus 2%	2013	_	5,520
\$7.577 Million Corporate Notes CHF3.055 Million Availment under the	3-month LIBOR plus 2%	2009	-	91
Master Credit Agreement \$4.668 Million Availment under the	6-month LIBOR plus 0.7%	2010	19	38
Master Credit Agreement	6-month LIBOR plus 0.65%	2009	_	22
Total			₽7,682	₽6,069

#### Debt Covenants and Security Arrangements

The Company's loan agreements require compliance to financial ratios such as debt service coverage and debt-to-equity calculated at relevant measurement dates.

MERALCO's loan agreements contain restrictions with respect to creation of liens or encumbrances on assets, issuance of guarantees, mergers or consolidations, disposition of a significant portion of its assets and related party transactions.

All of *Rockwell Land*'s interest bearing loans and borrowings outstanding as of December 31, 2009 and 2008 are secured by assignment of receivables from the sale of *One Rockwell* and *Joya* units and Mortgage Participation Certificates on a Mortgage Trust Indenture and its amendments and supplements over the Rockwell Power Plant Mall

#### Unamortized Debt Issuance Costs

Unamortized debt discount, representing debt issuance costs and any difference between the fair value of consideration given or received in the initial recognition, included in the financial liabilities amounted to P123 million as at December 31, 2009 and P80 million as at December 31, 2008.

The following presents all changes to the unamortized debt issuance costs as at December 31, 2009 and 2008:

	2009	2008
	(Amounts i	n Millions)
Unamortized debt issuance costs at beginning of year	₽80	₽91
Additions during the year	97	7
Accretions during the year charged to interest and other		
financial charges	(54)	(18)
Unamortized debt issuance costs at end of year	₽123	₽80

#### Redeemable Preferred Stock

The movements, in terms of number of shares, of the Company's redeemable preferred stock are as follows:

	2009	2008
Balance at beginning of year	266,364,384	243,415,560
Redemptions	(55,435,729)	(19,447,517)
Reclassification	_	42,396,341
Balance at end of year	210,928,655	266,364,384

The *Company*'s Series "B" preferred stock was issued at par value of P10 a share to applicants/stockholders as required under the *MERALCO*'s terms and conditions for the purpose of extension of lines and facilities. Such shares are nonparticipating, nonconvertible and, like common stock, has no preemptive right to subscribe to any or all issues or other disposition of preferred stock. The preferred stock is also nonvoting, except in those cases expressly provided by law. Preferred stockholders are entitled to cumulative preferential dividends not exceeding 20% a year, payable at such interval as may be determined by the *BOD*. As provided for in the Articles of Incorporation of the *Parent Company*, redeemed shares are not considered retired and may be reissued. Such preferred stock is redeemable five years from date of issue at the option of the *Parent Company* or holder upon a 90-day notice.

The original "Terms and Conditions" of the *MERALCO*'s Special Stock Subscription Agreement, which require an applicant to subscribe to preferred stock with 10% dividend to cover the cost of such extension or new distribution facilities, has been amended by the Magna Carta for Residential Electricity Consumers or *Magna Carta* and the Distribution Services Open Access Rules or *DSOAR* effective July 19, 2004 and January 18, 2006, respectively. The amendment sets forth the issuance of preferred stock, only if such instrument is available.

The following table details the quarterly dividends paid at 10% per annum to preferred shareholders in 2009 and 2008:

Record Date	Payment Date	Amount
		(In Millions)
March 31, 2008	April 30, 2008	₽46
June 30, 2008	July 31, 2008	42
September 30, 2008	October 31, 2008	40
December 31, 2008	January 30, 2009	37
March 31, 2009	April 30, 2009	37
June 30, 2009	July 31, 2009	35
September 30, 2009	October 30, 2009	33
December 31, 2009	January 29, 2010	14

#### 22. Customers' Deposits

		2009			2008	
	Current			Current		
	Portion	Long-term		Portion	Long-term	
	(see Note 26)	Portion	Total	(see Note 26)	Portion	Total
			(Amounts	in Millions)		
Meter deposits:						
Principal	₽744	₽645	₽1,389	₽267	₽1,271	₽1,538
Accrued interest	628	644	1,272	190	1,151	1,341
Bill deposits:			·			
Principal	518	15,256	15,774	530	13,918	14,448
Accrued interest	167	8,518	8,685	630	7,103	7,733
	₽2,057	₽25,063	₽27,120	₽1,617	₽23,443	₽25,060

Meter Deposits

Meter deposit is intended to guarantee provision of metering equipment.

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

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," which required the refund to be completed not later than 66 months from March 26, 2008. Under the terms of the resolution, a customer has the option of receiving his refund through cash, credit to future monthly billings, or as an offset to other due and demandable claims of the private utility against him.

The Magna Carta and DSOAR also required the payment of interest on outstanding meter deposit as follows:

Interest Coverage Period	Interest Rate
Meter deposits paid before September 22, 1995	
From payment date prior to September 22, 1995	6%
From September 22, 1995 to date prior to effectivity of <i>Magna Carta</i> or <i>DSOAR</i> , as applicable	10%
From effectivity of Magna Carta or DSOAR, as applicable through start of refund of meter deposits	6%
Meter deposits paid on or after September 22, 1995	10%

On August 8, 2008, in compliance with *ERC* Resolution No. 8, the *Parent Company* submitted to the *ERC* an accounting of the total meter deposit principal amount for refund which as of June 30, 2008 was at \$\mathbb{P}\$1,507 million. The actual refund of meter deposits commenced on November 3, 2008.

For the period ended December 31, 2009 and 2008, the *Parent Company* has already refunded ₱387 million and ₱309 million in principal and interests, respectively.

#### Bill Deposits

Bill deposit serves to guarantee payment of bills by a customer, which based on corporate policy is to equal one month's consumption or bill of the customer.

As required under the *Magna Carta* and *DSOAR*, residential and non-residential customers, respectively, are required to deposit with the *DU* an amount equivalent to the estimated monthly bill calculated based on applied load, which shall be recognized as bill deposit of the customer. Such deposit shall be adjusted after one year based on the historical 12-month average bill. A customer who has paid his electric bills on or before due date for three consecutive years, may now 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 month from termination of service, provided all bills have been paid.

A series of exchanges was initiated by *MERALCO* with the Energy Regulatory Board or *ERB* and its successor organization, *ERC* to seek clarification with respect to the interest rate applicable to the bill deposits to the consumer groups as well as the effectivity dates.

The interest rates applied by *MERALCO* on meter deposits of residential and non-residential customers were based on the "*Implementing Guidelines of the Magna Carta*," the *DSOAR*, provisions of *Magna Carta* and clarificatory letters of the *ERC*. The *Implementing Guidelines of the Magna Carta* was specific with respect to the interest rates on meter deposits while the *DSOAR* superseded *ERB* Resolution 95-21, which adopted a 10% interest on customers' deposits.

On January 24, 2007, the *ERC* confirmed that the interest rate on bill and meter deposits of residential customers shall be governed by the *Magna Carta* and its implementing guidelines, while the interest rate for bill deposits of non-residential customers shall be either 10% or 1% depending on the date of contract effectivity.

With respect to contracts of service executed by non-residential customers on or after the effectivity of *DSOAR*, the 1% interest rate for bill deposits applies, while in the case of residential customers, the latter shall continue to be entitled to 10% interest rate, as incorporated in the *Parent Company*'s weighted average cost of capital or *WACC*, in accordance with the provisions of the *Magna Carta*, until such time that a new *WACC* is put in place where bill deposits are no longer incorporated.

The Parent Company believes that the foregoing interpretation is consistent with law and in harmony with the ERC's own interpretation as embodied in the Implementing Guidelines of the Magna Carta, considering that the same principle of law applies to meter and bill deposits.

Based on the foregoing, there are certain legal impediments and inconsistencies with previous pronouncements of the *ERC* on the issue of interest on bill deposits, as noted by *MERALCO*. Hence, the *Parent Company* believes that rules similar to those applied to meter deposits, must be put in place by the *ERC* to apply to bill deposits. In the meantime, the *Parent Company* adopted the "Rules to Govern the Refund of Meter Deposits," insofar as the computation of interest for bill deposits is concerned. Accordingly, interests on bill deposits using the rates of interest applied were as follows:

#### Residential Customers

<ul> <li>For those paying bill deposits before effectivity of ERB Resolution 95-21 or September 22, 1995:</li> </ul>	
- From date of payment to date prior to September 22, 1995	6%
- From September 22, 1995 to date prior to the refund	10%
For those paying bill deposits on or after September 22, 1995	10%
<ul> <li>For those paying bill deposits before effectivity of ERB Resolution 95-21 or September 22, 1995:</li> </ul>	
1 3 0 1	
- From date of payment to date prior to September 22, 1995	6%
- From September 22, 1995 to date prior to the effectivity of <i>DSOAR</i>	10%
- From effectivity of <i>DSOAR</i> until the date prior to the refund	1%
For those paying bill deposit on or after September 22, 1995:	. 70
- From September 22, 1995 to date prior to the effectivity of <i>DSOAR</i>	10%
·	
- From effectivity of the DSOAR until the day prior to the refund	1%

Under the *DSOAR*, the *Parent Company* shall pay interest on bill deposits paid by non-residential customers at the rate equivalent to the prevailing interest rate for savings deposits as approved by the Bangko Sentral ng Pilipinas. In a letter dated November 3, 2006, the *ERC* clarified that the "currently prevailing interest rate for savings deposits is 1% since this is the interest rate used by two largest commercial banks and the Land Bank of the Philippines or *Land Bank*, as government bank."

Subsequently, on February 22, 2010, the *ERC* promulgated the amended *DSOAR*, which shall be effective by April 1, 2010. Under the amended *DSOAR*, interest on bill deposits for both residential and non-residential customers shall be computed using a rate equivalent to the peso savings account interest rate of Land Bank or other government banks on the first working day of the year, subject to the approval of the *ERC*.

Based on the relevant *ERC* Guidelines as discussed in the foregoing, meter and bill deposits and the related accrued interest are currently being refunded.

#### 23. Provisions

Provisions consist of amounts provided for legal and regulatory claims, as well as probable losses and possible refunds such as for transmission charge over-recoveries.

Movements in 2009 and 2008 are as follows:

		2009			2008	
	L	osses and		Losses and		
	Claims	Refunds	Total	Claims	Refunds	Total
	(Amounts in Millions)					
Balance at beginning of year	₽1,645	₽4,098	₽5,743	₽1,396	₽_	₽1,396
Provisions	3,351	3,333	6,684	318	4,098	4,416
Settlements/reversals	(18)	(4,917)	(4,935)	(69)	_	(69)
Balance at end of year	₽4,978	₽2,514	₽7,492	₽1,645	₽4,098	₽5,743

See Note 6 - Significant Accounting Judgments and Estimates and Note 33 - Contingencies.

#### 24. Customers' Refund

This account represents the balance of the unclaimed refund related to the SC of the Philippines decision promulgated on April 30, 2003:

	2009	2008
	(Amounts	s in Millions)
Gross refund amounts:		
Phase I	₽335	₽338
Phase II	295	295
Phase III	181	334
Phase IV	8,561	10,418
	9,372	11,385
Less present value effect:		
Balance at beginning of year	780	1,626
Less interest accretion during the year	555	846
Balance at end of year	225	780
•	9,147	10,605
Less current portion	9,147	7,925
·	₽_	₽2,680

On June 2003, the *ERC*, in implementing the *SC* decision, ordered *MERALCO* to refund to its customers an equivalent P0.167 per kWh for billings covering the period February 1994 to April 2003. The refund is being implemented in four phases up to December 2010 as follows:

a. Phase I, which involves refunds to residential and general service customers who consumed 100 kWh or less of electricity as at April 2003 (or in their last complete month's bill for services whose contracts with the *Parent Company* have been terminated).

- b. Phase II, which involves refunds to residential and general service customers who consumed 101 to 300 kWh as at April 2003 (or in their last complete month's bill for services whose contracts with the *Parent Company* have been terminated), from September 2003 to February 2004.
- c. Phase III, which involves refunds to residential and general service customers who consumed more than 300 kWh of electricity as at April 2003, was implemented by the *Parent Company* over a period of 12 months starting January 2004.
- d. Phase IV, involves refunds to commercial and industrial customers and all other customers not covered by Phases I–III. There are two sub-phases for Phase IV, based on the kWh consumption.

Based on Revenue Regulation 8-2005, refunds under Phase IV are subject to withholding tax at the rate of 25% for active customers and 32% for terminated accounts, as defined by the *BIR*. In connection with such regulation, *MERALCO* advanced a portion of the withholding tax and remitted the same to the *BIR*. Such amount was applied against amounts actually withheld from the refunded claims.

As of December 31, 2009, the advanced portion of the withholding tax has been fully applied against amounts actually withheld from the refunded claims. See *Note 18 – Other Current Assets* for the related discussions.

All notifications for refund claim have been sent out to customers. The gross refund amounts have been adjusted for the present value effect since actual refund is expected to be implemented over four years beginning July 2005. Based on the *ERC* order, *MERALCO* shall complete payment of all refund claims by December 31, 2010.

#### 25. Notes Payable

Notes payable represent unsecured, peso-denominated, interest-bearing working capital loans obtained from various local financial institutions maturing within a year or less. Annual interest rates ranged from 4.00% to 9.50% in 2009 and 6.50% to 10.50% in 2008.

Interest expense on notes payable amounted to P170 million, P595 million and P260 million in 2009, 2008 and 2007, respectively. See *Note 29 – Expenses and Income*.

#### 26. Trade Payables and Accrued Expenses

This account consists of the following:

	2009	2008
	(Amounts	s in Millions)
Trade accounts payable (see Note 27)	₽16,943	₽9,836
Output VAT - net	2,238	2,890
Accrued expenses:		
Interest	430	588
Taxes	770	956
Liability for GSL payout	124	_
Current portions of:		
CERA I and II over recoveries and carrying charges	983	917
Meter deposits (see Note 22)	744	267
Interest on meter deposits (see Note 22)	628	190
Bill deposits (see Note 22)	518	530
Liability arising from deferred pass-through fuel costs (see Note 12)	433	1,242
Security deposit	191	87
Interest on bill deposits (see Note 22)	167	630
Retentions payable	96	94
Deferred lease income	62	32
Derivative liability (see Note 31)	28	35
Dividends payable on:		
Redeemable preferred stock	288	307
Common stock	26	14
Accrued universal charges	425	178
Advances for construction	163	105
Transmission backbillings	132	134
Excess collections over recognized receivables	_	1,578
Accrued development costs	_	149
Other current liabilities	2,872	1,909
	₽28,261	₽22,668

#### Trade Accounts Payable

Trade accounts payable mainly represent obligations to power suppliers, namely, *NPC*, *NGCP* (effective January 15, 2009), Philippine Electricity Market Corporation or *PEMC*, *FGPC* and *FGP*, Quezon Power (Philippines) Limited Company or *QPPL* and Philippine Power Development Corporation or *Philippodeco* for costs of power purchased. Trade accounts payable also include transmission line fee charges in connection with the *Parent Company*'s Transmission Line Agreement or *TLA*, with *QPPL*. Such liability includes monthly transmission line fee for the scheduled extension costs, which the *ERC* has not allowed as pass through costs. In addition, this account includes liabilities due to local and foreign suppliers for purchases of goods and services, which are mainly transformers, poles, contracted services and operating materials and supplies.

As of December 31, 2009, the *Parent Company*'s obligation to *NPC* (assigned to Power Sector Assets and Liabilities Management Corporation or *PSALM*) of ₱5,712 million was included in a ₱64 million garnishment issued by the Municipal Trial Court of Pili, Camarines Sur on December 16, 2009 in favor of the Estate of Susano J. Rodriguez. Separately, on December 23, 2009, another order of garnishment in favor of *NPC* Drivers and Mechanics Association, et. al., amounting to ₱38 million was issued by the *SC*. As of December 31, 2009, the *Parent Company* was legally prevented from paying its obligation to *NPC*.

Trade payables are noninterest-bearing and are generally settled within the 60-day terms. Other payables are noninterest-bearing and have an average recognition period of no more than six months.

See Note 27 - Related Party Transactions and Note 34 - Significant Contracts and Commitments.

#### CERA I and II

The amounts of *CERA* I and II refunds pertain to over-recoveries of foreign exchange adjustments related to foreign currency-denominated debt outstanding from June 2003 to December 2006. The related foreign currency-denominated loans were substantially settled in 2006.

MERALCO began to refund such over-recoveries amounting to ₱3,092 million plus carrying charge of ₱833 million, at the rate of ₱0.1461 per kWh. The refund was implemented since March 2009 and shall continue until such time that the full amount shall have been fully refunded.

As of December 31, 2009, the outstanding amount to be refunded in the next four months is ₱983 million, inclusive of ₱209 million in carrying charges. The refund is expected to be completed by April 2010.

#### Transmission Backbillings

This account pertains to the amount refundable to customers related to *ERC*'s decision on the revision of the minimum charge provision in the *Parent Company*'s rate schedules. This revision, which involves a change in the basis of the computation of the transmission charge component of the minimum charge, resulted in a liability to customers estimated at \$\mathbb{P}\$1,085 million. *MERALCO* implemented the refund based on an *ERC* order beginning 2006.

As of December 31, 2009 and 2008, the outstanding liability amounted to P132 million and P134 million, respectively.

#### Advances for Construction

Article 14 of the "Magna Carta for Residential Customers," specifically, "Right to Extension of Lines and Facilities" requires customers requesting for an extension of lines and facilities beyond 30 meters serving distance from the nearest voltage facilities of the *DU* to advance the cost of the project. As of February 22, 2009, such advances from customers are being refunded at the rate of 25% of the distribution revenue generated from the extension lines and facilities until such amounts are fully refunded or five years, whichever is shorter. The customer advances are noninterest-bearing. The related asset forms part of the *Company*'s rate base only at the time a refund has been paid out.

The amended *DSOAR* promulgated on February 22, 2010 increased the refund rate to 75% of the distribution revenue generated from the extension lines and facilities until such amounts are fully refunded.

As of December 31, 2009 and 2008, the noncurrent portion of advances for construction of ₱3,022 million and ₱2,220 million, respectively, is included under "Other noncurrent liabilities" account in the consolidated statement of financial position.

## 27. Related Party Transactions

The following provides the total amount of transactions, which have been entered into by the *Company* with related parties for the relevant financial year. The outstanding balances at reporting date are unsecured, interest free (except those relating to deferred pass-through fuel costs) and settled in cash. There have been no guarantees provided or received for any related party receivables or payables. See *Note 12 – Deferred Pass-through Fuel Costs* and *Note 34 – Significant Contracts and Commitments* for the related discussions.

PPA with FGPC and FGP

MERALCO has distinct PPAs with FGPC and FGP for the purchase of 7,271 million kWh from the Sta. Rita Power Plant and 3,635 million kWh of power from the San Lorenzo Power Plant, respectively. Total purchases of power from FGCP and FGP amounted to ₱48,519 million, ₱55,283 million and ₱44,976 million for the years ended December 31, 2009 2008, and 2007, respectively.

Pole Attachment Contracts with PLDT and Smart Communications, Inc. or SMART

The Parent Company has a Pole Attachment Contract with PLDT for a three year period up to December 31, 2011. PLDT facilities shall be attached to their designated pole space in accordance with the standards set forth by MERALCO. Under the Pole Attachment Contract, the PLDT shall use the contacted cable position exclusively for its telecommunication cable network facilities. The annual revenue under such contract based on the contracted pole spaces as of contract date is \$\mathbb{P}220\$ million.

Total fees billed under the contracts amounted to about P100 million for the period July 14, 2009 (date at which *PLDT* has effective ownership interest in *MERALCO*) to December 31, 2009.

Sale of Electricity under Various Service Contracts

Several offices, service branches, manufacturing facilities of *MERALCO*'s shareholders and affiliates are located within the franchise area of *MERALCO*. As such, *MERALCO* sells electricity to such shareholders and affiliates. The rates charged to related parties are the same *ERC*-mandated rates charged to all customers within the franchise area.

Total revenues billed to its major shareholders, *PLDT*, *MPIC*, *SMC* and *First Holdings* and their respective subsidiaries amounted to ₱719 million for the period July 14, 2009 to December 31, 2009, ₱1,004 million for the period January 1 to December 31, 2009 and ₱81 million for the period January 1 to December 31, 2009, respectively.

Purchase of Telecommunication Services from PLDT and Subsidiaries

The *Company*'s primary telecommunications carriers are *PLDT* for its wireline and *SMART* for its wireless services. Such services are covered by distinct service contracts between the telecommunications carrier and each legal entities of the *Company*.

The total amount of services purchased by the *Company* from *PLDT* and *SMART* amounted to about P12 million and P6 million, respectively, for the period July 14, 2009 to December 31, 2009.

Purchase of Goods and Services

In the ordinary course of business, the *Company* purchases goods and services from its affiliates and sells power to such affiliates. The details of the transactions are as follows:

Related Party	Relationship	Nature of Transaction	Year	Amount	Amount Owed by Related Party	Amount Owed to Related Party
riolated Farty	rtorationoriip	Trataro di Trandadioni	1001		ounts in Million	
GEPMICI	Associate	Purchase of meters and devices	<b>2009</b> 2008	<b>P194</b> 129	<b>P</b> _ _	<b>P</b> -
Indra Philippines	Associate	IT solutions provider	<b>2009</b> 2008	<b>571</b> 493	<del>-</del> 6	<b>15</b> 5
Philippine Electric Corporation	Affiliate	Purchase of power transformers	<b>2009</b> 2008	<b>957</b> 876	- -	<b>24</b> 34

Compensation of Key Management Personnel of the Company

The compensation of key officers of the Company by benefit type is as follows:

	2009	2008	2007
		(Amounts in Millions)	
Short-term employee benefits	₽220	₽275	₽288
Long-term and retirement benefits	62	71	84
Share-based payments	11	25	9
Total compensation paid to key management personnel	₽293	₽371	₽381

Each of the directors is entitled to a director's per diem of \$\mathbb{P}30,000\$ for each meeting of the \$BOD\$ attended. Each of the members or advisors of the Audit and Risk Management, Compensation, Finance, Governance and Nomination Committees is entitled to a per diem of \$\mathbb{P}6,000\$ or \$\mathbb{P}8,000\$ for the committee chairman for each committee meeting attended. The fees were last adjusted on June 10, 2009.

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 the retirement and pension plans.

#### 28. Revenues and Purchased Power

Electricity Revenue

Electricity revenues account for 97% of the total revenues in 2009 and 98% for both 2008 and 2007. Following is a breakdown electricity revenues for the years ended December 31, 2009, 2008 and 2007:

	2009	2008	2007
	(Amounts in Millions)		
Pass-through charges:			
Generation charge	₽106,695	₽120,445	₽126,816
Transmission charge	23,250	25,512	27,227
System loss charge	16,108	16,139	17,316
Power Act reduction	(660)	(814)	(584)
Inter-class, lifeline subsidies and others	1,600	(488)	(427)
CERA I and II	_	· –	4
Wheeling charges:			
Distribution charges	21,276	17,594	17,435
Supply charge	6,560	5,753	5,707
Metering charge	3,923	2,923	2,894
	178,752	187,064	196,388
Less intersegment sales	66	65	217
	₽178,686	₽186,999	₽196,171

Distribution revenue accounted for 18% of total revenues in 2009 and 14% in 2008 and 13% in 2007.

See Note 7 – Segment Information and Note 26 – Trade Payables and Accrued Expenses for related discussions.

Purchased Power

Actual purchased power costs are pass-through costs and are revenue-neutral to the *Parent Company*. The details are as follows (see Note 34):

	2009	2008	2007
		(Amounts in Million	s)
Generation charge	₽127,116	₽131,863	₽144,388
Transmission charge	23,812	25,009	28,449
	₽150,928	₽156,872	₽172,837

Purchased power includes capacity fees, fixed operating fees and transmission line fees that are accounted for similar to a lease under Philippine Interpretation *IFRIC 4*. These amounted to ₱20,900 million, ₱21,592 million and ₱17,107 million in 2009, 2008 and 2007, respectively, and are presented as part of "Purchased power" account in the consolidated statements of income. This is inclusive of the allowable system loss charges up to the 9.5% cap. In 2009 and 2008, the *Parent Company*'s system loss rates were below the 9.5% cap.

In 2009 and 2007, the *Company* had net under-recoveries with respect to pass-through charges amounting to \$\mathbb{P}\$5,535 million and \$\mathbb{P}\$1,802 million, respectively, while it incurred net over-recoveries of \$\mathbb{P}\$4,410 million in 2008. Over-or under-recoveries are refundable to or recoverable from customers, respectively, subject to the approval of the *ERC*.

Net over (under)-recoveries from generation and transmission pass-through costs for the period follow:

	2009	2008	2007
		(Amounts in Millions	)
Generation charge	₽106,695	₽120,445	₽126,816
Transmission charge	23,250	25,512	27,227
System loss charge	16,108	16,139	17,316
Power act reduction	(660)	(814)	(584)
Recoverable purchased power	(150,928)	(156,872)	(172,577)
Net over (under)-recoveries for the year	(₽5,535)	₽4,410	(₽1,802)

See Note 13 – Other Noncurrent Assets and Note 33 – Contingencies for the status of accumulated over- or under-recoveries.

The details of purchased power follow:

	2009	2008	2007
		(Amounts in Millions	s)
FGPC and FGP	₽48,519	₽55,283	₽44,976
NPC/PSALM	51,807	49,406	54,998
TransCo/NGCP	23,811	25,009	28,449
QPPL	15,477	14,072	12,813
WESM (PEMC)	11,284	13,083	31,578
Others	30	19	23
	₽150,928	₽156,872	₽172,837

# 29. Expenses and Income

Operations and Maintenance

	2009	2008	2007
		(Amounts in Million	ns)
Salaries, wages and employee benefits			
(see Notes 20, 27 and 30)	₽7,866	₽7,279	₽7,999
Contractors' services	3,626	3,283	2,954
Provision for doubtful accounts, net of recoveries (see Note 15)	886	1,566	576
Transportation and travel	398	272	379
Materials and supplies	326	338	360
Corporate expenses	302	306	300
Supervision and regulation fees	269	328	198
Property insurance	199	92	70
Others	30	163	344
	₽13,902	₽13,627	₽13,180

Salaries, Wages and Employee Benefits

	2009	2008	2007
		(Amounts in Millions)	
Salaries and wages	₽5,466	₽4,986	₽4,882
Pension cost (see Note 30)	1,886	1,889	2,858
Employee share-based payments (see Note 20)	301	116	73
Post-employment benefits other than pensions (see Note 30)	109	184	87
Social security costs	104	104	99
·	₽7,866	₽7,279	₽7,999

#### Cost of Contracts and Services

	2009	2008	2007
		(Amounts in Millio	ns)
Salaries, wages and employee benefits	₽708	₽584	₽563
Contractors' cost	661	517	437
Materials and supplies	171	163	294
Others	263	192	121
	₽1,803	₽1,456	₽1,415

# Interest and Other Financial Charges

	2009	2008	2007
		(Amounts in Million	s)
Interest expense on interest-bearing long-term financial liabilities			
(see Note 21)	₽1,541	₽1,325	₽1,285
Interest expense on bill deposits (see Note 22)	1,120	925	864
Carrying charge on <i>ERC</i> -approved over-recoveries (see Note 2)	543	934	124
Interest expense on notes payable (see Note 25)	170	595	260
Interest expense on meter deposits (see Note 22)	81	89	99
Amortization of:			
Debt issue costs (see Note 21)	54	18	21
Loan premium (see Note 21)	(27)	(27)	(25)
Interest expense on deferred pass-through fuel costs	15	141	320
Capitalized interest	(175)	(88)	(102)
Others	<b>.</b> 6	223	153
	₽3,328	₽4,135	₽2,999

## Interest and Other Financial Income

	2009	2008	2007
		(Amounts in Millions	s)
Carrying costs on ERC-approved under-recoveries (see Note 2)	₽2,782	₽813	₽19
Interest income on placements Amortization of unearned interest on installment trade	413	321	369
receivables Mark-to-market gains (losses) from derivative instruments	293	450	574
(see Note 31)	82	(167)	187
Others	354	1,502	998
	₽3,924	₽2,919	₽2,147

## 30. Retirement Plan

Defined Benefit Pension Plan

The features of the Company's defined benefit plans are discussed in Note 5 – Summary of Significant Accounting Policies.

Net Pension Cost (included as part of "Operations and maintenance expenses - Salaries, wages and employee benefits" account)

Actuarial valuations of the retirement plans are done annually by independent actuaries. The present value of accrued benefit costs and period net benefit costs as at and for the years ended December 31, 2009, 2008 and 2007 are as follows:

	2009					
	MIESCOR					
		Rockwell	Group			
	Parent	Land	and CEDC	Total		
	(Amounts in Millions)					
Interest costs on benefit obligation	₽2,033	₽6	₽4	₽2,043		
Current service costs	793	5	2	800		
Expected return on plan assets	(722)	(4)	(1)	(727)		
Past service costs	1	17	-	18		
Actuarial loss (gain)	_	(1)	5	4		
Settlement gain	(252)	_	_	(252)		
Net pension cost	₽1,853	₽23	₽10	₽1,886		
Actual return on plan assets	₽4,127	₽21	₽2	₽4,150		

	2008			
			MIESCOR	
		Rockwell	Group	
	Parent	Land	and CEDC	Total
	(Amounts in Millions)			
Interest costs on benefit obligation	₽1,730	₽6	₽4	₽1,740
Current service costs	964	9	3	976
Expected return on plan assets	(826)	(4)	(1)	(831)
Past service costs	1	1	_	2
Actuarial loss	_	_	2	2
Net pension cost	₽1,869	₽12	₽8	₽1,889
Actual return (loss) on plan assets	(₽1,695)	(₽6)	₽1	(₽1,700)

	2007			
			MIESCOR	
		Rockwell	Group	
	Parent	Land	and CEDC	Total
		(Amoun	ts in Millions)	
Interest costs on benefit obligation	₽1,915	₽5	₽5	₽1,925
Current service costs	1,104	8	4	1,116
Expected return on plan assets	(373)	(2)	(1)	(376)
Past service costs	1	<u>-</u>	_	1
Actuarial loss	609	_	2	611
Settlement gain	(419)	_	_	(419)
Net pension cost	₽2,837	₽11	₽10	₽2,858
Actual return on plan assets	₽5,889	₽5	₽	₽5,894

Pension Liability (Asset)

	2009			
			MIESCOR	
		Rockwell	Group	
	Parent	Land	and CEDC	Total
	(Amounts in Millions)			
Defined benefit obligation	₽25,067	₽126	₽62	₽25,255
Fair value of plan assets	(16,166)	(164)	(18)	(16,348)
Unrecognized net actuarial gains (losses)	1,380	<b>2</b>	(20)	1,362
Unrecognized past service cost	(4)	(30)	· -	(34)
Pension liability (asset)	₽10,277	( <b>P</b> 66)	₽24	₽10,235

			2008	
			MIESCOR	
		Rockwell	Group	
	Parent	Land	and CEDC	Total
		(Amoun	ts in Millions)	
Defined benefit obligation	₽22,594	₽50	₽50	₽22,694
Fair value of plan assets	(10,309)	(82)	(17)	(10,408)
Unrecognized net actuarial gains (losses)	(421)	11	(15)	(425)
Unrecognized past service cost	(5)	(7)		(12)
Pension liability (asset)	₽11,859	(₽28)	₽18	₽11,849

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

	2009				
		MIESCOR			
		Rockwell	Group		
	Parent	Land	and CEDC	Total	
		(Amour	nts in Millions)		
Defined benefit obligation at beginning					
of year	<b>₽</b> 22,594	₽50	₽50	₽22,694	
Interest costs	2,033	6	4	2,043	
Current service costs	793	5	2	800	
Benefits paid	(1,705)	_	(4)	(1,709)	
Past service costs		40	_	40	
Actuarial losses (gains) due to:					
Changes in assumptions	2,051	18	2	2,071	
Experience adjustments	(482)	7	8	(467)	
Effect of settlement	(217)	_	_	(217)	
Defined benefit obligation at end of year	₽25,067	₽126	₽62	₽25,255	

			2008	
			MIESCOR	
		Rockwell	Group	
	Parent	Land	and CEDC	Total
		(Amoun	ts in Millions)	_
Defined benefit obligation at beginning				
of year	₽24,714	₽57	₽54	₽24,825
Interest costs	1,730	6	4	1,740
Current service costs	964	9	3	976
Benefits paid	(1,096)	_	(6)	(1,102)
Actuarial losses (gains) due to:				
Changes in assumptions	(3,886)	(19)	(5)	(3,910)
Experience adjustments	168	(3)	_	165
Defined benefit obligation at end of year	₽22,594	₽50	₽50	₽22,694

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

	2009				
	<b>5</b> /	Rockwell	Group		
	Parent	Land	and CEDC	Total	
		(Amounts in	Millions)		
Fair value of plan assets at beginning of year	<b>₽</b> 10,309	₽82	₽17	<b>₽</b> 10,408	
Expected return on plan assets	722	4	1	727	
Actuarial gains	3,405	17	1	3,423	
Benefits paid	(1,705)	_	(4)	(1,709)	
Contributions by employer	3,435	61	`3	3,499	
Fair value of plan assets at end of year	₽16,166	₽164	₽18	₽16,348	

	2008				
	MIESCOR				
		Rockwell	Group		
	Parent	Land	and CEDC	Total	
	(Amounts in Millions)				
Fair value of plan assets at beginning of year	₽11,800	₽47	₽10	₽11,857	
Expected return on plan assets	826	4	1	831	
Actuarial losses	(2,521)	(10)	_	(2,531)	
Benefits paid	(1,096)	· –	(6)	(1,102)	
Contributions by employer	1,300	41	12	1,353	
Fair value of plan assets at end of year	₽10,309	₽82	₽17	₽10,408	

The Parent Company expects to contribute ₱3,435 million to its defined benefit pension plan in 2010.

The major categories of plan assets of the *MERALCO* Pension Fund as a percentage of the fair value of total plan assets are as follows:

	2009	2008
	(In Perc	entage)
Marketable equity securities	94	49
Real properties	5	7
Bonds and commercial notes	1	25
Government securities	_	18
Receivables	-	1
	100	100

The overall expected rate of return on assets is determined based on the prevailing rates of equity securities applicable to the period over which the obligation is to be settled.

The key information of the retirement plan is as follows:

	For the years ended					
	2009	2008	2007	2006	2005	
	(Amounts in Millions)					
Present value of defined benefit obligation	₽25,255	₽22,694	₽24,825	₽27,473	₽12,851	
Fair value of plan assets	16,348	10,408	11,857	(5,967)	3,064	
Excess of present value of defined benefit				,		
obligation over fair value of plan assets	8,907	12,286	12,968	(21,506)	9,787	
Experience losses (gains) on plan liabilities	(467)	165	(748)	233	(3)	
Experience gains (losses) on plan assets	3,423	(2,531)	5,518	3,176	(79)	

Other Post-employment Benefits Expense (included as part of "Operations and maintenance expenses - Salaries, wages and employee benefits" account)

	2009	2008	2007
		(Amounts in Millions)	
Interest costs	₽78	₽92	₽92
Current service costs	43	33	29
Actuarial loss	36	59	49
Settlement gain	(48)	_	(83)
Net other post-employment benefit			
expense	₽109	₽184	₽87

Other Post-employment Benefits Liability (recorded as part of "Other noncurrent liabilities" account)

	2009	2008	
	(Amounts in Millions)		
Other post-employment benefit obligation	₽1,887	₽1,115	
Unrecognized net actuarial losses	(1,201)	(488)	
Benefit liability at end of year	₽686	₽627	

Changes in the present value of the other post-employment benefit liability are as follows:

	2009	2008	
	(Amounts in Millions)		
Balance at beginning of year	₽1,115	₽1,321	
Actuarial losses (gains)	835	(264)	
Interest costs	78	92	
Current service costs	43	33	
Benefits paid	(51)	(67)	
Effect of settlement	(133)		
Balance at end of year	₽1,887	₽1,115	

The principal assumptions used as of January 1, 2009, 2008 and 2007 in determining pension and other postemployment benefits obligations are shown below:

	2009	2008	2007
		(In Percentage)	
Discount rate	8.0-9.2	7.0-10.2	7.0-8.3
Expected rate of return on assets	6.0-10.0	7.0	7.0
Future range of salary increases	5.0-10.0	5.0-10.0	5.0-10.0

Defined Contribution Plan

In addition to its distinct defined benefit retirement plan, *MIESCOR* has a contributory defined contribution retirement plan. The annual contribution of *MIESCOR* to the Provident Fund is equivalent to 6% of the current monthly basic salaries of covered employees. The Provident Fund is maintained primarily for the purpose of establishing periodically the amounts of the benefits pertaining to the covered employees and is managed by a Board of Trustees. The employees' shares are represented by the units of the Provident Fund. Each unit is determined by dividing the net asset value of the Provident Fund by the aggregate number of units earned by the employee. Although the plan is a defined contribution, *MIESCOR* regularly monitors compliance with *RA* 7641, otherwise known as "The Retirement Pay Law." As at December 31, 2009 and 2008, *MIESCOR* is in compliance with the requirements of *RA* 7641.

Pension expense under this plan amounted to ₱1 million in 2009, 2008 and 2007.

The investment portfolio of such defined contribution plan seeks to achieve regular income and long-term capital growth and, consistent capital growth over its own portfolio benchmark. In order to attain this objective, the trustee's mandate is to invest in a diversified portfolio of bonds and equities, primarily domestic instruments. The portfolio mix is kept at 75% to 100% for debt and fixed income securities while 0% to 25% is allotted to equity securities.

The allocation of the fair value of the defined contribution plan asset of *MIESCOR* as at December 31, 2009 and 2008 is as follows:

	2009	2008	
	(In Percentage)		
Marketable equity securities	_	22	
Bonds and commercial notes	100	79	
Others	_	(1)	
	100	100	

MIESCOR currently expects to contribute ₱2 million to the defined benefit plan.

#### Consolidated Pension Benefit Costs

	2009	2008
	(Amounts	in Millions)
Expense recognized for defined benefit plans	₽1,886	₽1,889
Expense recognized for defined contribution plan	1	1
Consolidated pension benefit costs	₽1,887	₽1,890

## 31. Financial Assets and Liabilities

The *Company*'s principal financial liabilities, other than derivatives, consist of bank loans, including redeemable preferred shares and, trade and non-trade payables. The main purpose of such financial liabilities is to finance operations. Financial assets consist of and cash and cash equivalents and, trade and non-trade receivables, which arise directly from operations. Accounting policies related to financial assets and liabilities are set out in *Note 5 – Summary of Significant Accounting Policies*.

The following table sets forth the financial and nonfinancial assets and liabilities as at December 31, 2009 and 2008:

	Loans and Receivables	Held-to- maturity Investments	Designated at Fair Value through Profit or Loss	Held-for- trading	Available- for-sale Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities	Non- financial Assets and liabilities	Total
				(Am	ounts in Million	s)			
Assets as at December 31, 2009									
Noncurrent									
Utility plant and others - net	₽_	₽_	₽_	₽_	₽_	₽_	₽_	₽98.409	₽98.409
Construction in progress								3,703	3,703
Investment in associates and a joint	_	_	_	_	_	_	_	3,703	3,703
ventures		_		_			_	1,203	1,203
	_		_	_		_		8,021	8,021
Investment properties - net	-	_	-	_	_	_	_	3,161	3,161
Deferred pass-through fuel costs	_	_	_	_	_	_			
Deferred tax assets - net	-	-	4=0	-	_	-		17	17
Other noncurrent assets	6,240	-	172	-	361	-	6,773	6,157	12,930
Current									
Cash and cash equivalents	17,068	_	_	-	_	_	17,068	_	17,068
Trade and other receivables - net	21,600	-	-	_	-	-	21,600	-	21,600
Inventories	-	-	_	_	_	_		1,857	1,857
Land and development costs	-	-	_		_	_		1,191	1,191
Other current assets	_	_	11	_	_	_	11	2,958	2,969
Total assets	44,908	_	183	_	361	-	45,452	126,677	172,129
Liabilities as at December 31, 2009									
Noncurrent									
Interest-bearing long-term financial									
liabilities - net of current portion	_	_	_	_	_	17,234	17,234	_	17,234
Customers' deposits - net of current						,	,		,
portion	_	_	_	_	_	25,063	25.063	_	25,063
Deposits from condominium units sold	_	_	_		_			343	343
Deferred tax liabilities - net	_	_	_	_	_	_	_	4,230	4.230
Pension liability	_	_	_	_	_	_	_	10.301	10.301
Provisions	_		_	_	_	_		7.492	7.492
Other noncurrent liabilities	_	_	_	_	_	3,180	3,180	1,017	4,197
Current	_	_	_	_	_	3,100	3,100	1,017	4,137
						513	513		513
Notes payable	-	_	_ 28	-	_			4 4 2 4	
Trade payables and accrued expenses	-	-	28	_	_	24,099	24,127	4,134	28,261
Income tax payable	-	_	_	-	-			133	133
Customers' refund - current portion	_	_	_	-	_	9,147	9,147	_	9,147
Interest-bearing long-term financial									
liabilities - current portion	-	-	_	_	-	4,069	4,069	-	4,069
Total liabilities	-	-	28	-	_	83,305	83,333	27,650	110,983
Net Assets (Liabilities)	₽44,908	₽_	₽155	₽_	₽361	(₽83,305)	(₽37,881)	₽99,027	₽61,146

			Designated						
F	Loans and Receivables	Held-to- maturity Investments	at Fair Value through Profit or Loss	Held-for- trading	Available- for-sale Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities	Non- financial Assets and liabilities	Total
				(Am	ounts in Million	s)			
Assets as at December 31, 2008									
Noncurrent									
Utility plant and others - net	₽_	₽_	₽_	₽_	₽_	₽_	₽_	₽95.704	₽95,704
Construction in progress			· _	· _	· _	· _		5,149	5,149
Investment in associates and a joint								0,140	0,140
venture	_	_	_	_	_	_	_	1.378	1.378
Investment properties - net	_	_	_	_	_	_	_	5,505	5,505
Deferred pass-through fuel costs	_	_	_	_	_	_	_	3,792	3.792
Deferred tax assets - net	_	_	_	_	_	_	_	7	7
Other noncurrent assets	3.145	_	102	_	403	_	3.650	5,965	9.615
Current	0,		.02				0,000	0,000	0,0.0
Cash and cash equivalents	5.402	_	_	_	_	_	5.402	_	5.402
Trade and other receivables - net	37,509	_	_	_	_	_	37,509	_	37.509
Inventories	_	_	_	_	_	_	_	1,648	1,648
Land and development costs	_	_	_	_	_	_	_	1,566	1,566
Other current assets	_	_	19	_	_	_	19	2,591	2,610
Total assets	46,056	_	121		403		46,580	123,305	169,885
Liabilities as at December 31, 2008	,								,
Noncurrent									
Interest-bearing long-term financial									
liabilities - net of current portion	_	_	_	_	_	13,228	13,228	_	13,228
Customers' deposits - net of current									
portion	_	_		_	_	23,443	23,443	_	23,443
Deposits from condominium units pre-sold	_	_	_	_	_	_	_	36	36
Deferred tax liabilities - net	_	_	_	_	_	_	_	4,815	4,815
Pension liability	_	_		_	_	_	_	11,877	11,877
Provisions	_	_		_	_	_	_	5,743	5,743
Customers' refund - net of current portion	_	_	_	_	_	2,680	2,680	_	2,680
Currency Exchange Rate Adjustment									
(CERA) I and II over-recoveries,									
including carrying charges - net of									
current portion	_	_	_	_	_	3,008	3,008	_	3,008
Other noncurrent liabilities	_	_	_	_	_	2,431	2,431	628	3,059
Current									
Notes payable	_	_	_	_	_	9,828	9,828	_	9,828
Trade payables and accrued expenses	_	_	35	_	_	17,177	17,212	5,456	22,668
Income tax payable	_	-		_	_	_	_	2,285	2,285
Customers' refund - current portion	_	-	_	_	_	7,925	7,925	_	7,925
Interest-bearing long-term financial									
liabilities - current portion	_	_	_	_	_	3,131	3,131	_	3,131
Total liabilities	_	_	35	_	_	82,851	82,886	30,840	113,726
Net Assets (Liabilities)	₽46.056	₽_	₽86	₽_	₽403	(₽82.851)	(₱36,306)	₽92,465	₽56,159

The following table sets forth the consolidated carrying values and estimated fair values of the *Company*'s financial assets and liabilities recognized as at December 31, 2009 and 2008:

	Carryin	g Value	Fair \	/alue
	2009	2008	2009	2008
		(Amounts	in Millions)	
Noncurrent Financial Assets				
AFS financial assets:				
Quoted equity securities	₽339	₽329	₽339	₽329
Unquoted equity securities	22	74	22	74
Other noncurrent assets:				
Unbilled receivables	5,406	2,250	5,406	2,250
Derivative assets	172	102	172	102
SC GRAM case refund	780	780	780	780
Noncurrent portion of installment contracts				
receivable	54	115	70	115
Total noncurrent financial assets	6,773	3,650	6,789	3,650
Current Financial Assets				
Cash and cash equivalents:				
Cash on hand and in banks	6,399	3,601	6,399	3,601
Temporary cash placements	10,669	1,801	10,669	1,801
Trade and other receivables - net:				
Billed electricity	13,274	14,943	13,274	14,943
Unbilled electricity	5,537	20,078	5,537	20,078
Current portion of installment contracts	367	642	367	642
Service contracts and others	1,278	734	1,278	734
Nontrade - others	1,328	1,112	1,328	1,112
Other current assets -				
Derivative assets	11	19	11	19
Total current financial assets	38,863	42,930	38,863	42,930
Total Financial Assets	₽45,636	₽46,580	₽45,652	₽46,580

	Carrying Value		Fair Value		
	2009	2008	2009	2008	
		(Amounts i	n Millions)		
Noncurrent Financial Liabilities					
Interest-bearing long-term financial liabilities:	₽17,234	₽13,228	₽17,574	₽11,919	
Customers' deposits - net of current portion	25,063	23,443	24,872	23,443	
Customers' refund - net of current portion	25,005	2,680	24,012	2,680	
CERA I and II over-recoveries, including	_	2,000	_	2,000	
carrying charges - net of current portion	_	3,008	_	3,008	
Other noncurrent liabilities	3.180	2,431	3,180	2,431	
Total noncurrent financial liabilities	45.477	44.790	45.626	43,481	
Current Financial Liabilities	45,477	44,730	43,020	45,461	
Trade payables and accrued expenses:					
Trade accounts payable	16,943	9,836	16,943	9,836	
Accrued expenses	10,040	3,000	10,040	3,000	
Interest	430	588	430	588	
Liability for GSL payout	124	_	124	-	
Current portion of -			12-7		
CERA I and II over-recoveries and					
carrying charges	983	917	983	917	
Meter deposits	744	267	744	267	
Interest on meter deposits	628	190	628	190	
Bill deposits	518	530	518	530	
Liability arising from deferred pass-		000	• • • • • • • • • • • • • • • • • • • •	000	
through fuel costs	433	1.242	433	1.242	
Security deposits	191	87	191	87	
Interest on bill deposits	167	630	167	630	
Retentions payable	96	94	96	94	
Derivative liability	28	35	28	35	
Dividends payable	314	321	314	321	
Accrued universal charges	425	178	425	178	
Advances for construction	163	105	163	105	
Transmission backbillings	132	134	132	134	
Accrued development costs	_	149	_	149	
Other current liabilities	1,810	1.909	1,810	1.909	
Customers' refund - current portion	9,147	7,925	9,147	7,784	
Interest-bearing financial liabilities:	•	,	•	, -	
Notes payable	513	9,828	513	9,828	
Current portion of long-term debt	4,069	3,131	4,069	3,131	
Total current financial liabilities	37,858	38,096	37,858	37,955	
Total Financial Liabilities	₽83,335	₽82,886	₽83,484	₽81,436	

The fair value of the financial assets and liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. 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 – Billed, Unbilled, Service Contracts and Others and Nontrade, Refundable Deposits, Trade Payables and Accrued Expenses, Notes Payable and Liability Arising from Deferred Pass-through Fuel Costs

Due to the short-term nature of transactions, the fair values of these instruments approximate their carrying amounts as of reporting date. The value of "Trade payables and accrued expenses" includes the value of bifurcated embedded currency forwards.

Installment Contracts Receivable

The fair values of installment contracts receivable were calculated by discounting the expected future cash flows at prevailing credit adjusted *PDEx* interest rates ranging from 6.5% to 8.3% in 2009 and 7.1% to 8.7% in 2008.

Bifurcated Foreign Currency Forward and Foreign Currency Forward

The fair values of embedded currency forwards and freestanding currency forwards were calculated by reference to forward exchange market rates.

#### Bifurcated Call Option

The fair values of the embedded prepayment option were estimated based on prices derived using the binomial pricing methodology. The following inputs were used to determine the fair value of the bifurcated call option; contractual future cash flows, exercise price of P105, interest rate volatility of 26.29%, interest rate spot curves ranging from 6.28% to 8.12% in 2009 and 7.72% to 8.82% in 2008.

#### AFS Investments

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

Interest-bearing Long-term Financial Liabilities

The fair values were computed by discounting the expected future cash flows using the prevailing credit adjusted LIBOR, PDST-F, CHF LIBOR and EURIBOR rates ranging from 4.68% to 7.30% in 2009 and 1.75% to 8.135% in 2008 and *PDEx* interest rate ranging from 6.5% to 8.4% in 2009 and 6.5% to 7.7% in 2008.

#### Bill Deposits

The fair values of bill deposits are not determinable since the timing of each refund is linked to the cessation of service which is not reasonably predictable. Bill deposits are presented at cost.

#### Meter Deposits

The fair values of meter deposits were computed by discounting the expected future cash flows using the prevailing credit adjusted PDST-F rates ranging from 4.81% to 5.12% in 2009 and 6.22% to 6.83% in 2008.

#### Customers' Refund

The fair values were computed by discounting the expected future cash flows using the prevailing credit adjusted PDST-F rates ranging from 7.75% to 8.44% in 2008.

#### Preferred Stock

The fair values of preferred stock are not determinable since the timing of each redemption is not reasonably predictable. Preferred stock is presented at cost.

## Retention Payable and Security Deposits

The fair values were calculated by discounting the expected future cash flows at prevailing credit adjusted *PDEx* interest rates ranging from 6.3% to 7.4% in 2009 and 6.4% to 7.5% in 2008.

## Fair Value Hierarchy

As at December 31, 2009, the *Parent Company* held the following financial instruments measured at fair value. The *Parent Company* uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

	2009				
	Level 1 <sup>(1)</sup>	Level 2 <sup>(2)</sup>	Total		
	(Ar	nounts in Millions)			
Assets measured at fair value					
AFS investments (see Note 13)	₽_	₽361	₽361		
Derivative assets - current and noncurrent	_	183	183		
Liability measured at fair value					
Derivative liability	_	(28)	(28)		

<sup>(1)</sup> Fair values determined using observable market inputs that reflect quoted prices in active markets for identical assets and liabilities.

As at December 31, 2009 and 2008, the *Company* does not have financial instruments whose fair values are determined using inputs that are not based on observable market data (Level 3).

For the reporting year ended December 31, 2009, 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 *Company*'s financial instruments are cash flow interest rate risk, foreign currency risk, commodity price risk, credit risk and liquidity risk. The importance of managing those 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 summarized below.

Cash Flow Interest Rate Risk

The Company's exposure to the changes in market interest rates relates primarily to the Company's debt obligations with floating interest rates since the Company's interest-bearing short-term investments mature within 45 days or less.

The *Company*'s policy is to manage its interest rate risk exposure using a mix of fixed and variable rate debts, depending on what strategy will yield a reasonably lower effective cost based on market conditions. Refinancing of fixed rate loans may also be undertaken to manage interest cost. As of December 31, 2009 and 2008, approximately 61% and 73% of the *Company*'s borrowings are at a fixed rate of interest, respectively.

Rockwell Land's policy is to source loans with fixed interest rates whenever available.

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

	Within					More than	
	1 Year	1-2 Years	2-3 Years	3-4 Years	4-5 Years	5 Years	Total
						(Amounts	in Millions)
2009 Floating Rate Interest-bearing long-term financial liabilities	₽1,044	₽1,173	₽717	₽717	₽716	₽3,315	₽7,682
2008 Floating Rate Interest-bearing long-term financial liabilities	1,010	499	480	480	3,600	-	6,069

Interest on bank loans classified as floating rate is repriced at intervals of less than one year. The other financial liabilities of the *Company* that are not included in the foregoing table are non-interest-bearing or have no fixed or determinable maturity and are, therefore, not subject to interest rate risk. As previously mentioned, the *Company*'s short-term investments are not exposed to significant changes in market rates because they mature within 30 days or less to coincide with the *Company*'s monthly payment obligations.

<sup>(2)</sup> Fair values determined using inputs other than quoted prices that are either directly or indirectly observable for the assets or liabilities.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the *Parent Company* and *Rockwell Land*'s profit before tax as of December 31, 2009 and 2008 (through the impact on floating rate borrowings). There is no other impact on the *Parent Company* and *Rockwell Land*'s equity other than those already affecting the consolidated statements of income.

	2	2009	2	800			
	Increase	Effect on	Increase	Effect on			
	(Decrease) in	Profit	(Decrease) in	Profit			
	<b>Basis Points</b>	before Tax	<b>Basis Points</b>	before Tax			
	(Amounts in Millions)						
Parent Company							
Floating rate loans from various banks	+100	(₱69 million)	+100	(₱56 million)			
•	(100)	69 million	(100)	56 million			
Rockwell Land							
Floating rate loans from various banks	+100	(₱3 million)	+100	(₽8 million)			
-	(100)	3 million	-100	8 million			

Interest expense on floating rate loans is computed for the year, taking into account actual principal movements during the year, 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 the management in the above analysis.

#### Foreign Currency Risk

The revaluation of any of the *Company*'s foreign currency-denominated financial assets and 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 any amount of foreign currency-denominated debt. While an insignificant percentage of the *Company*'s revenues and debt is denominated in U.S. dollars, a substantial portion of the *Company*'s capital expenditures for electricity capital project 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 *Company*'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.

To manage foreign currency risks and stabilize cash flows, the *Parent Company* is allowed to recover foreign exchange losses on foreign currency-denominated loans through adjustments in customers' bills in accordance with *CERA* II

The following table shows the consolidated foreign currency-denominated financial assets and liabilities as of December 31, 2009 and 2008, translated to Philippine peso at the following exchange rates:

	2009	2008
US Dollar (\$)	₽46.20	₽47.52
Japanese Yen (¥)	0.51	0.52
Euro (€)	66.67	66.25
Swiss Francs (CHF)	44.81	43.66

		December 31, 2009			
		Foreign Cur	rency		
	J	apanese		Swiss	Peso
	US Dollar	Yen	Euro	Franc	Equivalent
		(Amou	nts in Millions)		
Financial assets:					
Cash and cash equivalents	\$85	¥–	€–	CHF-	₽3,936
Trade and other receivables	4	_	_	_	150
Advance payments to suppliers	3	-	_	_	138
	92	-	_	_	4,224
Financial liabilities:					
Trade payables and accrued expenses	(140)	_	(2)	_	(6,582)
Liability arising from deferred pass-through					
fuel costs	(9)	_	_	_	(433)
Interest-bearing long-term financial liabilities	_	_	(1)	_	(54)
	(149)	-	(3)	_	(7,069)
	(\$57)	¥–	(€3)	CHF-	(₱2,845)

December 31, 2008

		Japanese		Swiss	Peso
	US Dollar	Yen	Euro	Franc	Equivalent
		(Amoui	nts in Millions)		
Financial assets:					
Cash and cash equivalents	\$9	¥–	€–	CHF-	₽417
Trade and other receivables	2	_	_	_	94
Advance payments to suppliers	_	15	_	_	20
	11	15	_	_	531
Financial liabilities:					
Trade payables and accrued expenses Liability arising from deferred pass-through	(70)	(15)	(1)	-	(3,385)
fuel costs	(28)	_	_	_	(1,333)
Interest-bearing long-term financial liabilities	`(2)	_	(1)	(1)	(222)
	(100)	(15)	(2)	(1)	(4,940)
	(\$89)	¥–	(€2)	(CHF1)	(₽4,409)

- a. The *Parent Company*'s exposure to foreign currency risk on long-term debt principal payments is minimal because almost 100% of the *Company*'s debt is denominated in Philippine Peso. Thus, the impact of ₱1 movement of the Philippine peso against the U.S. dollar will not have a significant impact on the *Parent Company*'s principal and interest payments. Further, *PBR* assumes a forecast level of foreign currency movements in its calculation of the forecasted regulatory asset base and expenditures. *PBR* also allows for adjustment of the rates the *Parent Company* charges under *PBR* should there be significant deviations in the foreign exchange forecast from what is actually realized.
- b. As a result of *Rockwell Land*'s marketing operations in the United States, its statement of financial position can be affected significantly by movements in the U.S. dollar exchange rates.

It is *Rockwell Land*'s policy to limit its U.S. dollar-denominated receivables to an amount that approximately matches the U.S. dollar-denominated component of its development costs as well as its U.S. dollar-denominated borrowings. Also, *Rockwell Land* enters into deliverable currency forward contracts to hedge its foreign currency exposure should there be an excess in U.S. dollar-denominated assets over the U.S. dollar-denominated liabilities.

The following table demonstrates the sensitivity to a reasonably possible change in the U.S. dollar exchange rate vis-a-vis the peso, with all other variables held constant, of the *Company*'s profit before tax as of December 31, 2009 and 2008 (due to changes in the fair value of financial assets and liabilities). There is no other impact on the *Company*'s equity other than those already affecting the profit and loss.

	20	009	2008		
		Effect on		Effect on	
	Change	Profit	Change	Profit	
	in US\$ Rate	before Tax	in US\$ Rate	before Tax	
	(In %)	(In Millions)	(In %)	(In Millions)	
U.S. dollar-denominated financial assets	+5	(₽140)	+5	(₽218)	
and liabilities	-5	<b>₽</b> 140	-5	₽218	
Euro-denominated financial assets	+5	(₽9)	+5	(₽6)	
and liabilities	-5	₽9	-5	₽6	
Swiss Francs-denominated financial	+5	(₽1)	+5	(₱2)	
assets and liabilities	-5	P1	-5	₽2	
Others*	+5	(₽0.5)	+5	(₽0.3)	
	-5	₽0.5	-5	₽0.3	

<sup>\*</sup> Includes various currencies (Deutschmark, Australian dollar and Japan Yen)

Foreign exchange gain or loss is computed for the year based on management's best estimate of a +/-5 percent change in the closing Philippine peso-U.S. dollar conversion rate using the year end balances of U.S. dollar-denominated cash and cash equivalents, accounts receivable, loans, and forward contracts. 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 *Company*'s exposure to price risk is minimal. The cost of fuel is part of the *Parent Company*'s generation cost that is recoverable from the customers through the *Parent Company*'s generation charge.

#### Credit Risk

Credit risk is the risk that the *Company* will incur a loss arising from customers, clients or counterparties who fail to discharge their contracted obligations. The *Company* manages and controls credit risk by setting limits on the amount of risk that the *Company* is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

The *Company* trades only with recognized, creditworthy third parties. It is the *Company*'s policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis. In addition, receivable balances are monitored on an ongoing basis to reduce exposure to bad debt. Power distribution receivables are, to a certain extent, backed by bill deposits. Also, as a policy, disconnection notices are sent three days after the due date.

Trade receivables from sale of condominium units are secured with pre-completed condominium units the legal title and ownership of which are transferred to the customers upon full payment of the contract price. Receivables from leases are assured by security deposits, while receivables from sale of club shares are guaranteed by the shares held by the *Company*.

With respect to placements of excess cash with financial institutions, these institutions should pass the *Company*'s accreditation standards based on liquidity and solvency ratios and on the bank's credit rating. The *Company* shall transact only derivatives with similarly accredited financial institutions.

Credit risk arising from the other financial assets, which include cash and cash equivalents, trade and other receivables, *AFS* financial assets and certain derivative instruments, result from the *Company*'s exposure to credit risk arises from 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 *Company*'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 *Company*.

The table below shows the maximum exposure to credit risk for the components of the consolidated statements of financial position, including derivatives. The maximum exposure is shown gross, without taking account of collateral and other credit enhancement such as bill deposits and accrued interest.

	Gross Maximum Exposure		
	2009	2008	
	(Amount	s in Millions)	
Cash and cash equivalents:			
Cash on hand and in banks	₽6,399	₽3,601	
Temporary cash investments	10,669	1,801	
Trade and other receivables:			
Billed	13,274	14,943	
Unbilled	5,537	20,078	
Current portion of installment contracts receivables	367	642	
Service contracts and others	1,278	734	
Other receivables	1,328	1,112	
Other current assets -			
Derivative assets	11	19	
Other noncurrent assets:			
AFS investments	361	403	
Derivative assets	172	102	
Unbilled receivables	6,186	3,030	
Installment contracts receivables	54	115	
	₽45,636	₽46,580	

The credit quality of financial assets is managed by the *Parent Company* using "High Grade," "Standard Grade" and "Sub-standard Grade" as internal credit ratings. The table below shows the credit quality by class of asset:

			December	31, 2009		
	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 and cash equivalents Trade and other receivables: Trade:	₽15,430	₽_	₽	₽	₽-	₽15,430
Billed	3,676	2,835	4,547	2,100	2,088	15,246
Unbilled	· _	5,537	· _	· _	· _	5,537
Nontrade	372	· –	236	233	50	891
Other current assets -					_	
Derivative assets	11	_	_	_	_	11
Other noncurrent assets:						
AFS investments	98	_	_	_	_	98
Derivative assets	172	_	_	_	_	172
Unbilled receivables	_	6,186	_	_	_	6,186
	₽19,759	₽14,558	₽4,783	₽2,333	₽2,138	₽43,571

			December 3	31, 2008		
	Neither Pa	ast Due nor Im	paired			
		Standard	Sub- standard	Past Due but not	Impaired Financial	
	High Grade	Grade	Grade	Impaired	Assets	Total
			(Amounts in	Millions)		
Cash and cash equivalents	₽4,023	₽_	₽_	₽_	₽_	₽4,023
Trade and other receivables:						
Trade:						
Billed	4,040	3,330	4,912	2,661	1,927	16,870
Unbilled	_	20,078	_	_		20,078
Nontrade	829	_	_	283	49	1,161
Other current assets -						
Derivative assets	19	_	_	_	_	19
Other noncurrent assets:						
AFS investments	146	_	_	_	_	146
Derivative assets	102	_	_	_	_	102
Unbilled receivables	_	3,030	_	_	_	3,030
	₽9,159	₽26,438	₽4,912	₽2,944	₽1,976	₽45,429

Credit ratings are determined as follows:

## "High Grade"

This includes cash and cash equivalents, derivative assets and *AFS* investments to counterparties with good credit rating or bank standing, thus credit risk is minimal. This normally includes large prime financial institutions, companies and government agencies. For trade receivables, this consists of current month's billings (less than 30 days) that are expected to be collected within 10 days from bills are sent out.

#### "Standard Grade"

This includes *AFS* investments that are not classified as "High Grade." For trade receivables, this consists of current month's billings (less than 30 days) that are expected to be collected before expiry date (10 to 14 days after billed date).

#### "Sub-standard Grade"

This includes trade receivables that consist of current month's billings which are not foreseen to be collected within 60 days.

The credit quality of financial assets is managed by *Rockwell Land* using internal credit ratings. The table below shows the credit quality by class of asset:

	December 31, 2009				
	A Rating	B Rating	Total		
	(Amounts in Millions)				
Cash and cash equivalents	₽393	₽_	₽393		
Trade receivables from:					
Installment contracts	175	140	315		
Leases	60	7	67		
Advances to officers and employees	9	_	9		
Other receivables	17	_	17		
AFS investments	245	_	245		
	₽899	₽147	₽1,046		

	December 31, 2008			
	A Rating	B Rating	Total	
	"			
Cash and cash equivalents Trade receivables from:	₽456	₽-	₽456	
Installment contracts	243	273	516	
Lease	42	29	71	
Advances to officers and employees	7	_	7	
AFS investments	243	_	243	
	₽991	₽302	₽1,293	

For trade receivables from sale of condominium units, customers who have no history of delayed payment are classified as having a credit rating of "A" while customers who have history of delayed payment but is currently updated are given a credit rating of "B."

Trade receivables from leases are classified as having a credit rating of "A" when tenants pay within the discount period and "B" when tenants pay on or before due date.

The following table shows the aging analysis of financial assets of the Company:

			Dec	ember 31, 20	09		
		Pa	ast Due But N	ot Impaired			
	Neither Past Due nor Impaired	Less than 30 days	31 to 60 Days	61 to 90 Days	More than 90 Days but Less than 360 Days	Impaired Financial Assets	Total
			(Amo	ounts in Millio	ns)		
Cash and cash equivalents:							
Cash on hand and in banks	₽6,399	₽_	₽_	₽_	₽_	₽_	₽6,399
Temporary cash investments	10,669	_	_	_	_	_	10,669
Trade and other receivables:							
Trade:							
Billed electricity	11,165	-	1,064	373	672	2,088	15,362
Unbilled electricity	5,537	-	_	_	-	_	5,537
Current portion of installment							
contracts receivables	262	62	15	11	17	_	367
Service contracts and others	1,144	78	18	13	25	_	1,278
Nontrade receivables	902	2	4	3	233	234	1378
Other current assets -							
Derivative assets	11	_	_	_	_	_	11
Other noncurrent assets:							
AFS investments	361	_	_	_	_	_	361
Derivative assets	172	_	_	_	_	_	172
Unbilled receivables	6,186	_	_	_	_	_	6,186
Installment contracts receivable	54	_	_		_	_	54
	₽42,862	₽142	₽1,101	₽400	₽947	₽2,322	₽47,774

December 31, 2008

			Dec	ember 51, 200	J0		
		P	ast Due But N	ot Impaired			
	•	"			More than		
					90 Days		
	Neither Past				but Less	Impaired	
	Due nor	Less than	31 to	61 to	than 360	Financial	
	Impaired	30 days	60 Days	90 Days	Days	Assets	Total
			(Amo	ounts in Million	ns)		
Cash and cash equivalents:							
Cash on hand and in banks	₽3,601	₽_	₽_	₽_	₽_	₽_	₽3,601
Temporary cash investments	1,801	_	_	_	_	_	1,801
Trade and other receivables:							
Trade:							
Billed electricity	12,282	_	1,183	431	1,047	1,927	16,870
Unbilled electricity	20,078	_	_	_	_	_	20,078
Current portion of installment							
contracts receivables	401	174	3	11	53	_	642
Service contracts and others	716	11	1	_	6	_	734
Nontrade receivables	805	22	7	3	275	92	1,204
Other current assets -							
Derivative assets	19	_	_	_	_	_	19
Other noncurrent assets:							
AFS investments	403	_	_	_	_	_	403
Derivative assets	102	_	_	_	_	_	102
Unbilled receivables	3,030	_	_	_	_	_	3,030
Installment contracts receivable	115	_	_	_	_	_	115
	₽43,353	₽207	₽1,194	₽445	₽1,381	₽2,019	₽48,599

## Liquidity Risk

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

The *Company* maintains an adequate amount of cash and cash placements in the event of unforeseen interruption of its cash collections and if available, government securities. The *Company* also maintains accounts with several relationship banks to avoid significant concentration of cash with one institution.

The following table sets out the maturity profile of the *Company*'s financial liabilities based on contractual undiscounted payments:

			2009		
	Less than 3	3–12		More than	
	Months	Months	1-5 Years	5 Years	Total
		(Ar	nounts in Million	s)	
Notes payable	₽513	₽_	₽_	₽_	₽513
Trade payables and accrued expenses	23,602	495	32	_	24,129
Customers' refund	365	8,782	_	_	9,147
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	104	1,366	4,968	3,668	10,106
Fixed rate borrowings	807	1,395	12,711	_	14,913
Preferred stock	_	1,784	325	_	2,109
Customers' deposits	350	1,188	26,595	_	28,133
Other noncurrent liabilities	_	_	3,180	_	3,180
Total undiscounted financial liabilities	₽25,741	₽15,010	₽47,811	₽3,668	₽92,230

			2008		
	Less than 3			More than	
	Months	3-12 Months	1–5 Years	5 Years	Total
		(Ar	mounts in Millions	s)	
Notes payable	₽_	₽9,976	₽_	₽_	₽9,976
Trade payables and accrued expenses	14,159	703	2,350	_	17,212
CERA I and II over-recoveries, including					
carrying charges	_	_	3,008	_	3,008
Customers' refund	726	7,754	2,905	_	11,385
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	403	1,051	6,315	_	7,769
Fixed rate borrowings	43	1,263	8,807	_	10,113
Preferred stock	_	1,465	1,199	_	2,664
Customers' deposits	311	343	25,865	_	26,519
Liability arising from deferred pass-through					
fuel costs - current and noncurrent	_	325	_	_	325
Other noncurrent liabilities	_	_	3,233	_	3,233
Total undiscounted financial liabilities	₽15,642	₽22,880	₽53,682	₽_	₽92,204

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, the *Company* estimates that a portion of bill deposits (including related interest), amounting to P687 million, will be refunded in 2010. This is shown as part of "Trade payables and accrued expenses" account in the 2009 consolidated statement of financial position.

#### Capital Management

The primary objective of the *Company*'s capital management is to enhance shareholder value. It reviews its capital structure with the end view of achieving a competitive cost of capital and at the same time ensures 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.

To do this, the *Company* manages its level of long-term debt versus equity ratio, as well as its gearing, based on levels with comparable electric utilities.

The *Company* monitors capital using a gearing ratio, which is net debt divided by total capital. The *Company* includes within net debt the interest-bearing long-term financial liabilities, preferred shares less cash and cash equivalents.

	2009	2008	
	(Amounts in Millions, except Gearing Ratio)		
Interest-bearing long-term financial liabilities	₽19,194	₽13,695	
Notes payable	513	9,828	
Preferred shares	2,109	2,664	
Cash and cash equivalents	(17,068)	(5,402)	
Net debt (a)	₽4,748	₽20,785	
Capital (b)	57,369	52,607	
Gearing ratio (a/b)	8%	40%	

#### Derivative Financial Instruments

#### Embedded Currency Forward

The Parent Company has bifurcated embedded currency forwards noted in various purchases and service agreements denominated in US\$, Euro and various other currencies. As of December 31, 2009 and 2008, these agreements represent around 15% and 56% of the Parent Company's trade payables, respectively. As of December 31, 2009, the US\$ and Euro-denominated agreements amounted to \$12 million (equivalent to ₱572 million) and €6 million (equivalent to ₱396 million), respectively. As of December 31, 2008, the US\$ and Euro-denominated agreements amounted to \$27 million (equivalent to ₱1,274 million) and €8 million (equivalent to ₱519 million), respectively. These are part of "Trade payables and accrued expenses" account in the consolidated statements of financial position. Net fair value loss amounted to ₱13 million in 2009 and ₱9 million in 2008.

#### Currency Forward

Rockwell Land entered into deliverable currency forward contracts to hedge its foreign currency exposure arising from its US\$ denominated receivables. As of December 31, 2009 and 2008, the *Company* has outstanding currency forward contracts to sell US\$ with an aggregate notional amount of \$2.4 million and \$4.15 million, respectively, and weighted average contracted forward rate of P46.21 to \$1.00 and P45.30 to \$1.00, respectively. Outstanding derivatives will mature in 2010. The net fair value gain on the outstanding currency forward contracts amounted to P10.4 million as of December 31, 2009 and loss of P43.7 million as of December 31, 2008. As of December 31, 2009 and 2008, *Rockwell Land*'s outstanding currency forward contracts had a fair value loss of P4 million and P21 million, respectively.

#### Embedded Call Option

As discussed in Note 21, the *Parent Company* has an embedded call option (prepayment option) in its \$\mathbb{P}6,000\$ million 9% Tranche A Fixed rate corporate note issued in December 2006. The *Parent Company* recognized separately at transaction date the fair value of the embedded call option on Tranche A Note amounting to \$\mathbb{P}167\$ million. As of December 31, 2009 and 2008, net fair value gain of this derivative is \$\mathbb{P}172\$ million and \$\mathbb{P}102\$ million, respectively.

The net movements in fair value changes of the *Company*'s derivative instruments as of December 31, 2009 and 2008 are as follows:

	2009	2008
	(Amounts	in Millions)
Balance at beginning of year Net changes in fair value of derivatives not designated	₽72	₽300
as accounting hedges	82	(167)
Fair value of settled instruments	1	(61)
Balance at end of year	₽155	₽72

The fair value changes of the *Company*'s derivative instruments as of December 31, 2009 and 2008 are presented as follows:

	2009	2008
	(Amounts i	n Millions)
Derivative assets:		
Current portion (see Note 18)	₽11	₽19
Noncurrent portion (see Note 13)	172	102
Derivative liabilities:		
Current portion (see Note 26)	(28)	(35)
Noncurrent portion (included as part of "Other		` ,
noncurrent liabilities" account in 2008)	_	(14)
·	₽155	₽72

## 32. Income and Franchise Taxes

Income Tax

The components of deferred tax assets (liabilities) as at December 31, 2009 and 2008 are as follows:

	2009	2008
	(Amounts in Millions)	
Deferred tax assets:		
Unfunded pension cost and unamortized past service		
cost	₽3,685	₽4,039
Provision for probable losses from refund		
(see Note 23)	1,257	1,229
Provision for various claims (see Note 23)	991	494
Allowance for nonrecovery of receivables	758	758
Allowance for excess of cost over net realizable value	19	26
Allowance for doubtful accounts	648	602
Employee share-based payment plan	_	81
Others	173	161
	7,531	7,390

	2009	2008
	(Amounts in Millions)	
Deferred tax liabilities:		
Revaluation increment in utility plant and others		
(see Note 19)	₽8,242	₽8,432
Depreciation method differential	1,204	1,669
Capitalized interest	866	843
Capitalized duties and taxes deducted in advance	728	741
Net book value of capitalized/realized		
foreign exchange losses	109	133
Present value of impact on customers' refund	68	234
Excess of effective interest rate amortization over		
straight-line amortization of debt issue costs	(1)	6
Others	52̀8	140
	11,744	12,198
	(₽4,213)	(₽4,808)

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

	2009	2008	
	(Amounts in Millions)		
Deferred tax assets - net	₽17	₽7	
Deferred tax liabilities - net	(4,230)	(4,815)	
	( <b>P4</b> ,213)	(₽4,808)	

There are no income tax consequences for payment of dividends by the *Parent Company* to its shareholders, which are domestic corporations.

Provision for (benefit from) income tax consists of:

	2009	2008	2007	
		(Amounts in Milli	ions)	
Current	₽3,218	₽5,122	₽2,729	
Deferred	(595)	(3,055) (672		
	₽2,623	₽2,067	₽2,057	

A reconciliation between the provision for (benefit from) income tax computed at statutory income tax rate using tax rates of 30% in 2009 and 35% in 2008 and 2007, and provision for (benefit from) income tax as shown in the consolidated statements of income is as follows:

	2009	2009 2008		
		(Amounts in Millions	)	
Income tax computed at statutory tax rate	₽2,695	₽1,820	₽2,133	
Income tax effects of:				
Interest income subjected to a lower final				
tax rate	(113)	(105)	(113)	
Nondeductible interest expense	43	` 77 <sup>′</sup>	` 60´	
Equity in net earnings of associates and				
a joint venture	(73)	(70)	(113)	
Nondeductible expenses	265	65	92	
Nontaxable income	(54)	(4)	(273)	
Others	(140)	284	271	
	₽2,623	₽2,067	₽2,057	

RA No. 9337, otherwise known as "Expanded Value-Added Tax Law" in 2005, amended the regular corporate income tax rate for domestic corporations and resident/non-resident foreign corporations in the Philippines which increased from 32% to 35% effective November 1, 2005, then reduced to 30% effective January 1, 2009, pro-rata to the number of months covered by the new rate. Also, credit of input VAT on capital goods against output VAT due was spread evenly over estimated useful life of 60 months, whichever is shorter, if the acquisition cost, excluding the VAT component therefore, exceeded P1 million.

On December 18, 2009, the *BIR* issued Revenue Regulation No. 16–2008, which implemented the provisions of *RA* No. 9504 on Optional Standard Deductions, or *OSD*. Such regulation allowed both individual and corporate taxpayers to use *OSD* in computing their taxable income. For corporations, they may elect a standard deduction in an amount not exceeding 40% of gross income in lieu of the itemized allowed deduction. For the year ended December 31, 2009, none of the entities in the *MERALCO Group* opted to use the *OSD* in computing their taxable income, except for *RSIC*.

The details of deductible temporary differences, carryforward benefits of unused tax credits from excess of *MCIT* over *RCIT*, for which no deferred tax assets was recognized and the equivalent amount of unrecognized deferred tax asset as at December 31, 2009 and 2008 are as follows:

	2009	2008
	(Amounts in Millions)	
Allowance for doubtful accounts	₽41	₽41
Unfunded pension cost and unamortized past service cost	_	17
MCIT	_	6
Unrealized foreign exchange loss	_	1
	P41	₽65

In 2009, MCIT amounting to ₱6 million has been applied to current RCIT due.

Franchise Tax

Local Franchise Tax

Consistent with the *ERC* on Case Nos. 2001-646 and 2001-900, franchise tax is identified as a separate line item on the customers' bill and computed as a percentage of the sum of all charges, except taxes and the universal charge.

Further, the Implementing Rules and Regulations provides that franchise taxes shall be paid only on its distribution wheeling and captive market supply revenues. At present, pending the promulgation of guidelines from the Department of Finance, the *Parent Company* is paying local franchise tax based on gross receipts, as provided for under the Local Government Code. The *Parent Company*'s legal counsel believes that this is consistent with the aforesaid provision of the *IRR*, since open access and retail competition has not yet been declared.

National Franchise Tax

In accordance with the provisions of *RA* No. 9337, starting November 1, 2005, *MERALCO* collects VAT on electricity generation, transmission, distribution, and supply revenue, instead of the 2% national franchise tax previously levied on electricity consumptions.

## 33. Contingencies

Contingent Assets

Advances for Pass-through Costs

As at December 31, 2009, *MERALCO* has contingent assets relating to unrecovered pass-through costs totaling P813 million, consisting of transmission charge of P8 million, and system loss charges of P805 million.

Up to May 2008, *MERALCO* referred to the "Guidelines for the Calculation of the Over or Under Recovery in the Implementation of the System Loss Rate by Distribution Utilities" issued by the *ERC* on November 23, 2005 to recover the system loss under-recoveries and began to bill customers for such under-recoveries beginning the February 2006 billing month. The guidelines allowed the recovery to be being implemented over a period of 17 months or until such time that the amount has been collected. Following such guideline, a total of ₱284 million in unbilled system loss charges have been billed. However, on June 4, 2008, the *ERC* decided and directed *MERALCO* to file a new application for the recovery of the system loss adjustments after the *ERC* has confirmed and approved the average transmission rate to be used in computing the system loss adjustment.

Overpayment of Income Tax related to SC Refund

As a result of the *SC*'s Decision for *MERALCO* to refund ₱0.167 per kWh to affected customers in April 2003, *MERALCO* overpaid income tax in the amount of ₱7,107 million for taxable years 1994–1998 and 2000–2001. Hence, *MERALCO* filed a claim for the recovery 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 on grounds that the period for filing a claim has prescribed. Thus, the BIR has approved the refund of ₱894 million through issuance of tax credit certificates or TCCs, proportionate to the actual refund of claims to utility customers. As of December 31, 2009 and 2008, the amount of unissued TCCs amounted to ₱577 million and is presented as part of "Other noncurrent assets" account in the consolidated statements of financial position.

To avoid prescription of the *Company* to file a claim with the Court of Tax Appeals or *CTA*, *MERALCO* filed a Petition assailing the denial by the *BIR* of its tax refund claim of ₱6,690 million less the ₱894 million, as approved by the *BIR* for taxable year 2001. Trial of the Petition is ongoing with *MERALCO* directed to present evidence in support of such claim.

In line with the foregoing, on February 3, 2006, *MERALCO* also filed a letter-request with the *BIR* seeking a ruling or confirmation that the refund of rollback rates by the *Parent Company* to its customers as a consequence of the decision of the *SC*, is deductible against gross income as ordinary and necessary business expenses, consistent with the provision of Section 34(A) (1) of the National Internal Revenue Code or *NIRC* of 1997.

The foregoing is pending response from the BIR.

#### Change in Tax Basis

On February 4, 2008, the *SC* denied with finality a motion for reconsideration filed by the Commissioner of Internal Revenue or *CIR*, against *MERALCO*, with respect to the issue on excess income tax paid by the latter. The *SC* affirmed a *CA* decision and ordered the *CIR* to refund or issue a tax credit certificate in favor of *MERALCO* for ₱107 million representing overpaid income taxes for taxable years 1987 and 1988. The overpayment stemmed from the effectivity of Executive Order No. 72, which subjected *MERALCO* to regular corporate income tax instead of 2% franchise tax based on gross receipts it was previously liable for. As at December 31, 2009, *MERALCO* is in the process of filing for the issuance of the tax credit certificates.

Contingent Liabilities

#### Real Property Tax Assessments

Six local governments units or *LGUs* have assessed *MERALCO* for deficiency real property taxes on electric poles, wires, insulators, and transformers. Of these *LGUs*, one has secured a favorable decision from the *CA*, whereby the appellate court directed the *LGU* concerned to present an assessment of the foregoing properties and collect the pertinent tax in accordance with the Local Government Code of 1991. Such Decision is pending review of the petition by the *SC*. With respect to the cases of the five *LGUs*, these are pending with their respective court, administrative bodies, or government offices.

In the meantime, on December 23, 2004, *MERALCO* filed an application for a mechanism to recover all types of tax assessments by LGUs, excluding the local franchise tax. A series of events ensued, which effectively modified the manner by which *MERALCO* may possibly recover such taxes, should any final assessment be served.

On December 8, 2008, the *ERC* promulgated Resolution No. 20, Series of 2008, "Resolution Modifying the Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Entering Performance Based Regulation (*RDWR*)," which provides, among others, that (i) a change in a relevant tax, of which real property tax is defined as such, or (ii) the way by which a relevant tax is calculated, or (iii) the removal or imposition of a relevant tax, which results in a regulated entity incurring materially higher or lower costs than it would have incurred, shall qualify as a tax change event, which allows the regulated entity to recover such cost through the rates as long as such change in the relevant costs exceeds 1% of the total forecast operating and maintenance expenditure of the regulated entity.

Management believes that any impact of an adverse decision from these cases will be mitigated by the filing by the *Parent Company* of the appropriate application with the *ERC* for the recovery of these costs under the recovery mechanisms approved by the *ERC*.

## Local Franchise Tax Assessments

Certain municipalities have served assessment notices on *MERALCO* for local franchise taxes. As provided in the Local Government Code, only cities and provincial governments may impose taxes on establishments doing business in their localities. On the basis of the foregoing, the management of *MERALCO* and its legal counsel believes that it strong legal grounds to contest such assessments.

#### Income Tax Assessment on Taxable Year 1999

In line with the SC's Decision ordering MERALCO to refund P0.167 per kWh to affected consumers for the period February 1994 to May 2002, MERALCO amended its tax return for taxable year 1999, which had then been served a Letter of Authority to examine its books by the BIR. The amended tax return for 1999 reflected an overpayment of P977 million, which was subsequently applied against the income tax liability for taxable year 2002. As discussed under "Overpayment of Income Tax related to SC Refund" section of this Note, a claim for refund has been filed for taxable years 2000 and 2001.

On March 16, 2007, *MERALCO* was served a Preliminary Assessment Notice dated January 2, 2007 by the *BIR*-Large Taxpayers Division disallowing the carryover and crediting of overpaid income tax of P977 million for the year 1999 against 2002 income tax due. The disallowance was premised on the ground that crediting of the 1999 overpayment was beyond the two-year prescriptive period for application of tax refund while carryover of tax credit can only be applied to the immediately succeeding year.

In 2007, MERALCO availed of the tax amnesty program of the BIR and covered this assessment in the amnesty return filed.

In February 2010, the BIR issued a tax clearance to MERALCO, which included taxable year 1999.

#### Mediation with NPC

On November 21, 1994, *MERALCO* entered into a Contract for the Sale of Electricity or *CSE* with the *NPC*, covering a period of 10 years from January 1, 1995 to December 31, 2004. One of the provisions of *RA No. 9136* or the *EPIRA* is for *NPC* to submit to *ERC* for approval of its Transition Supply Contracts or *TSC* with *DU*s before year-end 2001. Under the said law, utilities having *TSC*s with *NPC* may nominate their contract demand. Also, henceforth, the *TSC* supersedes any *CSE* in place.

On September 8, 2001, *MERALCO* wrote the *NPC* signifying its intention to enter into a *TSC* with *NPC*, to which the *NPC* never responded. Instead, the *NPC* assessed *MERALCO* with monthly billing adjustments based on the contracted volumes starting January 2002 under the CSE, which should have been already superseded by the *TSC*. In response, on February 20, 2002, *MERALCO* formally informed *NPC* the reasons for its refusal to pay the said billing adjustments and also served a notice exercising its right to terminate any arrangements with the *NPC*, as provided in the *CSE*.

In the meantime, on March 24, 2003, the *Parent Company* served a written demand to *NPC* for the collection of P9,787 million representing the following: *NPC*'s failure to provide timely transmission service to *MERALCO*'s *IPP*s, recovery of the 50% penalty for excess imbalance charges, imbalance charge adjustments, back-up energy rates, nocredit over-deliveries and *NPC*'s failure to turnover directly-connected customers to the *Parent Company*, and delay in the commissioning of *QPPL*'s power plant.

As a result of a mediation process undertaken from March to June 2003, *MERALCO* and *NPC* signed a proposed Settlement Agreement on July 15, 2003. While a proposed Settlement Agreement was signed, the enforceability hinges on the *ERC* approving such agreement. Under the proposed Settlement Agreement, *MERALCO* shall pay *NPC* an amount equivalent to the difference between the aggregate contracted energy for the years 2002 to 2004 and the total energy it has already bought from January 2002 until April 2003 plus the quantity it intends to buy until December 31, 2004 with the *IPPs* being dispatched at contract levels, subject to adjustments depending on actual purchases from July 15, 2003. On the other hand, *NPC* shall credit the *Parent Company* for transmission delays as well as for energy corresponding to *NPC*'s sales to directly-connected customers in *MERALCO*'s existing franchise areas. The net resulting liability of *MERALCO* shall be part of the generation charge billable to customers based on the approved terms of payment. While such provision exists, the *Parent Company* did not recognize a liability to *NPC* and a corresponding receivable from the consumer with respect to the settlement amount.

As previously mentioned, the Settlement Agreement shall be filed as a Petition with *ERC* and subject to the latter's approval before it may be enforced. The Petition was initially filed on November 24, 2003. With the required dispatch of the *IPP*s at contract levels as provided for in the settlement agreement, an Amendatory Dispatch Agreement was subsequently entered into by *MERALCO* and *NPC*. The Settlement Agreement together with the Amendatory Dispatch Agreement were jointly filed by *NPC* and *MERALCO* at the *ERC* on April 14, 2005.

Meanwhile, due to the non-dispatch of the *IPP*s at the contract levels from July 15, 2003, the date of the signing of the Settlement Agreement to December 31, 2004, *MERALCO* purchases from *NPC* during the period were higher than the baseline quantities specified in the Settlement Agreement. As provided for in the Settlement Agreement, this resulted in the reduction of the settlement amount to ₱14,320 million.

As of July 10, 2006, hearings on the joint application have already been completed although the case remains pending with the *ERC*.

Subsequently, on April 17, 2008, *NASECORE* wrote the Office of the Solicitor General or *OSG* asking the latter to intervene in the case. In response, 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 the *Parent Company.*" Consequently, *MERALCO* filed a "Manifestation and Motion to Suspend Proceedings" dated June 3, 2008 and Comment *Ad Cautelam* dated June 12, 2008, the objective of which was to inform the *ERC* of the need to suspend this case in order to allow *MERALCO* to obtain a ruling from the regular court on the civil and corporate law issues, to enable the *ERC* to decide on the merits of the joint application.

On September 14, 2009, the *ERC* issued an Order granting *MERALCO*'s Petition for the suspension of proceedings on the joint petition for the approval of the proposed Settlement Agreement. In the same Order, the *ERC* agreed with the *Parent Company* that the OSG's issues are not within the jurisdiction of the *ERC* and should be litigated before the regular courts. Accordingly, the *ERC* ordered "the 'Joint Application' filed by *NPC* and *MERALCO* [be] temporarily archived until further notice."

On November 23, 2009, *MERALCO* filed a Petition for Declaratory Relief with the Regional Trial Court of Pasig City or *RTC Pasig* against *NPC*, *PSALM* and the Republic of the Philippines as represented by the *OSG*. The Petition seeks a declaration that the proposed Settlement Agreement, independent of the pass-through provision, which is subject to the approval of the *ERC*, is valid and binding. As of February 22, 2010, *MERALCO* is awaiting the comments of *PSALM*, *NPC* and the *OSG*, as required by the *RTC Pasig* on December 2, 2009.

In the event the proposed Settlement Agreement is disapproved, *MERALCO* and *NPC* shall revert to their respective positions before the mediation, which shall be resolved through arbitration. On the other hand, a decision by the *RTC Pasig* shall mean that the agreement is valid although enforcement of the proposed Settlement Agreement is dependent on the final approval by the *ERC*, which shall be the basis for the recognition of any liability or receivable.

#### Deferred PPA

On October 14, 2009, the *ERC* released its findings on the *Parent Company*'s implementation of the collection of certain pass-through cost under-recoveries, which it had previously approved. According to the *ERC*, *MERALCO* over-recovered ₱268 million of deferred PPA, transmission line costs related to *QPPL* and deferred accounting adjustments, or DAA incurred in 2004 and, directed *MERALCO* to refund said amount to customers, along with ₱184 million in carrying charges, via a rate of ₱0.0169 per kWh beginning the next billing cycle after receipt of the *ERC*'s ruling until the amount is fully refunded. However, the *ERC* has yet to rule on *MERALCO*'s under-recovered deferred PPA of ₱106 million. In the meantime, *MERALCO* is studying the *ERC*'s findings for possible appeal.

#### COA Audit

As discussed in *Note 2 – Rate Regulations*, the *SC*, in its Decision dated December 6, 2006 on the *MERALCO* Unbundling case, ruled that a *COA* audit was not a prerequisite for the determination of a utility's rates. While affirming the *ERC*'s authority on rate-fixing, the *SC* nevertheless directed the *ERC* to request the *COA* to conduct a complete audit of the books, records and accounts of *MERALCO* given the potential social impact of the matter. Thus, in compliance with the *SC* directive, on January 15, 2007, the *ERC* engaged the *COA* to conduct an audit covering test periods, calendar years 2004 and 2007.

The COA audit, which began in September 2008 was completed in August 2009.

On February 17, 2010, the *Parent Company* received a copy of the *ERC* Order related to Case No. 2001-900 RC, entitled "In the Matter of the Application for the Approval of the Unbundled Rates pursuant to the Provision of the Application for the Approval of the Unbundled Rates pursuant to the Provision of *RA* No. 9136, *MERALCO*, Applicant," which directed all intervenors in the case to submit within 15 days from receipt of their respective comments on the *COA*'s "Report No. 2009-01 Rate Audit Unbundled Charges."

As of February 22, 2010, MERALCO is still waiting for copies of comments of the intervenors.

## Others

The *Company* is either a plaintiff or a defendant in lawsuits filed by or claims against *Company*. There are also labor cases, which have been heard by the National Labor Relations Commission or *NLRC* and/or are pending decision by the courts, the outcome of which is not presently determinable. There are also ongoing examinations conducted by tax authorities.

Related provisions for items estimable amounted to ₱3,351 million, ₱318 million and ₱400 million in 2009, 2008 and 2007, respectively, while reversal of provisions amounted to ₱728 million in 2007.

Management, after consultations with internal and external counsels with respect to other contingencies, believes that the probable resolution of these issues will not materially affect the *Company*'s financial position and results of operations.

## 34. Significant Contracts and Commitments

NPC

Transition Supply Contract or TSC with NPC

MERALCO and NPC have a Transition Supply Contract or TSC, effective the shorter of five years from November 16, 2006 or one year after the introduction of open access, should open access be in place within the five-year contract period. The contracted volumes under the TSC as amended on July 20, 2007 are as follows:

	Volume		
Year	(In GigaWatthours or <i>gWh</i> )		
2007	7,156		
2008	7,624		
2009	7,666		
2010	7,666		
2011	7,666		

Billings of NPC to MERALCO for the contracted volume are calculated based on NPC's time-of-use or TOU generation rate as approved by the ERC, plus certain mandated adjustments.

The *TSC* requires *MERALCO* to submit to *NPC* its month-ahead nomination of 720 hourly energy quantities in kilowatt hours and its day-ahead nomination of 24-hourly energy quantities in kilowatt hours for committed purchase quantity.

Certain salient features of the TSC are as follows:

- a. *MERALCO* may increase its monthly contracted energy if the increase is due to the non-availment by the *Parent Company*'s customers of the one day power sales or ODPS, and/or Customer Choice Program or *CCP*;
- MERALCO may reduce its monthly contracted energy if the reduction is due to the transfer of its customers to be directly connected to NPC or to any other supplier during the advent of open access, or due to termination of electric service to or closure of a commercial or industrial customer of the Parent Company;
- c. MERALCO may source power from NPC in excess of the Contract Energy by a quantity equivalent to not more than 20% of the Contract Energy subject to additional premium charge of 20% of TOU rates;
- d. upon request of MERALCO within 24 hours from occurrence of shutdown or inability of any or all of MERALCO's IPPs, NPC shall provide replacement power to the Parent Company, priced at 10% above the actual generation cost plus all applicable ERC-approved charges and fees; and
- e. Energy off-take in excess of the TSC quantities shall be deemed to be taken from the WESM.

In relation to a Petition filed by the *BTRCP-DTI* against the *Parent Company*, the *ERC* directed the *Parent Company* to negotiate and contract with *NPC* for an increase in the *TSC* contracted volume to match this with the updated demand forecast, net of the quantities under its *IPP* contracts. Discussion between the *Parent Company* and *NPC* are ongoing.

Memorandum of Agreement or MOA for CCP

On August 16, 2006 prior to the signing of the *TSC*, the *Parent Company* also signed an *MOA* with *NPC* for the implementation of *CCP* for Large Industrial and Commercial Customers with an average peak demand of at least 1 MW for the preceding 12 months, wherein the latter may avail of the *TOU* generation rates of *NPC*.

A joint application for the approval of said MOA was filed by the Parent Company and NPC with the ERC on September 27, 2006. On November 17, 2006, the ERC provisionally approved the joint application enabling the Parent Company to implement the CCP. In relation to this, an application for the Approval of Rate Schedules for the CCP was filed by the Parent Company with the ERC on December 21, 2006. Said application sought to recover incremental charges that would be incurred by the Parent Company as a result of the implementation of the CCP. On March 14, 2007, a provisional authority was issued by the ERC authorizing the imposition of the said incremental charges.

On March 8, 2007, the *Parent Company* and *NPC* filed a Second Joint Supplemental Motion with Manifestation aimed at lowering the threshold of the *CCP* to 750 kW, to enable more customers to avail of *NPC*'s *TOU* rates. The *ERC* has yet to resolve said motion.

In the meantime, upon mutual agreement by both the *Parent Company* and *NPC*, the term of the *CCP* was extended until otherwise directed by the *ERC* or when any of the grounds for the termination of the *MOA* for *CCP* exist.

#### MOA for Ecozone Rates

On September 17, 2007, the *Parent Company* executed a *MOA* with *NPC* for the provision of special economic zone or *ecozone* rates to high load factor industries, which are registered with the Philippine Economic Zone Authority or *PEZA*. See *Note 36 – Other Matters*.

In line with the foregoing, the *Parent Company* and *NPC* agreed on additional contract volumes of 90 gWh and 296 gWh for contract years 2008 and 2009, respectively, to accommodate additional consumption of the ecozone customers.

#### TransCo/NGCP

Pursuant to Section 8 of RA No. 9136, TransCo was created and assumed the electrical transmission function of NPC.

Beginning January 15, 2009, the *NGCP* assumed *TransCo*'s operations from the government via a concession agreement and a franchise granted by the Philippine Congress through *RA No. 9511*.

## FGPC and FGP

MERALCO is committed to absorb 1,500 MW of the 3,000 MW output of the Camago (Malampaya) gas field, as directed by the Department of Energy or DOE.

Hence, on March 14, 1995 and January 9, 1997, the *Parent Company* entered into separate *PPA* with *FGPC* and *FGP*, respectively. Under the terms of the *PPA*, *MERALCO* is committed to purchase a specific volume of electric power and energy from *FGPC*'s Sta. Rita Power Plant and *FGP*'s San Lorenzo Power Plant. The termination date of the agreements with *FGPC* and *FGP* shall be on March 13, 2020 and January 8, 2022, respectively.

Subsequently, on May 31, 2006, the *ERC* approved the amendments to the purchase power agreements. Under the approved amendments, *FGPC* shall (i) shoulder the local business and community taxes, (ii) provide discount at graduated rate on excess generation costs, (iii) pay higher penalties for non-performance and include increasing discounts on excess generation, higher penalties for non-performance, and (iv) not charge *MERALCO* capacity fee and fixed operations and maintenance fee for energy delivered beyond the contracted amount but within the 90% capacity factor level through 2011.

In line with the power purchase agreements, *MERALCO* entered into a Substation Interconnection Agreement with *NPC* and *FGPC* for the interconnection of the power plant to the *NPC* Grid System as well as receipt and delivery of energy and capacity from the power plant of *FGPC* to the *Parent Company*'s point of receipt through 35-kilometer dedicated transmission line.

## QPPL

The *Parent Company* 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 Power Purchase Contract is for a period of 25 years.

In line with the foregoing, MERALCO entered into a Transmission Line Agreement or TLA with QPPL on June 13, 1996 (amended on December 1, 1996). The term of the TLA is co-terminus with that of the PPA with QPPL. Under

the *TLA*, the *Parent Company* is obligated to make a monthly capital cost recovery payment and a monthly operating payment to *QPPL*.

On February 21, 2008, *MERALCO* entered into an arrangement with *QPPL*, which allows the *Parent Company* to dispatch the *QPPL* Plant and increasing sales of excess generation output at the discounted per kWh tariff for such generation. Under the agreement, the base generation shall be 3,388 million kWh while the target excess generation or *TEG* of the plant is equal to 74 million kWh per annum from 2008 to 2017, each referred to as a "Guarantee Year." The excess generation shall be paid for by the *Parent Company* for each kWh of excess generation during the Guarantee Years in accordance with the existing terms of the *PPA* relating to excess generation. If the *TEG* is not reached in a Guarantee Year, the *Parent Company* will pay *QPPL* an "Advance Payment," reflecting the difference in the *TEG* and the actual excess generation or *AEG*.

Should the *AEG* be in excess or equal to the *TEG* for an Annual Period, the *Parent Company* shall not be obligated to pay any Advance Payment to *QPPL* for that Annual Period. In addition, the *Parent Company* will receive one kWh credit for each kWh by which the *AEG* exceeds the *TEG*. At the *Parent Company*'s option, the kWh credit may be added to the computation on of the *AEG* in a subsequent Annual Period. Any payments by *QPPL* from 2018–2025 shall be made in eight annual installments, without interest.

TSCs with Privatized Generating Assets and IPP Contracts of NPC

From 2008 to 2009, *NPC* privatized a number of its generating assets and *IPP* contracts and the assets and contracts were taken over by the successful bidders. As a result, the contracted energy volume under the original *TSC* between *MERALCO* and *NPC* were assigned by *NPC* to the respective new owners. Following are the privatized plants and *IPP* contracts:

Year	Power Plant	Successor Owner	% Volume
2008	Masinloc coal-fired power plant	Masinloc Power Partners Co. Ltd. or	
		Masinloc Power	14.8
2009	Tiwi-Makban geothermal power plants	Aboitiz Power Renewable, Inc. or	
		Aboitiz Power	9.6
	Pagbilao power plant	Therma Luzon Inc. or Therma	22.04
	1,000 MW – Sual coal-fired power plant	San Miguel Energy Corporation or	
		SMEC	5.253
	600 MW – coal-fired Calaca power plant	Sem-Calaca Power Corporation or	
		Sem-Calaca	7.34

Pending the finalization of the purchase agreement between each of the successor owners of the assets and *IPP* contracts with *NPC*, the supplier of power of *MERALCO* is still *NPC/PSALM*. Payments of the contracted volume are made based on the billing instructions received by *MERALCO*.

Montalban Methane Power Corporation or MMPC

On April 3, 2009, the *Parent Company* signed a Contract for the Sale of Electricity or *CSE* with *MMPC*. The *MMPC* power plant is a renewable energy generation facility located in the Municipality of Rodriguez (formerly Montalban), Rizal, which utilizes the landfill gas extracted from Montalban's sanitary landfill with an installed capacity of 8MW. The plant's designed capacity is 11 MW. The *ERC* issued *MMPC* its Certificate of Compliance by the *ERC* on February 9, 2009.

The contract is for a period of two years, extendible by mutual agreement of the parties. Energy is sold on a "take and pay" basis and therefore, there is no minimum energy volume. Energy delivered to *MERALCO* is billed on an hourly basis, based on the *ERC*-approved *TOU* rates of *NPC*. *MMPC*'s *TOU* rates consist of *NPC*'s basic *TOU* rate plus ₱0.01 per kWh for the Franchise and Benefits to Host Communities or *FBHC* charge and is zero-rated. The *GRAM* and *ICERA* components of the *NPC* rates do not form part of the *MMPC TOU* rate. In addition, energy deliveries from *MMPC* are exempt power delivery service charge.

On June 1, 2009, the *ERC* provisionally approved the *CSE*, subject to any subsequent amendments to the *CSE*, including the imposition of Capacity Recovery Fee, which shall be pre-approved by the *ERC*, among others. Should the *ERC* find the provisionally approved rates to be higher than the final rates, the amount corresponding to the excess shall be refunded by *MERALCO* to its customers.

MMPC started delivering electricity to MERALCO on June 11, 2009.

The hearings on the MMPC CSE have been completed and the CSE is pending final approval by the ERC.

## Committed Energy Volume to be Purchased

Total commitments for the purchase of power from FGPC, FGP and QPPL, including transmission line fees, are estimated as follows:

	Minimum Energy	Equivalent
Year	Quantity (MEQ)	Amount
	(In Million Kilowatt-Hours)	(In Millions)
2010	14,295	₽63,574
2011	14,295	62,236
2012	14,325	72,258
2013	14,295	79,019
2014	14,295	83,124
2015	14,295	89,994

## Operating Lease Commitments

Rockwell Land is a lessor into commercial properties included in its investment property portfolio. These noncancellable leases have remaining terms of between two to 10 years up to 2013. All leases include a clause to enable upward revision of the rental charge on an annual basis according to prevailing market conditions. Future minimum lease revenue follows:

	Amount
	(In Millions)
2010	₽207
2011	57
2012	17
2013	2
	₽283

#### Construction Contract

In April 2008, *Rockwell Land* entered into a contract with DATEM Incorporated for the construction of the superstructure of *One Rockwell*, amounting to ₱2,500 million, inclusive of all taxes and related costs. As of December 31, 2009, ₱1,200 million has been incurred.

## 35. Earnings Per Share Attributable to Equity Holders of the Parent

Basic and diluted earnings per share are calculated as follows:

	2009	2008	2007
	(Amounts in Millions,, Except Shares and Per Share Data)		
Net income attributable to equity holders of the parent (a)	₽6,005	₽2,800	₽3,759
Shares:			
Common shares at beginning of year	1,103,768,012	1,103,342,882	998,812,167
Weighted average common shares - issuances	4,282,979	303,714	61,350,763
Weighted average common shares (b)	1,108,050,991	1,103,646,596	1,060,162,930
Number of shares under option	_	9,767,651	10,382,537
Weighted average number of shares that would have been			
issued at fair value	_	(7,738,824)	(5,931,999)
Adjusted weighted average common shares – diluted (c)	1,108,050,991	1,105,675,423	1,064,613,468
Per Share Amounts:			
Basic earnings per share (a/b)	₽5.42	₽2.54	₽3.55
Diluted earnings per share (a/c)	₽5.42	₽2.53	₽3.53

#### 36. Other Matters

#### Revised System Loss Caps

On September 29, 2004, the *ERC* issued the "Guidelines for the Application and Approval of Cap on the Recoverable Rate of Distribution System Losses" requiring the submission of segregated system loss caps for technical, non-technical and administrative losses and the *Parent Company* estimates for the succeeding five years. Thereafter, a series of exchanges were made between *ERC* and the different distribution utilities.

On December 8, 2008, the *ERC* promulgated Resolution No. 17, Series of 2008, entitled "A Resolution Adopting a New System Loss Cap for Distribution Utilities," where a lower maximum rate of system loss (technical and non-technical) that a utility can pass on to its customers. The new system loss cap shall be the lower of the actual but not to exceed 8.5% for private utilities, effective January 2010 billing, which is one percentage point lower than the 2009 system loss cap of 9.5%. The actual company use (administrative loss) shall be treated as part of the operation and maintenance expense in the next reset for utilities under *PBR*. The manner by which the utility will be rewarded for their efforts in system loss reduction shall be addressed by the *ERC* in the Performance Incentive Scheme or *PIS* under *PBR*.

On December 8, 2009, *MERALCO* filed a Petition to Amend the said Resolution with an urgent prayer for the immediate suspension of the implementation of the new system loss 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 level of system loss cap to not less than 9%.

Prior to the Petition, *ERC* denied *MERALCO*'s appeal contained in a letter to the Commission, seeking deferment of the imposition of the revised system loss cap citing the abrupt and substantial decline in industrial energy sales brought about by the economic downturn, as well as the continued increase in residential sales, which has pushed up the share of low voltage energy sales to the total consumption.

As of February 22, 2010, the ERC has yet to act on the Petition.

#### Retail Competition

On February 9, 2007, the timeline for the implementation of open access and retail competition or *OARC*, were set out by the *ERC* in Resolution No.3, Series of 2007. According to the said Resolution, retail competition shall commence upon the establishment of necessary infrastructures (such as a customer switching system), privatization of 70% of *NPC*'s generating capacity and *IPP* contracts and, the promulgation of pertinent regulations. The *ERC* shall announce the commencement of retail competition six months before its actual implementation.

As of December 31, 2009, the *ERC* has promulgated the seven pillars of retail competition, which are the regulations that embody a framework for implementing retail competition and open access, as envisioned in the *EPIRA*, namely, Retail Electricity Supplier or *RES*, Licensing Guidelines, the amended Business Separation Guidelines, the Code of Conduct for Competitive Retail Market Participants, the Competition Rules, the Supplier of Last Resort or *SoLR*, Rules, the Distribution Services and Open Access Rules, and the Rules for Customer Switching or *RCS*. Subsequently, the Rules for Contestability were also promulgated.

Under the Rules for Contestability, retail competition will begin with end-users with an average peak demand of 1MW. Two years thereafter, the threshold of contestability shall go down to 750kW, for both single and aggregated loads with the threshold gradually going down until it reaches the household level within seven years.

On November 10, 2008, the *ERC* approved the implementation of the Power Supply Option Program or *PSOP*, which was previously referred to as Interim Open Access. The *PSOP* provided the guidelines for the implementation thereof, which covered the default supplier, accounting and settlement rules, duration of the *PSOP* and the impact on existing contracts and transactions, among others.

On September 14, 2009, the *ERC* issued an Order which included (a) clarification with respect to adjustment of the contracted volume under the *TSC* should be made based on the *PSOP* provisions; (b) affirmation that there is no cogent reason to allow the local *RES* to operate under the *PSOP*; and (c) responsibility of the *DU* with respect to the procurement of all energy related to distribution system losses. Based on the Order, the *PSOP* shall commence 90 days after the earlier of the transfer of the operation of the *Calaca NPC* Generation Assets or its equivalent capacity or privatization of at least 70% of the total capacity of generating assets of *NPC* in Luzon and Visayas.

On December 3, 2009, *PSALM* turned over the 600-MW *Calaca* coal-fired power plant to *Sem-Calaca*, after the conduct of a negotiated sale of the power plant. As represented by *PSALM*, with the privatization of *Calaca* coal-fired

power plant, more than 70% of *NPC*'s generating capacity have been privatized, which would be in compliance with one of *EPIRA*'s precondition for the implementation of *OARC*.

Also, as of December 31, 2009, the *ERC* released the third draft Rules for the Power Supply Option Program. Said rules were intended to provide the regulatory framework for the implementation of the *PSOP*. The said draft rules have been released for comments of all interested parties.

PEZA - ERC Jurisdiction

Sometime in 2007, the *Parent Company*, filed a "Complaint for the Declaration of Nullity of the *PEZA* Guidelines with Prayer for Temporary Restraining Order and Preliminary Injunction" to restrain *PEZA* from implementing its Guidelines for the "Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones," and "Supply of Electric Power in the Ecozones." Separately, the Private Electric Power Operators Association, Inc., or *PEPOA*, also filed a similar complaint while the *ERC* filed a motion to intervene in support of the complaint against *PEZA*.

The guidelines referred to in the complaint effectively, give *PEZA* franchising powers in Ecozones or declare additional ecozones within a franchise area of the distribution utility.

A series of negotiations among PEPOA, MERALCO and PEZA ensued, which resulted in the settlement of their differences. Among other provisions, the parties have agreed that until such time that PEZA and ERC come into an agreement, the distribution and other charges shall continue to be applied based on the principles of asset recognition, boundaries for rate-setting and fixing of distribution charge. The settlement caused MERALCO to withdraw as plaintiff in the case filed on July 7, 2008. PEPOA also filed a separate motion to withdraw as plaintiff, as well.

As of February 22, 2010, both motions to withdraw by the *Parent Company* and *PEPOA* are still pending resolution. Pending any resolution, the *PEPOA* filed a Motion for Intervention, which was granted by the Court on September 2, 2008.

Sucat-Araneta Transmission Line

The Sucat-Araneta-Balintawak transmission line is a two-part transmission line, which completed the 230kV-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.

Up to May 2001, *NPC* operates and develops the nationwide transmission grid. Thereafter, with the effectivity of the *EPIRA*, the authority and responsibility were transferred to *TransCo*. The distribution lines of *MERALCO* are connected to the transmission grid of *TransCo*. Beginning January 15, 2009, *NGCP* operates the transmission grid of *TransCo* under a Concession Agreement.

On March 10, 2000, the residents along Tamarind Road, Dasmariñas Village, Makati City or *plaintiffs*, filed a case with the *RTC Makati* against *NPC* enjoining the latter from further preparing and installing high voltage cables to the steel pylons erected 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. The *RTC Makati* initially issued on March 13, 2000 an Order directing the parties to maintain the status quo and then later granted the preliminary injunction prayed for by the *plaintiffs* on April 3, 2000. The decision was confirmed by the *SC* on March 23, 2006, which effectively reversed a decision of the *CA* to the contrary.

The *RTC Makati* subsequently issued a writ of execution based on the order of the *SC*, as moved by the *plaintiffs*. *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. The 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 a counter bond by defendant *NPC* in the amount of P10 million, intervenor *MERALCO* in the amount of P2.5 million, and intervenor *NGCP* in the amount of P2.5 million, subject to the condition that *NPC* and intervenors pay all damages, which the plaintiffs may incur as a result of the Writ of Preliminary Injunction.

Thereafter, the plaintiffs questioned the *RTC Makati* order before the *CA*. As of February 22, 2010, this remains pending for resolution in the *CA*.

#### Purchase of Subtransmission Assets or STAs

On June 30, 2008, the *ERC* approved the sale of various *STA*s of *NGCP* to the *Parent Company* as covered by a Contract to Sell for ₱188 million, which was fully paid in September 2008. The *Parent Company* began billing customers connected to the *STA*s from August 26, 2009 to September 25, 2009.

With respect to metering arrangement, *NGCP* will continue to be the meter service provider until *NGCP* is able to install its totalizing meters at the new delivery points. Thereon, it will be the *Parent Company*'s obligation and responsibility to meter the customers. However, even if the *Parent Company* has the technical capability to meter all these customers, it can assume the metering function from *NGCP* for the customers with *ESC* only upon securing a *WESM* Metering Provider License from the *ERC*.

A MOA which will cover in detail the protocol between the Parent Company, the NGCP, the Suppliers (NPC and Team Energy) and PEMC with regard to the foregoing arrangements is being finalized.

Acquisition of Carmelray Industrial Park II or CIP2's existing Distribution System and Concession Agreement

On April 11, 2009, pursuant to a MOA entered into between MERALCO and Carmelray-JTCl Corporation or CJC, and duly approved by the PEZA, MERALCO took over the 13.8-kV distribution line facilities and switching stations of the CIP2 in order to ensure adequate supply of electricity to the park and its locators for a period of 19 years from effective date until June 28, 2028. CIP2 is located in Calamba, Laguna, which is within the franchise area of MERALCO. On April 17, 2009, the board of PEZA approved the registration by MERALCO as a PEZA-registered utilities enterprise subject to certain conditions.

As a registered enterprise, *MERALCO* shall have the option to pay income tax at 5% of gross income, in lieu of all national and local taxes, except real property taxes.

## Petition for Dispute Resolution

On September 9, 2008, *MERALCO* filed a Petition for Dispute Resolution with the *ERC*, against *PEMC*, *TransCo*, *NPC* and *PSALM* as a result of the congestion in the transmission system of *TransCo* arising from the outage of the San Jose-Tayabas 500kV Line 2 on June 22, 2008, followed by the outage of the 500kV 600 MVA Transformer Bank #2 of *TransCo*'s San Jose, Bulacan substation on July 11, 2008. The Petition seeks to, among others, direct *PEMC* to adopt the *NPC-TOU* rate or the new price determined through the price substitution methodology of *PEMC* as approved by the *ERC*, as basis for its billing during the period of the congestion; 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 relation to said petition, *PEMC* has agreed to implement the segregation of the line rental amounts associated with the *Parent Company*'s bilateral contracts from the *WESM* energy trading amount in accordance with the *WESM* Rules, as requested by the *Parent Company*.

Hearings on the petition have been completed and pending the resolution by the ERC.

## PSALM versus PEMC and MERALCO

Due to the significant increases in *WESM* prices during the 3<sup>rd</sup> and 4<sup>th</sup> months of the *WESM* operations, a concern was raised by the *Parent Company* with *the PEMC* to investigate whether *WESM* rules were breached or if anticompetitive behavior has 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. A decision of the *ERC*, which directed the *WESM* settlement price for the 3<sup>rd</sup> and 4<sup>th</sup> billing months to be *NPC-TOU* rates prompted *PSALM* to file a Motion for Reconsideration with the *CA*, which was denied on November 6, 2009. In December 2009, *PSALM* filed a Petition for Review on Certiorari with the *SC* 

As of December 31, 2009, 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* regarding *NPC*'s imposition of premium charges for the alleged excess energy it supplied to the *MERALCO* covering the billing periods May 2005 to June 2006. The premium charges amounted to ₱315 million during the May–June 2005 billing periods and ₱318 million during the November 2005, February 2006 and April-June 2006 billing periods. *MERALCO* believes that there is no basis for the imposition of the premium charges as there was no *ERC*-approved *TSC* between petitioner and *NPC* and the premium charges imposed by *NPC* has not been approved by the *ERC*.

# **Corporate Information**

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#### **COMMON STOCK**

The company's common stock is listed in the Philippine Stock Exchange (Ticker symbol: MER). The declassification of the company's common stock removed the Class "A" and Class "B" classification effective September 3, 2007. The declassification does not entail a recall, a cancellation or a replacement of certificates previously issued. All existing stock certificates, whether Class "A" or Class "B", will remain valid. Shares are available to foreign investors up to a maximum of 40 percent of the outstanding capital stock.

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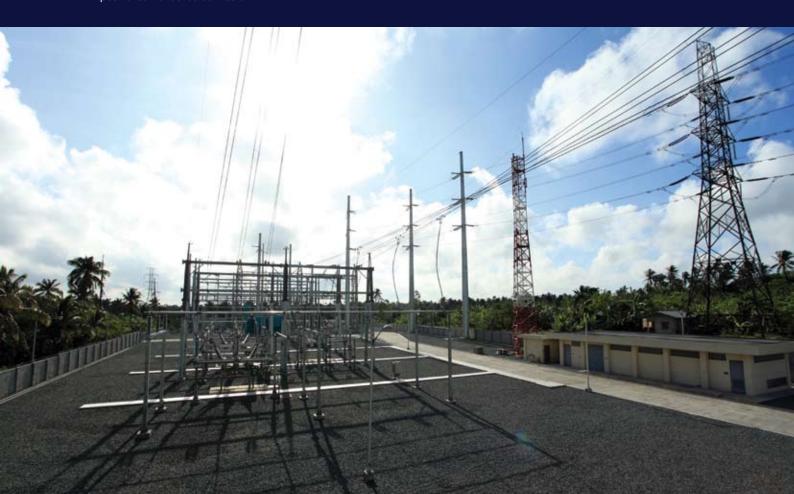






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