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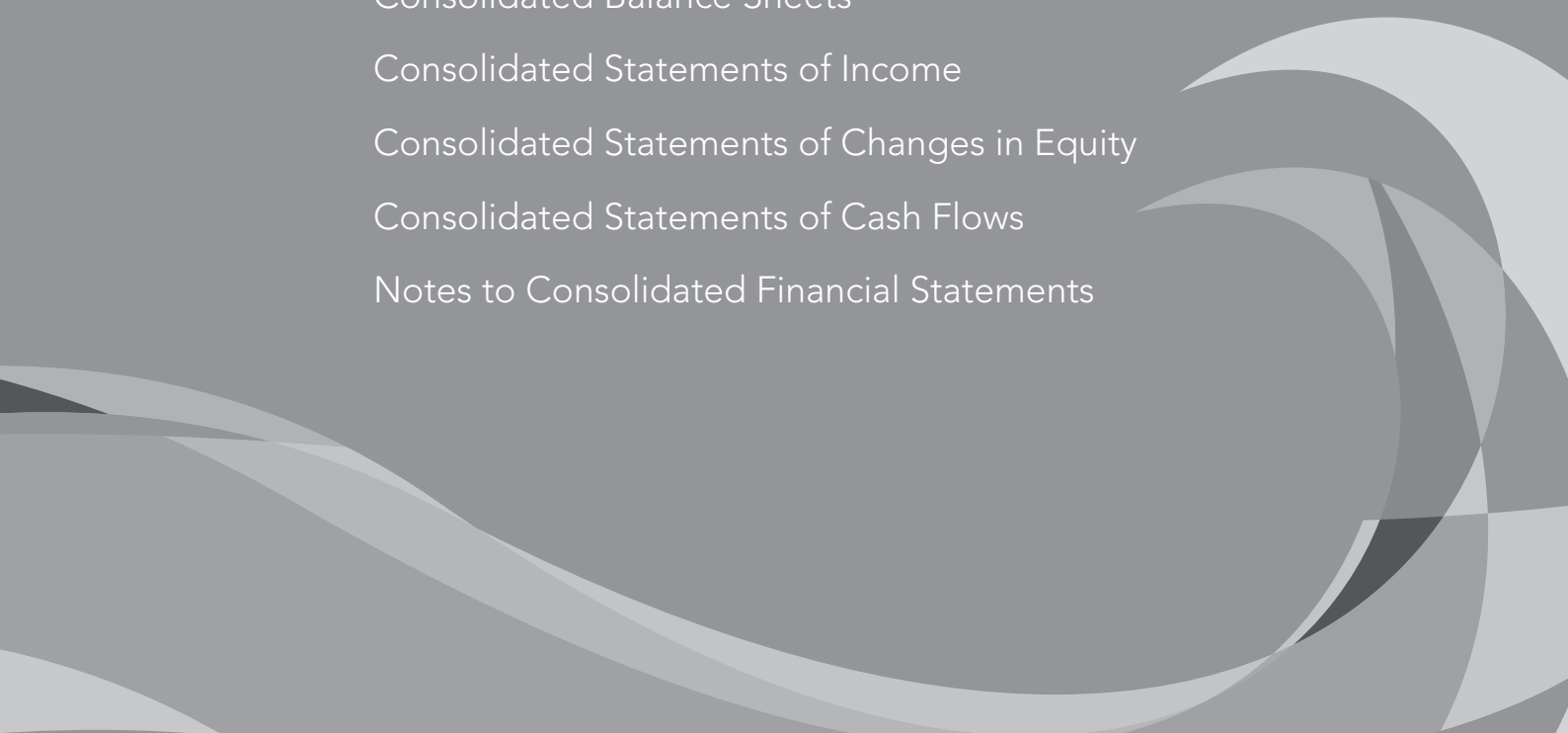
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Audit Committee Report

The Audit Committee's primary role and responsibility, as embodied in its Charter, is to provide assistance to the Board of Directors in fulfilling its oversight responsibility to the shareholders relating to the following:

- a) Financial statements and financial reporting process;
- b) System of internal controls and financial controls;
- c) Performance of internal and independent auditor; and,
- d) Compliance with legal and regulatory matters.

To fulfill its responsibilities, the Audit Committee has focused on the following tasks in 2008:

- An independent director chairs the Committee.
- Held fourteen (14) meetings during the year.
- Reviewed and discussed the quarterly unaudited financial statements and the audited 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 auditor of the Company. Responsibilities of financial reporting are further defined below:
 - o Management has the primary responsibility for preparing the financial statements and the financial reporting process; and
 - o The independent external auditor is responsible for expressing an opinion on whether the Company's consolidated audited financial statements conform with Philippine Financial Reporting Standards
- Discussed and approved the overall scope and respective audit plans of the internal auditors and the independent auditor.
- 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 audit services provided by independent auditor 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 Committee recommends to the Board of Directors the approval of the audited financial statements for the year ended December 31, 2008 and their filing with the Securities and Exchange Commission and other regulatory bodies.

On behalf of the Audit Committee,



Former Chief Justice ARTEMIO V. PANGANIBAN

Chairman, Audit Committee (May 2008 to December 2008)

February 18, 2009

Statement of Management's Responsibility

The management of MANILA ELECTRIC COMPANY is responsible for all information and representations contained in the consolidated balance sheets as at December 31, 2008 and 2007, and the consolidated statements of 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, 2008, 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.

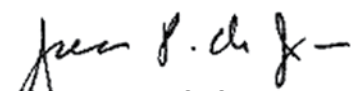
In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition, and liabilities are recognized. The management likewise discloses to the Company's audit committee and to its external auditor: (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) and 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.

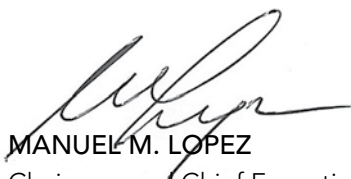
SyCip Gorres Velayo & Co., the independent auditors appointed by the Board of Directors and stockholders, has audited the consolidated financial statements of the Company and the major subsidiaries in accordance with auditing standards generally accepted in the Philippines and has expressed its opinion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



FERDINAND K. CONSTANTINO
Chief Finance Officer



JOSE P. DE JESUS
President and Chief Operating Officer



MANUEL M. LOPEZ
Chairman and Chief Executive Officer

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 balance sheets as at December 31, 2008 and 2007, and the consolidated statements of 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, 2008, 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, 2008 and 2007, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2008 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-1
Tax Identification No. 102-096-610
PTR No. 1566465, January 5, 2009, Makati City

February 24, 2009

A member firm of Ernst & Young Global Limited

Consolidated Balance Sheets

	December 31	
	2008	2007
	(Amounts in Millions)	
ASSETS		
Noncurrent Assets		
Utility plant and others - net (Notes 9, 10, 18 and 20)	₱95,704	₱93,696
Construction in progress (Notes 9, 10 and 17)	5,149	2,811
Investments in associates and joint venture (Note 11)	1,378	1,635
Investment properties - net (Notes 12 and 20)	5,505	5,578
Deferred pass-through fuel costs (Notes 13, 26 and 35)	3,792	4,896
Deferred income tax assets (Note 33)	8,533	6,226
Other noncurrent assets - net (Notes 2, 13, 15, 25, 31 and 33)	9,665	15,885
Total Noncurrent Assets	129,726	130,727
Current Assets		
Cash and cash equivalents (Notes 14 and 31)	5,402	4,876
Trade and other receivables - net (Notes 2, 13, 15, 26 and 31)	37,509	35,870
Inventories (Note 16)	1,648	1,538
Land and development costs (Notes 8 and 25)	1,566	1,987
Other current assets (Notes 10, 13, 17, 20, 23 and 31)	2,533	2,294
Total Current Assets	48,658	46,565
	₱178,384	₱177,292
EQUITY AND LIABILITIES		
Equity Attributable to Equity Holders of the Parent		
Common stock (Note 18)	₱11,038	₱11,033
Capital in excess of par value	2,932	2,931
Excess of acquisition cost over carrying value of minority interest acquired	(328)	(328)
Employee share-based payment plan (Note 19)	268	152
Unrealized fair value gains on available-for-sale investments (Note 13)	47	68
Appraisal increase in utility plant and others (Note 18)	19,926	20,292
Share in revaluation increment of an associate (Notes 11 and 18)	129	298
Share in cumulative translation adjustment (Note 11)	2	2
Unappropriated retained earnings (Note 18)	14,395	17,032
Appropriated retained earnings (Note 18)	4,198	200
	52,607	51,680
Minority Interests	3,552	3,341
Total Equity	56,159	55,021
Noncurrent Liabilities		
Interest-bearing loans and other borrowings - net of current portion (Notes 9, 12, 20, 28 and 31)	13,228	14,169
Customers' deposits - net of current portion (Notes 15, 21, 25, 28 and 31)	23,443	21,423
Provisions (Notes 6, 22 and 34)	5,743	1,396
Customers' refund - net of current portion (Notes 2, 23 and 31)	2,680	7,866
Pension liability (Note 29)	11,849	11,313
Deferred income tax liabilities (Note 33)	13,341	14,089
Liability arising from deferred pass-through fuel costs - net of current portion (Notes 13, 25 and 26)	—	692
Deposits from pre-selling of condominium units (Notes 5 and 8)	36	2,411
Currency Exchange Rate Adjustment (CERA) I and II over-recoveries, including carrying charges - net of current portion (Note 25)	3,008	—
Other noncurrent liabilities (Note 29)	840	802
Total Noncurrent Liabilities	74,168	74,161
Current Liabilities		
Notes payable (Notes 24, 28 and 31)	9,828	10,748
Trade and other payables (Notes 2, 5, 13, 15, 20, 21, 25, 26, 28 and 31)	25,754	30,285
Customers' refund - current portion (Notes 2, 23 and 31)	7,925	4,904
Interest-bearing loans and other borrowings - current portion (Notes 9, 12, 20, 28, and 31)	2,265	2,122
Income tax payable	2,285	51
Total Current Liabilities	48,057	48,110
Total Liabilities	122,225	122,271
	₱178,384	₱177,292

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Income

	Years Ended December 31		
	2008	2007	2006
<i>(Amounts in Millions, Except Per Share Data)</i>			
REVENUES			
Sale of electricity (Notes 2, 13, 25, 26 and 27)	₱186,999	₱196,171	₱186,576
Sale of real estate (Note 8)	2,213	2,122	1,787
Sale of contracts and services (Note 8)	1,512	1,346	1,542
Others (Note 12)	1,051	1,054	882
	191,775	200,693	190,787
EXPENSES (INCOME)			
Purchased power (Notes 26, 27 and 35)	156,872	172,837	161,263
Operations and maintenance (Notes 15, 19, 26, 28 and 29)	13,627	13,180	10,908
Provision for (recovery of) probable losses on disallowed receivables and refund - net [Notes 6c(1), 6d(1), 22, 25 and 35]	6,617	(646)	215
Depreciation and amortization (Notes 9 and 12)	4,426	4,492	4,394
Interest and other financial expenses (Notes 13, 20, 21, 24, 25, 26 and 28)	3,322	2,980	5,104
Interest and other income (Notes 15, 21, 28 and 31)	(2,106)	(2,128)	(2,858)
Cost of real estate sold (Note 8)	1,646	1,974	1,494
Cost of contracts and services (Note 28)	1,456	1,415	1,156
Present value impact on customers' refund (Note 23)	846	1,096	1,512
Foreign exchange losses (gains) - net (Note 28)	(467)	(162)	1,953
Provision for (reversal of) probable losses from tax assessments and legal claims - net (Notes 22 and 34)	318	(328)	452
Taxes other than income tax [Note 33(b)]	217	214	666
Equity in net earnings of associates and joint venture (Note 11)	(199)	(324)	(292)
Reversal of probable losses related to unbundling rate case [Note 21(b)]	-	-	(15,725)
CERA II revenues (Notes 20, 25 and 28)	-	-	(1,381)
	186,575	194,600	168,861
INCOME BEFORE INCOME TAX	5,200	6,093	21,926
PROVISION FOR (BENEFIT FROM) INCOME TAX (Note 33)			
Current	5,122	2,729	3,649
Deferred	(3,055)	(672)	4,396
	2,067	2,057	8,045
NET INCOME	₱3,133	₱4,036	₱13,881
Attributable To			
Equity holders of the parent (Note 36)	₱2,800	₱3,759	₱13,686
Minority interests	333	277	195
	₱3,133	₱4,036	₱13,881
Earnings Per Share Attributable to the Equity Holders of the Parent (Note 36)			
Basic	₱2.5370	₱3.5457	₱13.7023
Diluted	2.5324	3.5309	13.6589

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

Equity Attributable to Equity Holders of the Parent Company													Minority Interest	Total Equity
	Common Stock (Note 18)	Capital in Excess of Par value	Excess of Acquisition Cost Over Carrying Value of Minority Interest Acquired	Employee Share-Based Payment Plan (Note 19)	Unrealized Fair Value Gains on Available-for-Sale Investments (Note 13)	Appraisal Increase in Utility Plant and Others (Note 18)	Share in Revaluation Increment of an Associate (Notes 11 and 18)	Share in Cumulative Translation Adjustment (Note 11)	Unappropriated Retained Earnings (Note 18)	Appropriated Retained Earnings (Note 18)	Total	(In Millions)		
At January 1, 2008	P11,033	P2,931	(P328)	P152	P68	P20,292	P298	P2	P17,032	P200	P51,680	P3,341	P55,021	
Unrealized fair value loss on available-for-sale investments during the year														
Net income	-	-	-	-	(21)	-	-	-	-	-	(21)	-	(21)	
	-	-	-	-	-	-	-	-	2,800	-	2,800	333	3,133	
Total recognized income and expense for the year	-	-	-	-	(21)	-	-	-	2,800	-	2,779	333	3,112	
Depreciation on appraisal increase transferred to unappropriated retained earnings	-	-	-	-	-	(366)	-	-	366	-	-	-	-	
Share on depreciation of revaluation increment of an associate transferred to unappropriated retained earnings	-	-	-	-	-	-	(169)	-	169	-	-	-	-	
Issuance of shares	5	1	-	-	-	-	-	-	-	-	6	-	6	
Share-based payment	-	-	-	116	-	-	-	-	-	-	116	-	116	
Dividends and others	-	-	-	-	-	-	-	-	(1,974)	-	(1,974)	(122)	(2,096)	
Appropriations - net of reversal	-	-	-	-	-	-	-	-	(3,998)	3,998	-	-	-	
	5	1	-	116	(21)	(366)	(169)	-	(2,637)	3,998	927	211	1,138	
At December 31, 2008	P11,038	P2,932	(P328)	P268	P47	P19,926	P129	P2	P14,395	P4,198	P52,607	P3,552	P56,159	
At January 1, 2007	P9,988	P2,918	(P328)	P79	P43	P20,699	P467	P1	P12,703	P1,200	P47,770	P3,204	P50,974	
Unrealized fair value gain on available-for-sale investments during the year														
Equity adjustment from translation during the year	-	-	-	-	25	-	-	-	-	-	25	-	25	
Total recognized income for the year recognized directly in equity	-	-	-	-	-	-	-	1	-	-	1	-	1	
Net income	-	-	-	-	25	-	-	1	-	-	26	-	26	
	-	-	-	-	-	-	-	-	3,759	-	3,759	277	4,036	
Total income and expense for the year	-	-	-	-	25	-	-	1	3,759	-	3,785	277	4,062	
Depreciation on appraisal increase transferred to unappropriated retained earnings	-	-	-	-	-	(407)	-	-	407	-	-	-	-	
Share on depreciation of revaluation increment of an associate transferred to unappropriated retained earnings	-	-	-	-	-	-	(169)	-	169	-	-	-	-	
Issuance of shares	1,045	13	-	-	-	-	-	-	-	-	1,058	-	1,058	
Share-based payment	-	-	-	73	-	-	-	-	-	-	73	-	73	
Dividends and others	-	-	-	-	-	-	-	-	(6)	(1,000)	(1,006)	(140)	(1,146)	
	1,045	13	-	73	25	(407)	(169)	1	4,329	(1,000)	3,910	137	4,047	
At December 31, 2007	P11,033	P2,931	(P328)	P152	P68	P20,292	P298	P2	P17,032	P200	P51,680	P3,341	P55,021	

Consolidated Statements of Changes in Equity

	Equity Attributable to Equity Holders of the Parent Company										Minority Interest	Total Equity
	Common Stock (Note 18)	Capital in Excess of Par Value	Excess of Acquisition Cost Over Carrying Value of Minority Interest Acquired	Employee Share-Based Payment Plan (Note 19)	Unrealized Fair Value Gains on Available-for-Sale Investments (Note 13)	Appraisal Increase in Utility Plant and Others (Note 18)	Share in Revaluation Increment of an Associate (Notes 11 and 18)	Share in Cumulative Translation Adjustment (Note 11)	Unappropriated Retained Earnings (Note 18)	Appropriated Retained Earnings (Note 18)		
At January 1, 2006	P9,985	P2,918	P—	P56	P26	P21,123	P636	P1	P430	P200	P35,375	P38,461
Unrealized fair value gain on available-for-sale investments during the year	—	—	—	—	17	—	—	—	—	—	17	17
Net income	—	—	—	—	—	—	—	—	13,686	—	13,686	13,881
Total recognized income for the year	—	—	—	—	17	—	—	—	13,686	—	13,703	13,898
Depreciation on appraisal increase transferred to unappropriated retained earnings	—	—	—	—	—	(424)	—	—	424	—	—	—
Share on depreciation of revaluation increment of an associate transferred to unappropriated retained earnings	—	—	—	—	—	—	(169)	—	169	—	—	—
Issuance of shares	3	—	—	—	—	—	—	—	—	—	3	3
Acquisition of minority interest	—	—	(328)	—	—	—	—	—	—	—	(328)	(328)
Share-based payment	—	—	—	23	—	—	—	—	—	—	23	23
Dividends and others	—	—	—	—	—	—	—	—	(1,006)	—	(1,006)	(1,083)
Appropriation during the year	—	—	—	—	—	—	—	—	(1,000)	1,000	—	—
At December 31, 2006	P9,988	P2,918	(P328)	P79	P43	P20,699	P467	P1	P12,703	P1,200	P47,770	P50,974

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

	Years Ended December 31		
	2008	2007	2006
	(Amounts in Millions)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	₱5,200	₱6,093	₱21,926
Adjustments for:			
Provision for (recovery of) probable losses on disallowed receivables and refund - net (Notes 6, 22, 25 and 35)	6,617	(646)	215
Depreciation and amortization (Notes 9 and 12)	4,426	4,492	4,394
Interest and other financial expenses (Note 28)	2,085	1,864	3,764
Interest expense on bill deposits (Note 28)	925	864	858
Interest and other income (Note 28)	(2,106)	(2,128)	(2,858)
Present value impact on customers' refund (Note 23)	846	1,096	1,512
Provision for (reversal of) probable losses on tax assessments and legal claims (Note 22)	318	(328)	452
Equity in net earnings of associates and joint venture (Note 11)	(199)	(324)	(292)
Employee share-based benefits expense	116	73	23
Interest expense on meter deposits (Note 28)	89	99	102
Reversal of probable losses related to unbundling rate case [Note 21(b)]	—	—	(15,725)
CERA I over recoveries (Notes 27)	—	—	1,928
Operating income before working capital changes	18,317	11,155	16,299
Decrease (increase) in:			
Trade and other receivables	4,302	(3,376)	(6,852)
Inventories	(110)	(502)	194
Land and development costs	421	(1,349)	(804)
Deferred pass-through fuel costs	740	(1,116)	(145)
Other current assets	(951)	386	(4,298)
Increase (decrease) in trade and other payables	(7,346)	(5,452)	4,094
Net cash generated from (used in) operations	15,373	(254)	8,488
Interest paid	(2,093)	(2,561)	(2,928)
Income tax paid	(2,888)	(2,583)	(861)
Franchise tax paid	(42)	(235)	(51)
Net cash provided by (used in) operating activities	10,350	(5,633)	4,648
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to:			
Construction in progress (Note 10)	(8,573)	(6,469)	(5,547)
Utility plant and others (Note 9)	(629)	(326)	(552)
Investment properties (Note 12)	(48)	(74)	(29)
Decrease (increase) in:			
Other noncurrent assets	1,084	(3,364)	(4,661)
Other receivables	(1,048)	(1,047)	32
Acquisition of a subsidiary, net of cash acquired (Note 8)	—	(75)	—
Interest and dividends received (Notes 11 and 28)	2,032	3,385	3,169
Net cash used in investing activities	(7,182)	(7,970)	(7,588)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from:			
Notes payable	9,650	12,180	—
Long-term debt	1,235	644	13,126
Issuance of and subscriptions to common stock	5	—	3
Payments of:			
Customers' refund	(1,713)	(1,463)	(65)
Long-term debt	(1,557)	(193)	(19,917)
Notes payable	(10,570)	(1,742)	(74)
Increase in:			
Customers' deposits	1,259	1,515	2,099
Other noncurrent liabilities	1,203	1,788	594
Dividends paid	(1,960)	(1,006)	—
Redemption of preferred stock	(194)	(85)	(66)
Net cash provided by (used in) financing activities	(2,642)	11,638	(4,300)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	526	(1,965)	(7,240)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	4,876	6,841	14,081
CASH AND CASH EQUIVALENTS AT END OF YEAR	₱5,402	₱4,876	₱6,841

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

1. Corporate Information

Manila Electric Company (the Parent Company or Meralco) is incorporated in the Philippines. It is involved in the distribution and supply of electricity and is subject to the rate-making regulations and regulatory policies of the Energy Regulatory Commission (ERC).

On June 9, 2003, President Gloria Macapagal-Arroyo signed into law Republic Act (RA) No. 9209, otherwise known as the "Manila Electric Company Franchise" which took effect on June 28, 2003. The law consolidated the Parent Company's 50 franchises and granted the 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 Batangas, Laguna, Pampanga, and Quezon. On October 20, 2008, the ERC granted the Parent Company a consolidated Certificate of Public Convenience and Necessity (CPCN) for the operation of electric service within its franchise coverage, effective until June 28, 2028, to coincide with the Parent Company's congressional franchise.

Its subsidiaries (see Note 3) are mainly engaged in engineering, construction and consulting services, information systems and technology, real estate, insurance and other electricity-related services.

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

The accompanying consolidated financial statements were approved and authorized for issue by the Board of Directors (BOD) on February 24, 2009.

2. Rate Regulation

As discussed in Note 1, the Parent Company, as a distribution utility, is subject to the rate-making regulations and regulatory policies of the ERC. The Parent Company's billings to customers are itemized or "unbundled." The adjustment of each bill component is governed by corresponding mechanisms, promulgated and enforced by the ERC, such as:

Unbundled Bill Component	Mechanism
Generation and System Loss Charges (see Notes 13 and 34)	Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities, as Amended (AGRA)
Transmission Charge (see Note 34)	- Guidelines for the Adjustment of Transmission Rates by Distribution Utilities (TRAM) - Rules for Calculation of the Over or Under Recovery in the Implementation of Transmission Rates and the Corresponding System Loss Rates by Distribution Utilities
Distribution Charge, Supply Charge, and Metering Charge	Rules for the Setting of Distribution Wheeling Rates (RDWR), as modified by the ERC Resolution No. 20, Series of 2008
CERA (see Note 25)	Implementing Rules for the Incremental Currency Exchange Rate Adjustment (ICERA)
Lifeline Rate subsidy (see Note 34)	Guidelines for the Calculation of the Over or Under Recovery in the Implementation of Lifeline Rates by Distribution Utilities
Inter-class subsidy (see Note 34)	Guidelines for a "True-Up" Mechanism of the Over or Under Recovery in the Implementation of Inter-class Cross Subsidy Removal by Distribution Utilities

The status of the Parent Company's rate cases follow:

I. Rate Applications

a. Performance-Based Regulation (PBR) Application

The Parent Company, along with two other distribution utilities (Dagupan Electric Corporation or DECORP and Cagayan Electric Power and Light Company or CEPALCO), is among the first entrants to PBR and accordingly filed its first PBR application last September 1, 2006.

Rate-setting under PBR is governed by the RDWR. Under the previous Return on Rate Base (RORB) methodology, utility tariffs were based on historical costs plus a reasonable rate of return. On the other hand, 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 mechanism that will penalize or reward a utility company depending on its network and service performance.

On August 31, 2007, the ERC issued its Final Determination which set 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 (from July 1, 2008 to June 30, 2011). The approved Maximum Average Prices (MAP) are ₱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 regulatory year begins in July and ends in June of the following year. Thus, the 2008 regulatory year begins on July 1, 2007 and ends on June 30, 2008.)

On September 17, 2007, the Parent Company filed with the ERC a Motion for Reconsideration (MR) and Clarification that includes an appeal for a higher Weighted Average Cost of Capital (WACC) or a mechanism that would allow for a reopening of the ERC's determination should there be material changes in the components of the WACC computation. The ERC utilized a common WACC of 12.80% for the Parent Company, DECORP, and CEPALCO. The Parent Company proposed a WACC of 15.63%.

Through an Order released December 18, 2007, the ERC denied the Parent Company's MR. On the WACC, the ERC reaffirmed the 12.80% WACC used in its final determination, but it also said that it may "allow for the adjustment of the WACC during the Second Regulatory Period should material changes between later figures and that calculated at the start of the regulatory period arise." The ERC, thus, suggested a modification to the RDWR to allow for a re-opening of the approved rates should there be material changes in the WACC and in operating and maintenance expenditures during the Second Regulatory Period.

On January 11 and April 1, 2008, the Parent Company filed separate applications for the approval of its proposed translation of the MAP for regulatory years 2008 and 2009 into different rate schedules for the Parent Company's various customer segments. Because of the delay in the implementation of PBR for the Parent Company, substantial distribution charge under-recoveries have been incurred and these were partly incorporated in the proposed MAP of ₱1.3607 per kWh for the regulatory year 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 the regulatory year 2009 of only ₱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.

In a Manifestation dated October 22, 2008, the Parent Company manifested its intention to defer the recovery/collection of the Corporate Income Tax (CIT) component of its approved Annual Revenue Requirement and to avail of recovery mechanisms existing or to be promulgated by the ERC on suitable alternatives to the CIT component.

On October 24, 2008, intervenor National Association of Electricity Consumers for Reform, Inc. (NASECORE) filed a motion with the ERC asking for the deferment of the implementation of the Decision until such time that NASECORE shall have filed an MR and the same has been resolved by the ERC.

Acting on the motion filed by NASECORE, the ERC, in an Order dated October 27, 2008, resolved to defer the implementation of the Decision until final resolution of the motion for reconsideration to be filed by NASECORE. On October 29, 2008, the Parent Company filed an MR questioning the deferment of the implementation of the Decision. As of February 24, 2009, the motion is awaiting resolution by the ERC.

On November 11, 2008, the Parent Company received NASECORE's MR. The Parent Company filed an Opposition thereto last November 19, 2008 and is now awaiting the ERC's resolution of this matter.

On December 24, 2008, the ERC released Resolution No. 20, series of 2008, modifying certain provisions of the RDWR. The amendments to the RDWR were published on January 28, 2009. Among the salient provisions of the modification are:

- i. On the building blocks, the CIT component is set to zero for the Second Regulatory period.
- ii. On the WACC, the Debt-Equity ratio was changed from 45:55 to 40:60, while from zero escalation, the Asset Beta will now be escalated by 1.25. Furthermore, the WACC to be selected by the ERC will come from the 75th percentile of range of values, instead of the average, as was done previously.
- iii. Operation and maintenance expenses will now include company use and, finally, the S-factor will now be excluded from Side Constraint computations.

Notes to Consolidated Financial Statements

In a letter to the Parent Company dated February 16, 2009, the ERC stated that since the RDWR amendments will have substantial impact on the price resets for regulatory years 2010 and 2011, it had approved the Guidelines for the regulatory year 2010 Rate Reset to guide the first entrants to PBR in their next rate application which was due on March 20, 2009. As part of the said application, the ERC also requested the DUs to review their energy sales and expenditure forecasts "in light of the international economic downturn."

On March 19, 2009, the Parent Company wrote the ERC to ask for additional time within which to submit its regulatory year 2010 verification and reset filing. The request cited the Parent Company's need to more extensively assess the impact of the economic slowdown on its major customers.

b. Supreme Court (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 levels. However, on August 4, 2003, certain consumer and civil society groups filed with the Court of Appeals (CA) 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. According to the CA, the ERC should have asked the Commission on Audit (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, the CA denied the motion; thus, the ERC and the Parent Company elevated the case to the SC.

In an En Banc Decision promulgated on December 6, 2006, the SC set aside and reversed the CA ruling saying that a COA audit was not a prerequisite in the determination of a utility's rates. Under Philippine Accounting Standard (PAS) 37, "Provisions, Contingent Liabilities and Contingent Assets," if it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the obligation should be reversed. The reversal of such provision should be recognized prospectively as required by PAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors." Accordingly, in 2006, the Parent Company reversed the entire provision for probable losses related to this case. This amounted to ₱15,725 million and is shown separately in the 2006 consolidated statement of income. But, 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 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.

In a letter dated July 30, 2008, the ERC informed the Parent Company of the intention of the COA to audit the Parent Company's books, records and accounts and requested the latter to accommodate the request. In response, the Parent Company, in a letter dated August 6, 2008, expressed its reservation as the audit of private corporations is outside the ambit of the COA's mandated functions and responsibilities.

In a letter dated August 27, 2008, the COA clarified to the ERC that the audit will cover the test period calendar years 2004 and 2007 and will be conducted pursuant to the SC Decision dated December 6, 2006 to determine if the rate increases the Parent Company asked for are reasonable and justified. In view of the clarification made by the COA on the scope and purpose of the audit, the Parent Company, through a letter to the ERC dated September 5, 2008, agreed to the conduct of the rate audit and made arrangements for the necessary office space and other facilities required by COA. The audit is ongoing and is expected to be completed within the first semester of 2009.

II. Applications for Recoveries

The Parent Company filed applications with the ERC for recoveries of Advances in 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.

a. Ten Applications for Recovery of Generation Costs

During the period in which the AGRA mechanism was suspended by the ERC, the Parent Company filed ten 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 (VAT), incurred for the supply months of August 2006 to May 2007, which resulted in under-recoveries in the total amount 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 ₱8,829 million through a ₱0.1662 per kWh charge to customers. The charge was implemented beginning February 2008 and will continue until the ₱8,829 million is fully collected. Of the ₱8,829 million, the Parent Company billed and collected the amount of ₱4,221 million as of December 31, 2008. The remaining balance of ₱4,608 million is expected to be billed the following year and is shown as part of "Trade and other receivables - Unbilled" account (see Note 15).

In the same Order, the ERC directed the Parent Company to refund to its customers the amount refunded by Philippine Electric Market Corporation (PEMC) to the Parent Company relative to the Net Settlement Surplus (NSS) in order to mitigate the impact of the increase in its generation cost. As of December 31, 2007, NSS was estimated at ₱2,812 million. The amount is to be refunded through a ₱0.1614 per kWh credit to customers' bills beginning February 2008 until September 2008.

On September 3, 2008, the ERC released a Decision dated June 4, 2008 on the remaining ₱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 ₱1,149 million in generation cost under-recoveries, plus ₱813 million in carrying charges. However, a portion of the Parent Company's purchases from the Wholesale Electricity Spot Market (WESM) amounting to ₱2,701 million of the total amount applied for was disallowed. In addition, the Parent Company was also ordered to file a separate application for recovery of system loss adjustments amounting to ₱1,295 million 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.

On September 18, 2008, the Parent Company filed a Motion for Partial Reconsideration questioning the disallowance of ₱2,701 million representing the Parent Company's incremental generation cost for energy purchases from the WESM in excess of 10% of the Parent Company's total requirement, for the period December 2006 to May 2007. 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. The ERC has yet to resolve the Parent Company's motion.

b. Generation Rate Adjustment Mechanism (GRAM) Case

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

Under the GRAM rules promulgated by the ERC in February 2003, a distribution utility was required to file a deferred generation cost accounting application, setting forth its calculations of the generation rate. The GRAM rules neither require the publication of the application prior to its filing with the ERC, nor the conduct of formal hearings thereon.

The Parent Company made three filings under the GRAM rules and, with the replacement of GRAM by an Automatic Generation Rate Adjustment (AGRA) mechanism starting November 2004, the Parent Company also made a final GRAM filing to account for all generation costs prior to November 2004.

The ERC's approval of the Parent Company's second GRAM filing was questioned before the SC by a group of electricity consumers. According to their petition, the Parent Company and the ERC failed to comply with Sec. 4(e), Rule 3 of Electric Power Industry Reform Act's (EPIRA) Implementing Rules and Regulations (IRR), which required publication, notice, and hearing of application prior to issuance of the second GRAM Order.

In a Decision dated February 2, 2006, the SC ruled that strict compliance to Sec. 4(e), Rule 3 of the EPIRA IRR is jurisdictional and applies to 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 asking the SC to reconsider its decision. However, through a Resolution promulgated last August 16, 2006, the Motions for Reconsideration filed by the ERC and the Parent Company were denied with finality by the SC.

The Parent Company was thereby directed to refund to affected customers the amount of ₱0.1327 per kWh "reckoned from when the same was charged and collected." Accordingly, the Parent Company recognized the GRAM to be refunded amounting to ₱780 million. As of December 31, 2008 and 2007, the Parent Company refunded ₱746 million and ₱698 million, respectively, to its customers. The balance of ₱34 million in 2008 and ₱82 million in 2007 is shown as part of "Trade and other payables" account in the consolidated balance sheets (see Note 25). Generation costs for the period covered by the GRAM have all been confirmed for recovery from customers. 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 SC Resolution dated August 16, 2006, and the corresponding carrying charges.

c. Application for Recovery of Transmission Costs

On September 26, 2007, the Parent Company filed an application to recover ₱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 (see Note 34a).

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A significant portion of these under-recoveries were incurred prior to the promulgation of TRAM. TRAM provided for the annual updating of the transmission charges to customers but did not address the accumulated over-or under-recoveries in the collection of the transmission charge. While hearings on the application to recover ₱5,554 million transmission cost under-recoveries have been concluded and the case is awaiting resolution by the ERC, gross transmission cost under-recoveries already increased to ₱6,631 million as of December 31, 2008.

d. Applications for Recovery of Advances for Other Pass-Through Costs

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. The ERC concluded hearings on the petition on April 1, 2008 and the case is now submitted for the ERC's decision.

Finally, 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 system amounting to ₱864 million, with a corresponding carrying cost. Hearings on the petition were completed last May 6, 2008, and the case is now awaiting decision by the ERC.

III. Others

a. Bureau of Trade Regulation and Consumer Protection of the Department of Trade and Industry (BTRCP-DTI) Petition

On May 19, 2008, the BTRCP-DTI filed a petition that asked ERC to:

- i. Expand the coverage or increase the discounts under the lifeline rate within the Meralco area only. Further, the BTRCP-DTI said that the Parent Company should absorb the lifeline discounts;
- ii. Direct the Parent Company to buy more from WESM during off-peak hours;
- iii. Direct the Parent Company to extend preferential treatment to poor households and power-intensive industries in the allocation of transmission charges;
- iv. Direct the Parent Company to stop billing system losses to customers and customers are entitled to a refund; and,
- v. Direct the Parent Company to charge distribution rates equal to or lower than those of Visayan Electric Company, CEPALCO, or Davao Light and Power Company.

After the conduct of public hearings, the ERC issued its decision on December 10, 2008 denying all of the courses of action proposed by the BTRCP-DTI, except for 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 a ₱5 per month metering charge." The modification in the lifeline subsidy system, which is revenue neutral to the Parent Company, commenced in February 2009.

b. 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 last phase, Phase IV (for non-residential accounts), is ongoing (see Note 23).

3. Basis of Preparation and Statement of Compliance

The accompanying consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments and available-for-sale (AFS) financial assets, which are measured at fair value. Derivative financial instruments are shown as part of "Other current assets," "Other noncurrent assets," "Trade and other payables" and "Other noncurrent liabilities" accounts in the consolidated balance sheet. AFS financial assets are included as part of "Other noncurrent assets" account in the consolidated balance sheet.

The consolidated financial statements are presented in Philippine peso and all values are rounded to the nearest millions (₱000,000), except when otherwise indicated.

Statement of Compliance

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

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Parent Company and its subsidiaries as at December 31 of each year, except for Meralco Industrial Engineering Services Corporation (MIESCOR) and subsidiaries and Clark Electric Distribution Corporation (CEDC), 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 and CEDC's financial statements and the date of the consolidated financial statements. The consolidated financial statements are prepared using consistent accounting policies for like transactions and other events in similar circumstances.

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.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Parent Company obtains control, and continue to be consolidated until the date that such control ceases.

Minority interests represent the portion of profit or loss and net assets not held by the Company and are presented separately in the consolidated statement of income and within equity in the consolidated balance sheet, separately from parent equity. Acquisitions of minority interests are accounted for using the entity concept method, whereby the difference between the fair value of the consideration transferred and the book value of the share in the net assets acquired is treated as an equity transaction and is presented as "Excess of acquisition cost over carrying value of minority interest acquired" account within the equity section in the consolidated balance sheet.

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

	Country of Incorporation	Principal Activities	Percentage of Ownership	
			2008	2007
Corporate Information Solutions, Inc. (CIS)	Philippines	e-Transactions	100	100
Meralco Energy, Inc. (MEI)	Philippines	Energy Systems Management	100	100
e-Meralco Ventures, Inc. (e-MVI)	Philippines	e-Business Development	100	100
Asian Center for Energy Management (ACEM)*	Philippines	Research & Development	100	100
Meralco Financial Services Corporation (Finserv)	Philippines	Financial Services Provider	100	100
Republic Surety and Insurance Co. (RSIC)	Philippines	Insurance	100	100
Lighthouse Overseas Insurance Company, Limited (LOIL)**	Bermuda	Insurance	100	—
MIESCOR and Subsidiaries	Philippines	Engineering, Construction and Consulting Services	97	97
CEDC**	Philippines	Power Distribution	65	—
Rockwell Land Corporation (Rockwell)	Philippines	Real Estate	51	51

* For dissolution.

** Acquired in 2008 (see Note 8).

4. Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the following Philippine Interpretations which became effective on January 1, 2008, and amendments to existing standards that became effective on July 1, 2008. Adoption of these changes in PFRS did not have any significant effect to the Company:

- Philippine Interpretation IFRIC 11, "PFRS 2 - Group and Treasury Share Transactions" — This interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or the shareholder(s) of the entity provide the equity instruments needed. This interpretation has no material impact on the consolidated financial statements.
- Philippine Interpretation IFRIC 12, "Service Concession Arrangements" — This interpretation covers contractual arrangements arising from private entities providing public services. Currently, the Company does not have service concession agreement and therefore, this has no impact on the consolidated financial statements.
- Philippine Interpretation IFRIC 14, "PAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" — This interpretation provides guidance on how to assess the limit in PAS 19, "Employee Benefits," on the amount of the surplus that can be recognized as an asset, and how the pension asset or liability may be affected when there is a statutory or contractual minimum funding requirement. This interpretation has no material impact on the consolidated financial statements.
- Amendments to PAS 39, "Financial Instruments: Recognition and Measurement," and PFRS 7, "Financial Instruments: Disclosures - Reclassification of Financial Assets" — The amendments to PAS 39 are effective from July 1, 2008 and permit an entity to: (1) reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss

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category if the financial asset is no longer held for the purpose of selling or repurchasing it in the near term in particular circumstances; and (2) transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available-for-sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. These amendments have no impact on the consolidated financial statements since the Company does not have financial assets classified as held for trading and no transfers were made from the available-for-sale category to the loans and receivable category.

Standards and Interpretations not yet Effective

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 and amended PFRS and Philippine Interpretations to have significant impact on its financial statements.

Effective in 2009

- Amendments to PFRS 2, “Share-based Payments - Vesting Conditions and Cancellations” —This standard restricts the definition of “vesting condition” to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that an award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as cancellation. The Company has not entered into share-based payment schemes with non-vesting conditions attached and, therefore, does not expect significant impact on its consolidated financial statements upon adoption.
- PFRS 8, “Operating Segments” — PFRS 8 will replace PAS 14, “Segment Reporting,” and adopts a full management approach to identifying, measuring and disclosing the results of an entity’s operating segments. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. Such information may be different from that reported in the consolidated balance sheet and consolidated statement of income and the Company will provide explanations and reconciliations of the differences. This standard is only applicable to an entity that has 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 will assess the impact of this standard to its current manner of reporting segment information.
- PAS 1, “Presentation of Financial Statements (Revised)” — This amendment requires that statement of changes in equity includes only transactions with owners and all non-owner changes are presented in equity as a single line with details included in a separate statement. Owners are defined as “holders of instruments classified as equity.” The amendment also introduces a new statement of comprehensive income that combines all items of income and expenses together with “other comprehensive income.” Entities can choose to present all items in one statement or to present two linked statements, a separate income statement and a statement of comprehensive income. The Company will apply this amended standard in 2009.
- PAS 23, “Borrowing Cost (Revised)” — This standard requires capitalization of all borrowing costs if they are directly attributable to the acquisition, construction and production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Accordingly, borrowing costs will be capitalized on qualifying assets with a commencement date after January 1, 2009. No changes will be made for borrowing costs incurred to this date that have been expensed. The Company does not expect this amendment to have a significant impact on the consolidated financial statements as it has been the policy of the Company to capitalize borrowing costs attributable to qualifying assets.
- Amendments to PAS 27, “Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate” — These amendments prescribe changes in respect of the holding companies’ separate financial statements including: (a) the deletion of ‘cost method’, making the distinction between pre- and post-acquisition profits no longer required; and (b) in cases of reorganizations where a new parent is inserted above an existing parent of the group (subject to meeting specific requirements), the cost of the subsidiary is the previous carrying amount of its share of equity items in the subsidiary rather than its fair value. All dividends will be recognized in profit or loss. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment. The Company will evaluate the changes in its accounting policies when it adopts the foregoing accounting changes effective January 1, 2009.
- PAS 32, “Financial Instruments: Presentation” and PAS 1, “Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation” — The revisions provide a limited scope exception for puttable instruments to be classified as equity if they fulfill a number of specified features. The amendments to the standards will have no impact on the financial position or performance of the Company as the Company has not issued such instruments.

- Philippine Interpretation IFRIC 13, “Customer Loyalty Programs” — This interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and realized in income over the period that the award credits are redeemed or expired. This interpretation will not have a material impact on the consolidated financial statements as no such transaction exists.
- Philippine Interpretation IFRIC 16, “Hedges of a Net Investment in a Foreign Operation” — This interpretation is effective for annual periods beginning on or after October 1, 2008. The interpretation is to be applied prospectively. This 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. The Company is currently assessing which accounting policy to adopt for the recycling on disposal of the net investment.

Improvements to PFRS

The first omnibus of amendments to certain standards was issued, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The following amendments result in accounting changes and are effective for annual periods on or after January 1, 2009, unless specifically stated.

- PFRS 5, “Noncurrent Assets Held for Sale and Discontinued Operations” — When a subsidiary is held for sale, all of its assets and liabilities will be classified as held for sale under PFRS 5, even when the entity retains a non-controlling interest in the subsidiary after the sale.
- PAS 1, “Presentation of Financial Statements” — Assets and liabilities classified as held for trading are not automatically classified as current in the balance sheet.
- PAS 16, “Property, Plant and Equipment”
 - The amendment replaces the term “net selling price” with “fair value less costs to sell,” to be consistent with PFRS 5, “Noncurrent Assets Held for Sale and Discontinued Operations,” and PAS 36, “Impairment of Asset.”
 - Items of property, plant and equipment held for rental that are routinely sold in the ordinary course of business after rental, are transferred to inventory when rental ceases and they are held for sale. Proceeds of such sales are subsequently shown as revenue. Cash payments on initial recognition of such items, the cash receipts from rents and subsequent sales are all shown as cash flows from operating activities.
- PAS 19, “Employee Benefits”
 - Revises the definition of “past service costs” to include reductions in benefits related to past services (“negative past service costs”) and to exclude reductions in benefits related to future services that arise from plan amendments. Amendments to plans that result in a reduction in benefits related to future services are accounted for as a curtailment.
 - Revises the definition of “return on plan assets” to exclude plan administration costs if they have already been included in the actuarial assumptions used to measure the defined benefit obligation.
 - Revises the definition of “short-term” and “other long-term” employee benefits to focus on the point in time at which the liability is due to be settled.
 - Deletes the reference to the recognition of contingent liabilities to ensure consistency with PAS 37, “Provisions, Contingent Liabilities and Contingent Assets.”
- PAS 20, “Accounting for Government Grants and Disclosures of Government Assistance” — Loans granted with no or low interest rates will not be exempt from the requirement to impute interest. The difference between the amount received and the discounted amount is accounted for as a government grant.
- PAS 23, “Borrowing Costs” — Revises the definition of borrowing costs to consolidate the types of items that are considered components of “borrowing costs,” i.e., components of the interest expense calculated using the effective interest rate method.

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- PAS 28, “Investment in Associates”
 - If an associate is accounted for at fair value in accordance with PAS 39, only the requirement of PAS 28 to disclose the nature and extent of any significant restrictions on the ability of the associate to transfer funds to the entity in the form of cash or repayment of loans will apply.
 - An investment in an associate is a single asset for the purpose of conducting the impairment test. Therefore, any impairment test is not separately allocated to the goodwill included in the investment balance.
- PAS 31, “Interest in Joint Ventures” — If a joint venture is accounted for at fair value, in accordance with PAS 39, only the requirements of PAS 31 to disclose the commitments of the venturer and the joint venture, as well as summary financial information about the assets, liabilities, income and expense will apply.
- PAS 36, “Impairment of Assets” — When discounted cash flows are used to estimate “fair value less cost to sell,” additional disclosure is required about the discount rate, consistent with disclosures required when the discounted cash flows are used to estimate “value in use.”
- PAS 38, “Intangible Assets”
 - Expenditure on advertising and promotional activities is recognized as an expense when the Company either has the right to access the goods or has received the services. Advertising and promotional activities now specifically include mail order catalogues.
 - Deletes references to there being rarely, if ever, persuasive evidence to support an amortization method for finite life intangible assets that results in a lower amount of accumulated amortization than under the straight-line method, thereby effectively allowing the use of the unit of production method.
- PAS 39, “Financial Instruments: Recognition and Measurement”
 - Changes in circumstances relating to derivatives, specifically derivatives designated or de-designated as hedging instruments after initial recognition, are not reclassifications.
 - When financial assets are reclassified as a result of an insurance company changing its accounting policy in accordance with paragraph 45 of PFRS 4, “Insurance Contracts,” this is a change in circumstance, not a reclassification.
 - Removes the reference to a “segment” when determining whether an instrument qualifies as a hedge.
 - Requires use of the revised effective interest rate (rather than the original effective interest rate) when re-measuring a debt instrument on the cessation of fair value hedge accounting.
- PAS 40, “Investment Properties” — Revises 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.

The Company is in the process of evaluating the impact of the above amendments on its financial statements when the amendments are applied in 2009.

Effective in 2010

- PFRS 3, “Business Combinations (Revised)” and PAS 27, “Consolidated and Separate Financial Statements (Revised)” — These revised standards will be effective for annual periods beginning on or after July 1, 2009. The revised PFRS 3 introduces a number of changes in the accounting for business combinations occurring after this date that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. The revised PAS 27 requires that change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. 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 introduced by the revised PFRS 3 must be applied prospectively while the Revised PAS 27 must be applied retrospectively subject to certain exceptions. The Company will apply this amended standard in 2010 and will affect future acquisitions and transactions with non-controlling interests.

- PAS 39, "Financial Instruments: Recognition and Measurement - Eligible Hedged Items" —The amendment addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. The Company has concluded that the amendment will have no impact on its financial position or performance as the Company has not entered into any such hedges.

Effective in 2012

- Philippine Interpretation IFRIC 15, "Agreements for the Construction of Real Estate" — This interpretation is effective for annual periods beginning on or after January 1, 2012 and is to be applied retrospectively. FRSC decided to require mandatory application of this interpretation for Philippine financial reporting purposes in 2012 to allow entities engaged in the real estate business time to prepare for implementation of the interpretation. An entity that would like to make an explicit and unreserved statement of compliance with PFRS, however, would have to apply Philippine Interpretation IFRIC 15 for annual periods beginning on or after January 1, 2009.

This interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. It provides guidance on the recognition of revenue among real estate developers for sales of units, such as apartments or houses, "off plan," i.e., before construction is complete. It also provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of PAS 11, "Construction Contracts," or PAS 18, "Revenue," and when revenue from the construction should be recognized. Rockwell is in the process of quantifying the retrospective impact of this interpretation when it becomes effective in 2012. Except for Rockwell, this interpretation is not relevant to the Parent Company and other subsidiaries.

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 the costs of day-to-day servicing, less accumulated depreciation and any impairment loss, if any. Such costs include the cost of replacing part of such utility plant and other equipment when that cost is incurred, if the recognition criteria are met. When each major inspection is performed, its cost is recognized in the carrying amount of the 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.

Utility plant and others as of January 1, 2005 are stated at deemed cost. In 2005, when the Company adopted PFRS 1, it availed one of the voluntary exemptions allowed under the standard and as a result, the Company elected to change its accounting policy for measuring utility plant and others from revalued amounts to cost basis. The cost adopted is the "deemed cost" (recorded revalued amount as of January 1, 2004) as allowed by the transitional provisions of the standard. There are no further increases in the asset revaluation reserve and is reduced by the amount of depreciation on appraisal increase charged to operations, net of tax effect, until the item of utility plant and others is fully depreciated or upon its disposal (see Note 18b).

Upon the disposal of an item of utility plant and others, the relevant portion of the appraisal increase realized with respect to previous valuation is transferred from the appraisal increase directly to retained earnings or deficit. However, for certain subtransmission and distribution assets (e.g., poles, transformers and meters), when an asset in the group is sold or retired, the asset account is reduced for the cost of the asset retired and the accumulated depreciation account is decreased for the same amount.

Depreciation 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 significant parts involved
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 are reviewed, and adjusted prospectively if appropriate, at each financial year-end.

Construction in Progress

Construction in progress of subtransmission and distribution substations and buildings is stated at cost which includes cost of construction, plant and equipment and other direct costs. Borrowing costs that are directly attributable to the construction of utility plant and others are capitalized during the construction period. Construction in progress is not depreciated until such time that the relevant assets are completed and available for operational use.

Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset, an asset that necessarily takes a substantial period of time to get ready for its intended use or sale, are capitalized as part of the cost of the respective assets. All other borrowings are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds. 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 ready for their intended use.

Investment Properties

Investment properties are measured initially at cost, including transaction costs. Investment properties, except land, are presented at cost 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.

Investment properties are derecognized either when they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. The difference between the net disposal proceeds and the carrying amount of the asset is 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.

Investments in Associates

The Company's investments in associates are accounted for using the equity method of accounting 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 associate is carried in the consolidated balance sheet 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. 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 the equity of the associate, the Company recognizes its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity. Profits and losses resulting from transactions between the Company and the associate are eliminated to the extent of the interest in the associate.

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

Interest in a Joint Venture

The Company's interest in Soluziona Philippines, Inc. (Soluziona), a joint venture, is accounted for using the equity method of accounting in the consolidated financial statements. The interest in 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 recorded based on actual billings for unconsumed gas determined at the end of the year, less any impairment in value.

Business Combinations and Goodwill

Business combinations are accounted for using the purchase method of accounting. This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities but excluding future restructuring) of the acquired business at fair value.

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. 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 PAS 14, "Segment Reporting."

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.

When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation differences and goodwill is recognized in the consolidated statement of income.

Impairment of Non-financial Assets

The Company assesses at each reporting date whether there is an indication that the following assets may be impaired:

- Utility plant and others
- Construction in progress
- Investment in associates and joint venture
- Investment properties
- Deferred pass-through fuel cost

The Company also performs annual impairment testing for goodwill.

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 recoverable amount of an asset is the greater of net selling price or value in use. The net selling price 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 subsidiaries or other available fair value indicators.

Impairment losses 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.

Notes to Consolidated Financial Statements

For assets, excluding goodwill, an assessment is 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 unless the asset is carried at revalued amount, in which case the reversal is treated as revaluation increase. After such a reversal, the depreciation charge 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:

Goodwill. Goodwill is reviewed for impairment annually or more frequently if event or changes in circumstances indicate the carrying value maybe impaired. Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating units to which the goodwill relates. Where the recoverable amount of the cash-generating units is less than their carrying amount, an impairment loss is recognized. Impairment loss relating to goodwill cannot be reversed in future periods.

Associates and Joint Venture. After application of equity method, the Company determines whether it is necessary to recognize an additional impairment loss of the Company's investments in its associates and joint venture. The Company determines at each balance sheet date whether there is objective evidence that the investment in associates and joint venture is 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 associate and joint venture, including the cash flows from the operations of the associate and joint venture and the proceeds on the ultimate disposal of the investment; or the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal. The recoverable amount of an investment in associate or 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.

Cash and Cash Equivalents

Cash and cash equivalents in the consolidated balance sheet comprise cash on hand and in banks and short-term investments with an original maturity of three months or less from dates of acquisition and that are subject to an insignificant risk of change in value.

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 of Rockwell 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

Subdivided and unsubdivided lands of Rockwell are stated at the lower of cost and net realizable value less allowance for probable losses. 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 of completion and the estimated costs necessary to make the sale.

Financial Instruments

Initial Recognition. Financial assets and financial liabilities 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 fair value through profit or loss (FVPL).

The Company recognizes a financial asset or a financial liability in the consolidated balance sheet when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, is done using settlement date accounting.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. A financial instrument is classified as liability if it provided for a contractual obligation to (a) deliver cash or another financial asset to another entity; or (b) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Company; or (c) satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own shares. If the

Company does not have the unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity, net of any related income tax benefits.

Determination of Fair Value. 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 balance sheet 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.

"Day 1" Profit

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) in the consolidated statement of income, unless it qualifies for recognition as some other type of asset. In cases where use is made of data which is 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 amount.

Financial Assets

Financial assets are categorized as either financial assets at FVPL, loans and receivables, held-to-maturity (HTM) investments or AFS investments, as appropriate. The Company determines the category of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

The Company has no HTM investments.

Financial Assets at FVPL. Financial assets at FVPL include financial assets held for trading purposes, derivative financial instruments and those designated upon initial recognition as at FVPL.

Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term.

Derivatives, including separated embedded derivatives, are also classified under this category unless they are designated as effective hedging instruments.

Derivatives embedded in host contracts are accounted for as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value. These embedded derivatives are measured at fair value with gains or losses arising from changes in fair value recognized in the consolidated statement of income (shown as part of "Interest and other income – Mark-to-market gains (losses) from derivative instruments" account). Reassessment of embedded derivatives is only done when there are changes in the contract that significantly modifies the cash flows.

Financial assets may be designated at initial recognition as at FVPL if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis; or (ii) the assets or liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

The Company's derivative financial instruments including embedded derivatives that are not accounted for as accounting hedges are classified under this category as of December 31, 2008 and 2007 (see Note 3).

Loans and Receivables. Loans and receivables are nonderivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortized cost using the effective interest rate method. Gains and losses are recognized in consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Loans and receivables are included in current assets if maturity is within 12 months from the balance sheet date. Otherwise, these are classified as noncurrent assets.

Notes to Consolidated Financial Statements

This category includes cash and cash equivalents, trade and other receivables and refundable deposits (see Note 32).

AFS Investments. AFS investments are those nonderivative financial assets that are designated as AFS or are not classified in any of the other three categories. After initial recognition, AFS are measured at fair value with gains and losses being recognized in the “Unrealized fair value gains on AFS investments” account under equity until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the consolidated statement of income.

AFS investments also include unquoted equity investments, which are carried at cost, less any accumulated impairment in value. The fair value of these instruments is not reasonably determinable due to the unpredictable nature of future cash flows and the lack of other suitable methods for arriving at a fair value.

The Company's AFS investments include investments in golf and club shares and ordinary common shares (see Note 13).

Financial Liabilities

Financial liabilities are categorized as financial liabilities at FVPL or other financial liabilities at amortized cost. The Company does not have financial liabilities at FVPL.

Other Financial Liabilities at Amortized Cost. Other financial liabilities at amortized cost pertain to issued financial instruments or their components that are not classified or designated at FVPL and contain contractual obligations to deliver cash or another financial asset to the holder or to settle the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

This category mainly includes interest-bearing loans and other borrowings, customers' deposits, customers' refund, notes payable and trade and other payables which are initially recognized at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and other borrowings are subsequently measured at amortized cost using the effective interest rate method.

Gains and losses are recognized on the consolidated statement of income when the liabilities are derecognized as well as through the amortization process.

Debt issuance costs are deferred and amortized using the effective interest rate method and are removed from the accounts when the loans are fully settled or restructured.

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 the effective interest rate.

Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount reported in the consolidated balance sheet if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented at gross amounts in the consolidated balance sheet.

Impairment of Financial Assets

The Company assesses at each balance sheet 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.

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. Specifically for the Parent Company, it considers termination or disconnection of service and significant financial

difficulties of debtors as objective evidence that a financial asset is impaired. For Rockwell, it considers 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). The carrying amount of the asset shall be 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. Loans 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 future write-off is later 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.

The estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

Financial assets, particularly trade receivables, are written off to the extent of the amount determined by management to be uncollectible. Those with pending cases in court are recommended for write-off, subject to management's approval.

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.

AFS Investments. For AFS investments, the Company assesses at each balance sheet date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as AFS investments, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss which is measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in the consolidated statement of income, is removed from equity and recognized in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income; increases in their fair value after impairment are recognized directly in equity.

In the case of debt instruments classified as AFS investments, 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 of the asset 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 income" account in the consolidated statement of income. If, in subsequent year, the fair value of a debt instrument increased 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 through the consolidated statement of income.

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.

Notes to Consolidated Financial Statements

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 respective carrying amounts is recognized in the consolidated statement of income.

Derivative Financial Instruments

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 Parent Company has bifurcated embedded currency forwards and call options (see Note 31).

Rockwell enters into derivative instruments such as forward currency contracts to manage its currency exposure (see Note 31). The fair values of freestanding forward currency transactions are calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, 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 an interest expense.

Pension and Other Post-Employment Benefits

The Company has funded, noncontributory defined benefit retirement plans covering substantially all of its permanent employees. The Parent Company also provides additional post-employment benefits upon retirement. The cost of providing benefits under the defined benefit plan is determined using the projected unit credit actuarial valuation method. 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 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 are already vested immediately following the introduction of, or changes to, a pension plan, past service cost is recognized immediately.

The defined benefit liability is the aggregate of the present value of the defined benefit obligation 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. If such aggregate is negative, the asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service cost 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 plan.

In addition to its defined benefit retirement plan, MIESCOR also has a defined contribution retirement plan. The amount of MIESCOR's contribution to the retirement plan is recognized as expense in the period incurred.

Share-Based Payment Transactions

The Parent Company has a stock purchase plan for its employees and retirees to purchase fixed number of shares of stock at a stated price. When the grants vest, the capital stock transactions are recorded at the fair value of the awards on grant date as described below. The terms of the plan include, among others, a three-year holding period of the purchased shares and optional cancellation of the purchase prior to full payment of the purchase price.

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which they 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.

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 Parent Company'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 period.

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

The dilutive effect of outstanding awards is reflected as additional share dilution in the computation of earnings per share (see Note 36).

Revenue

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. 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 (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, the 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 indicated in the customers' billing statements. National and Local Franchise Taxes and Universal Charges, which are billed and collected merely on behalf of the national and local government, do not form part of the Company's revenue.

With the enactment of RA No. 9337, "An Act Amending Sections 27, 28, 34, 106, 107, 108, 109, 110, 111, 112, 113, 114, 116, 117, 119, 121, 148, 151, 236, 237 and 288 of the National Internal Revenue Code (NIRC) of 1997, As Amended, and For Other Purposes" on July 1, 2005, the ERC issued on November 7, 2005 Resolution No. 20, Series of 2005 which prescribed the "Guidelines for Implementing the Recovery of VAT and Other Provisions of RA No. 9337 Affecting the Power Industry." RA No. 9337 removes the 2% national franchise tax but imposes a VAT on the generation, transmission, distribution, and supply of electricity. Similar to the local franchise tax, the VAT is a separate item in the customers' bills. The 10% VAT was imposed on electricity consumptions starting November 1, 2005 and was increased to 12% beginning February 1, 2006.

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 sales of projects where the Company has material obligations under the sales contracts to complete the project after the property is 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 pre-selling of condominium units" 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 is shown separately as part of "Trade and other payables" account in the consolidated balance sheet.

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.

Other costs incurred to sell real estate are capitalized as prepaid costs if they are directly associated with and their recovery is reasonably expected from sale of real estate that is being accounted for under deposit method (shown as

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“Other current asset - prepaid cost” account in the consolidated balance sheet). Capitalized selling costs shall be charged to expense in the period in which the related revenue is recognized as earned.

For income tax purposes, full revenue recognition is applied when at least 25% of the selling price has been collected in the year of sale; otherwise, the installment method is applied.

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 year in which the changes are determined.

Service fees are recognized when the service is rendered and are based on the agreed rate per transaction of collections received by the Company as collecting agents of various billers.

Consultancy fees are recognized when software services are rendered.

Premiums and commissions from insurance contracts (shown as part of “Revenue - Others” in the consolidated statement of income) are recognized over the term of the policies using the 24th method. Under this method, it is assumed that the average date of issue of all policies written during any month is the middle of that month. The portion of the premiums written that relate to the unexpired periods of the policies at balance sheet date is accounted for as “Reserve for unearned premiums” account included as part of “Trade and other payables” account in the consolidated balance sheet.

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. Revenue from non-equitized holdings is recognized when the Company's right to receive the payment is established.

Lease Income. Lease income (shown as part of “Revenue - Others” account in the consolidated statement of income) arising from investment properties and poles is accounted for on a straight-line basis over the lease terms on ongoing leases.

Lease income from condominium units held for lease and mall operations (shown as part of “Revenue - Others” account in the consolidated statement of income) is accounted for on a straight-line basis over the lease term.

Cinema Ticket Sales, Bowling, Billiards and Snack Bar. Revenue from cinema ticket sales, bowling, billiards and snack bar (shown as part of “Revenue - Others” account in the consolidated statement of income) is recognized upon receipt of cash from the customer.

Operating 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. A reassessment is made after inception of the lease only if one of the following applies:

- a. there is a change in contractual terms, other than a renewal or extension of the agreement;
- b. a renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
- c. there is a change in the determination of whether the fulfillment is dependent on a specified asset; or
- d. there is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios a, c or d and the date of renewal or extension period for scenario b.

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 which do not transfer to the lessee substantially all the risk and benefits of ownership of the asset are classified as operating lease. Lease income from operating leases is recognized as income in the consolidated statement of income on a straight-line basis over the lease term.

Foreign Currency-Denominated Transactions and Translation

The consolidated financial statements are presented in Philippine Peso, which is the Company's functional and presentation currency. Each entity in the Company determines its own functional currency and items included in the consolidated financial statements of each entity are measured using that functional currency. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency closing exchange rate at the balance sheet date. For Parent Company, payables denominated in foreign currency are recorded using the exchange rate of the last working day of the previous month. In addition, foreign currency-denominated payables related to power purchases are recorded at the average exchange rate of the related US Dollar purchase transactions. However, these are restated using the actual exchange rate on payment date. In accordance with ERB Case No. 87-330 (CERA II), foreign exchange losses arising from the restatement of foreign currency-denominated loans of the Parent Company, from the base rate to the current exchange rate, are recoverable through corresponding adjustments in the customers' bills. In view of this automatic reimbursement mechanism, the Parent Company recognizes a Deferred CERA (included as part of "Other noncurrent assets - Others" account in the consolidated balance sheet) with a corresponding credit (debit) to CERA II revenues for the unrealized foreign exchange gain (loss) which have not been billed to the customers. All differences are taken to the consolidated statement of income with the exception of differences on foreign currency borrowings that provide a hedge against a net investment in a foreign entity. These are taken directly to equity 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 borrowings are also dealt with in equity. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the closing rate.

As at the reporting date, the balance sheet of an associate is translated into the presentation currency of the Company (the Philippine Peso) at the rate of exchange ruling at the balance sheet date and, the statement of income is translated at the monthly weighted average exchange rates for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognized in equity relating to that particular foreign operation is recognized in the consolidated statement of income.

Taxes

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

Deferred Income Tax. Deferred income tax is provided using the balance sheet liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in 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 income tax assets are recognized for all deductible temporary differences, carry-forward benefit of unused tax credits from excess minimum corporate income tax (MCIT) and net operating loss carryover (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward benefit of MCIT and NOLCO can be utilized except:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and 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.

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Deferred income tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries and associates. With respect to investments in other subsidiaries and associates, deferred tax liabilities are recognized except when the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred income tax assets is reviewed at each balance sheet 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 income tax assets are reassessed at each balance sheet 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 income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax assets and deferred income 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.

Income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statement of income.

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.

For the purpose of calculating diluted earnings per share, the net income attributable to equity holders of the parent and the weighted average number of shares outstanding are 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 Balance Sheet Date

Post year-end events that provide additional information about the Company's position at the balance sheet 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.

6. Significant Accounting Judgments, Estimates and Assumptions

The preparation of the 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 reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that would require a material adjustment to the carrying amount of the asset or liability affected in the future periods.

Judgments

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

a. National Power Corporation (NPC) Settlement Agreement

As discussed in Note 34b(4), the effectivity of the Settlement Agreement is dependent on the approval by the ERC. The approval of the ERC is vital since the amount to be settled shall form part of generation cost that is recoverable from the customers. Thus, this amount will be recognized as liability by the Parent Company only if the ERC or the Court, as the case may be, finally approves the Settlement Agreement and allows the pass-through of said amount to the customers. Upon approval by the ERC of the Settlement Agreement, the amount of liability to NPC shall be recognized with a corresponding recognition of receivable from the customers. In the event the Settlement Agreement is disapproved, NPC and the Parent Company (Parties) shall revert to their respective positions before the mediation. If this happens, the remedy available to both Parties, pursuant to their Contract for the Sale of Electricity (CSE), is arbitration. In such a case, the Parent Company will continue to dispute any liability to NPC arising from the CSE, including the amount subject of the Settlement Agreement.

b. Advances in Pass-Through Costs

As discussed in Note 2II(d), the Parent Company has advances for pass-through costs that have been the subject of various applications for recovery with the ERC. If these advances are not recovered through existing ERC-approved recovery mechanisms or orders, they remain unbilled to customers.

As of December 31, 2008, following is the breakdown of the Parent Company's total advances in Pass-Through costs presented as unbilled receivables under "Trade and other receivables" and "Other noncurrent assets" accounts and disclosed as contingent assets in the consolidated financial statements.

	Unbilled Receivables	Contingent Assets	Total
<i>(Amounts in Millions)</i>			
Generation costs net under-recoveries*	₱5,142	₱—	₱5,142
System loss under-recoveries	2,267	805	3,072
SC GRAM case refund amount	780	—	780
Net Settlement Surplus	(514)	—	(514)
Transmission cost gross under-recoveries	—	6,631	6,631
Lifeline rate under-recoveries	—	864	864
Inter-class subsidy removal under-recoveries	—	1,054	1,054
	₱7,675	₱9,354	₱17,029

* Includes carrying charges and net of allowance for nonrecovery (₱2,519 million) and over recoveries (₱1,425 million)

c. Unbilled Receivables

Unbilled receivables include generation and other pass-through costs incurred by the Parent Company, a portion of which are with approved recovery mechanism and currently being collected, while the remaining is still pending approval by the ERC. They consist of the following:

(1) Generation Cost Net Under-recoveries

This includes under-recoveries (with corresponding carrying charges) covering the supply months of August 2006 to May 2007 incurred by the Parent Company during the suspension of AGRA and for the WESM bill in July 2008.

As discussed in Note 2II(a), the ERC allowed the Parent Company to collect the amount of ₱8,829 million and ₱1,149 million out of the ₱12,679 million which the Parent Company sought to recover through the ten separate applications for recovery of generation costs. For the remaining ₱2,701 million, the ERC ruled that the amount be disallowed for recovery from the customers. While the Parent Company is awaiting the ERC's decision on the Parent Company's September 18, 2008 Motion for Partial Reconsideration questioning the disallowance, the Parent Company has made a provision for probable loss amounting to ₱2,519 million in 2008 for prudential reasons. As of December 31, 2008, the remaining balance of the approved generation cost for recovery of ₱9,978 million is ₱5,757 million.

(2) SC GRAM Case Refund Amount

As discussed in Note 2II(b), the Parent Company was directed to refund affected customers the GRAM refund amount of ₱0.1327 per kWh equivalent to a total amount of ₱780 million. As of December 31, 2008, the Parent Company has refunded ₱746 million to its customers. The Parent Company will be filing an application with the ERC for the recovery of the ₱746 million plus any additional amount that it will still refund to its customers pursuant to SC Resolution dated August 16, 2006, and the corresponding carrying charges.

(3) Net Settlement Surplus

Net Settlement Surplus (NSS) is "the settlement surplus remaining after all market transactions have been accounted for, including the assignment of transmission line rentals to Network Service Providers." This remainder is assumed to be attributable to economic rentals arising from other binding constraints, and accounted for in accordance with clause 3.13.16 of the WESM Rules. The NSS is then refunded by the Market Operator monthly to the Distribution Utilities (DUs) and other market participants, which in turn are redistributed by the DUs to its customers by way of credit to their bill in accordance with the orders from the ERC. The balance as of December 31, 2008, amounting to ₱514 million, is still the subject of an on-going and scheduled redistribution of NSS to customers by way of credit to their bill and is shown as a deduction from "Trade and other receivables - Unbilled" account.

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(4) System Loss Under-recoveries

This largely represents system loss under-recoveries incurred by the Parent Company during the supply months of August 2006 to May 2007 when the AGRA was suspended.

As discussed in Note 21(a), in the Decision dated June 4, 2008 on the Parent Company's ten consolidated applications for generation cost under-recoveries, the ERC directed the Parent Company to file a separate application for recovery of system loss adjustments amounting to ₱1,295 million after the ERC shall have confirmed the average transmission rate to be used in the calculation of the system loss rate in accordance with the AGRA Guidelines. The Parent Company is awaiting the confirmation and approval of the average transmission rate to be used in preparing its new application for recovery of the system loss adjustments.

d. Contingent Assets

The Parent Company has contingent assets amounting to ₱9,354 million consisting principally of accumulated advances in specific Pass-Through costs which do not have ERC-approved recovery mechanism as of balance sheet date. Discussion on other contingent assets is disclosed in Note 34.

(1) Application for Recovery of Transmission Cost Under-recoveries

As discussed in Note 34(a), on September 26, 2007, the Parent Company filed an initial application to recover ₱5,554 million in transmission charge under-recoveries. This filing covers accumulated transmission charge under-recoveries over the period June 2003 to July 2007. A significant portion of these under-recoveries were incurred prior to the promulgation of TRAM. TRAM provided for the annual updating of the transmission charges to customers but did not address the accumulated over-or under-recoveries in the collection of the transmission charge. While hearings on the application to recover ₱5,554 million transmission cost under-recoveries have been concluded and the case is awaiting resolution by the ERC, gross transmission cost under-recoveries already increased to ₱6,631 million as of December 31, 2008.

However, starting April 2008, a reduction in the National Transmission Corporation's (TransCo's) ancillary services charges caused transmission costs to go down. Although transmission cost is a pass-through, transmission charges in the customers' bills are updated on an annual basis in accordance with the TRAM. As a result, the Company incurred transmission charge over-recoveries for the period April to December 2008 which accumulated to ₱4,098 million. As of December 31, 2008 and 2007, net transmission cost under-recoveries amounted to ₱2,533 million and ₱6,361 million, respectively.

Following precedent decision of ERC on cases of under-recovery and over-recovery, the Company made provision for probable refund of the transmission cost over-recoveries of ₱4,098 million presented as part of "Provision for (recovery of) probable losses on disallowed receivables and refund" account in the consolidated statement of income.

(2) Application for Recovery of Under-recoveries in the Implementation of the Lifeline Rates

As discussed in Note 34(a), on February 19, 2008, the Parent Company filed an application with the ERC for the collection of the under-recoveries incurred by it in the implementation of the lifeline subsidy system, in the amount of ₱864 million, plus the corresponding carrying costs. The hearings on the said case are already completed and the case is now submitted for decision by the ERC. Similar to the other pass-through charges, the implementation of the lifeline subsidy system is revenue-neutral to the Parent Company. The amount of under-recoveries will be billed to and collected from the customers upon approval by the ERC.

(3) Application for Recovery of Under-recoveries in the Implementation of the Inter-Class Subsidy Removal

As discussed in Note 34(a), on November 14, 2007, the Parent Company filed a petition to recover ₱1,054 million in under-recoveries incurred in implementing the inter-class subsidy system, along with a corresponding carrying cost. Hearings on the said case are already completed and the case is now submitted for decision by the ERC. Similar to the other pass-through charges, the implementation and removal of the inter-class subsidy is revenue-neutral to the Parent Company. The amount of under-recoveries will be billed to and collected from the customers upon approval by the ERC.

Interest on Customers' Deposits. As discussed in Note 21, the ERC promulgated its Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers on June 4, 2008. The rules, however, cover only the meter deposits. As to the bill deposits, the Parent Company strongly believes that certain legal impediments and inconsistencies with previous pronouncements of the ERC on the issue of interest on bill deposits still exist. Hence, the Parent Company believes that similar rules must be put in place by the ERC to apply to bill deposits. In the meantime, the interest rates used by the Company in accruing interest on bill deposits are based on the Company's interpretation of existing ERC rules.

For the years ended December 31, 2008, 2007 and 2006, total interest expense on bill deposits amounted to ₱925 million, ₱864 million and ₱858 million, respectively (see Note 28). Total interest expense on meter deposits for the years ended December 31, 2008, 2007 and 2006, amounted to ₱89 million, ₱99 million and ₱102 million, respectively (see Note 28).

Accrued interest on bill deposits as of December 31, 2008 and 2007 amounted to ₱7,733 million and ₱6,981 million, respectively (see Note 21). Accrued interest on meter deposits as of December 31, 2008 and 2007 amounted to ₱1,341 million and ₱1,296 million, respectively (see Note 21).

Contingencies. There are various claims and tax assessments against the Parent Company. The Parent Company's estimate of the probable costs of such claims and assessments is arrived at in consultation with its legal counsel handling defense in these matters and is based upon an analysis of potential results. It is possible, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings or changes in government policies and decisions beyond the control of management (see Note 34).

Outstanding provisions to cover pending claims and tax assessments against the Parent Company which the Parent Company may be liable amounted to ₱1,645 million and ₱1,396 million as of December 31, 2008 and 2007, respectively (see Note 22).

Operating Lease Commitments - The Company as a Lessor. The Company has entered into commercial property leases on its investment property portfolio. The Company has determined, based on an evaluation of the terms and conditions of the arrangement, that it retains all the significant risks and rewards of ownership of these properties because the lease agreements do not 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 and so accounts for these agreements as operating leases.

Operating Lease Commitments - The Company as a Lessee. The Company has entered into commercial leases on certain payment offices, substation sites and tower and transmission lines. The Company has determined, based on an evaluation of the terms and conditions of the arrangement, that it has not acquired any significant risks and rewards of ownership of these properties because the lease agreements 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 and so accounts for these arrangements as operating leases.

Transfers of Investment Properties. The Company has made transfers to investment property after determining that 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 also 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 (see Note 12).

Arrangements that Contain a Lease. The Parent Company's purchase power agreements (PPAs) and transmission line agreements (TLAs) with Independent Power Producers (IPPs) qualify as leases on the basis that the Parent Company and the IPPs have a take or pay arrangement 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 has been accounted for similar to a lease amounted to ₱21,592 million, ₱17,107 million and ₱19,916 million in 2008, 2007 and 2006, respectively (see Note 27).

Estimates and Assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet 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 below.

Estimated Useful Lives. The useful life of each item of the Company's utility plant and others and investment properties is estimated based on the period over which the asset is expected to be available for use. Such estimation is based on a collective assessment of industry practice, internal technical evaluation and experience with similar assets. The estimated useful life of each asset is reviewed at each financial year-end and updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the asset. It is possible, however, that future results of operations could be materially affected by changes in the amounts and timing of recorded expenses brought about by changes in the factors mentioned above. A reduction in the estimated useful life of any utility plant and others and investment properties would increase the recorded operating expenses and decrease utility plant and others and investment properties.

Utility plant and others, net of accumulated depreciation and amortization, amounted to ₱95,704 million and ₱93,696 million as of December 31, 2008 and 2007, respectively (see Note 9).

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Investment properties, net of accumulated depreciation, amounted to ₱5,505 million and ₱5,578 million as of December 31, 2008 and 2007, respectively (see Note 12).

Allowance for Doubtful Accounts. For trade receivables, allowance for doubtful accounts is estimated based on specific identification method which includes different categories of customers, payment habits, historical loss experience and individual characteristics of customers. Specific accounts assessed as impaired and for probable write-off are provided with full allowance after offsetting corresponding customers' deposits.

For other receivables, if there is an objective evidence that an impairment loss on receivables carried at amortized cost has been incurred, the amount of the potential 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. Under collective assessment, the receivables are grouped according to the credit risk profile of customers and allowance provided is based on historical loss experience.

The total of the amounts calculated using these foregoing methods determine the total allowance to be maintained as of the reporting period.

The amount and timing of recorded expenses for any period would therefore differ based on the judgments or estimates made.

Provision for doubtful accounts, net of recoveries, amounted to ₱1,566 million in 2008, ₱576 million in 2007 and ₱612 million in 2006 (see Note 28). Trade and other receivables, net of allowance for doubtful accounts, amounted to ₱37,509 million and ₱35,870 million as of December 31, 2008 and 2007, respectively (see Note 15).

Impairment of AFS Investments. The Company treats AFS investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires judgment. The Company treats "significant" generally as 20% or more and "prolonged" as greater than six months for quoted equity securities. In addition, the Company evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

No impairment losses were recognized in 2008, 2007 and 2006. Unrealized fair value gain (loss) on AFS investments, net of tax effect, charged to equity amounted to (₱21 million) in 2008, ₱25 million in 2007 and ₱17 million in 2006. AFS investments amounted to ₱403 million and ₱351 million as of December 31, 2008 and 2007, respectively (see Note 13).

Allowance for Inventory Obsolescence. The allowance for obsolescence relating to inventories consists of collective and specific provisions. A collective provision is established as a certain percentage based on the age and movement of stocks. Condominium units of Rockwell are written down to net realizable values when net realizable values of condominium units are less than their carrying values. The amount and timing of recorded expenses for any period would therefore differ based on the judgments or estimates made.

No provisions were made in 2008, 2007 and 2006. Carrying values of inventories amounted to ₱1,648 million and ₱1,538 million as of December 31, 2008 and 2007, respectively (see Note 16).

Share-based Payments. The Parent Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payments requires determining the most appropriate valuation model for a grant of equity instruments, which is dependent on the terms and conditions of the grant. This also requires determining the most appropriate inputs to the valuation model including the share price, expected life of the option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share-based payments are disclosed in Note 19 to the consolidated financial statements.

Deferred Income Tax Assets. The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax assets to be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. Management believes that sufficient taxable profit will be generated to allow all or part of the deferred income tax assets to be utilized. However, the amounts of the deferred tax assets considered realizable could be adjusted in the future if estimates of taxable income are revised.

Deferred income tax assets as of December 31, 2008 and 2007 amounted to ₱8,533 million and ₱6,226 million, respectively (see Note 33).

The amount of the temporary differences and carryforward benefit of MCIT for which deferred income tax assets have not been recognized by MIESCOR as of December 31, 2008 and 2007 amounted to ₱65 million and ₱61 million, respectively (see Note 33).

Goodwill. Purchase accounting method requires intensive use of accounting estimates to allocate the purchase price to the fair values of the acquiree's identifiable assets and liabilities at the acquisition date. It also requires the acquirer to recognize goodwill.

The Company's business acquisition resulted in the recognition of goodwill which is subject to an annual impairment test or whenever there is an indication that such asset may be impaired.

The impairment on the goodwill is determined by comparing the recoverable amount and the carrying amount of the cash-generating unit. The recoverable amount of the cash-generating unit is its value-in-use. Value-in-use was determined using cash flow projections. Refer to Note 13 for the key assumptions used in testing for impairment of goodwill.

The carrying amount of goodwill at December 31, 2008 and 2007 amounted to ₱35 million, included under "Other noncurrent assets" account in the consolidated balance sheets (see Note 13).

No impairment losses were recognized in 2008 and 2007.

Impairment of Non-financial Assets. Determining the recoverable amounts of the non-financial assets listed below, which involves the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires the use of estimates and assumptions that can materially affect the consolidated financial statements. Future events could indicate that these non-financial assets are impaired. Any resulting impairment loss could have a material adverse impact on the financial condition and results of operations of the Company.

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

Noncurrent assets that are subjected to impairment testing when impairment indicators are present (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) are as follows:

	2008	2007
	<i>(Amounts in Millions)</i>	
Utility plant and others - net (see Note 9)	₱95,704	₱93,696
Construction in progress (see Note 10)	5,149	2,811
Investments in associates and joint ventures (see Note 11)	1,378	1,635
Investment properties - net (see Note 12)	5,505	5,578
Deferred pass-through fuel costs (see Note 13)	3,792	4,896

No impairment losses were recognized in 2008, 2007 and 2006.

Financial Assets and Liabilities. Where the fair value of financial assets and financial liabilities recorded in the consolidated balance sheets 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 where 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.

Financial assets carried at fair value as of December 31, 2008 and 2007 are as follows (see Note 31):

	2008	2007
	<i>(Amounts in Millions)</i>	
AFS investments (see Note 13)	₱403	₱351
Derivative assets - current and noncurrent (see Notes 13 and 17)	121	300
Derivative liabilities - current and noncurrent (see Note 25)	49	—

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

Revenue of the Parent Company is billed under different cycles with different cycle cut-off dates, while take up 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 accounts upon reconciliation normally in the following period. Management believes that such use of estimates will not result in material adjustments in future periods.

Notes to Consolidated Financial Statements

Revenue from real estate transactions of Rockwell 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 to material adjustments in future periods.

Pension Cost and Benefits. The determination of the obligation and cost for pension and other retirement benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 29 and include among others, discount rate, expected rate of return on plan assets and future salary rate increases. In accordance with PFRS, actual results that differ from the Company's assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods. While it is believed that the Company's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Company's pension and other retirement obligations.

Consolidated pension liability amounted to ₱11,849 million and ₱11,313 million as of December 31, 2008 and 2007, respectively (see Note 29).

Consolidated unrecognized net actuarial losses amounted to ₱433 million and ₱1,641 million as of December 31, 2008 and 2007, respectively (see Note 29).

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the expected long-term rate of return on the relevant plan assets and the discount rate, among others. Any changes in these assumptions will affect the carrying amount of pension obligations.

The expected return on plan assets assumption is determined on a uniform basis, taking into consideration long-term historical returns, asset allocation and future estimates of long-term investment returns.

The Company determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Company considers the interest rates on government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information is disclosed in Note 29.

7. Segment Information

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.

- The power distribution segment is involved in the distribution and supply of electricity covering franchise areas in the Luzon region.
- The real estate segment is involved in real estate development and leasing.
- The services segment is involved principally in engineering, construction and consulting services, e-transaction services and insurance.

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 revenues only in the Philippines (i.e., one geographical location). Thus, geographical segment information is not presented.

Business Segment Data

	Power Distribution			Real Estate			Contracts and Services			Eliminations			Consolidated		
	2008	2007	2006	2008	2007	2006	2008	2007	2006	2008	2007	2006	2008	2007	2006
<i>(Amounts in Millions)</i>															
Revenues															
External sales	P186,999	P196,171	P186,576	P2,213	P2,122	P1,787	P2,563	P2,400	P2,424	P-	P-	P-	P191,775	P200,693	P190,787
Inter-segment sales	65	217	173	-	-	-	492	524	9	(557)	(741)	(182)	-	-	-
Total revenues	187,064	196,388	186,749	2,213	2,122	1,787	3,055	2,924	2,433	(557)	(741)	(182)	191,775	200,693	190,787
Results															
Segment results	6,314	6,837	24,984	438	188	200	311	692	208	-	-	-	7,063	7,717	25,392
Interest and other charges - net	-	-	-	-	-	-	-	-	-	-	-	-	(2,062)	(1,948)	(3,758)
Equity in net earnings of associates and joint venture	-	-	-	-	-	-	910	831	638	(711)	(507)	(346)	199	324	292
Minority interests	-	-	-	-	-	-	-	-	-	-	-	-	(333)	(277)	(195)
Income tax expense	-	-	-	-	-	-	-	-	-	-	-	-	(2,067)	(2,057)	(8,045)
Net income attributable to equity holders of the Parent	-	-	-	-	-	-	-	-	-	-	-	-	2,800	3,759	13,686
Other Information															
Segment assets	159,556	160,218	159,852	12,200	12,399	9,543	2,585	2,266	1,770	(5,868)	(5,452)	(4,608)	168,473	169,431	166,557
Deferred tax assets	-	-	-	-	-	-	-	-	-	-	-	-	8,533	6,226	6,202
Investments in associates and joint ventures	-	-	-	-	-	-	-	-	-	-	-	-	1,378	1,635	1,759
Consolidated total assets	159,556	160,218	159,852	12,200	12,399	9,543	2,585	2,266	1,770	(5,868)	(5,452)	(4,608)	178,384	177,292	174,518
Segment liabilities	40,439	37,849	47,939	2,636	5,769	3,160	1,477	1,747	1,589	(487)	(1,061)	(706)	44,065	44,304	51,982
Interest-bearing liabilities	-	-	-	-	-	-	-	-	-	-	-	-	62,534	63,827	55,229
Deferred income tax liabilities	-	-	-	-	-	-	-	-	-	-	-	-	13,341	14,089	14,737
Income tax payable	-	-	-	-	-	-	-	-	-	-	-	-	2,285	51	1,596
Consolidated total liabilities	40,439	37,849	47,939	2,636	5,769	3,160	1,477	1,747	1,589	(487)	(1,061)	(706)	122,225	122,271	123,544
Capital expenditures	7,260	6,469	5,547	1,567	184	75	423	216	506	-	-	-	9,250	6,869	6,128
Depreciation and amortization	4,293	4,408	4,188	117	71	176	16	13	30	-	-	-	4,426	4,492	4,394
Noncash expenses other than depreciation and amortization	12,366	4,613	6,779	15	14	8	6	17	-	-	-	-	12,387	4,613	6,787

Notes to Consolidated Financial Statements

The following table presents additional information on the power distribution business segment of the Company for 2008, 2007 and 2006:

	Generation and Transmission	Distribution	Total
	<i>(Amounts in Millions)</i>		
Year Ended December 31, 2008:			
Revenue	₱161,282	₱25,782	₱187,064
Purchased power/cost and expenses	163,489	17,261	180,750
Segment results	(2,207)	8,521	6,314
Year Ended December 31, 2007:			
Revenue	₱170,775	₱25,613	₱196,388
Purchased power/cost and expenses	172,577	16,974	189,551
Segment results	(1,802)	8,639	6,837
Year Ended December 31, 2006:			
Revenue	₱163,316	₱23,433	₱186,749
Purchased power/cost and expenses	160,294	1,471	161,765
Segment results	3,022	21,962	24,984

Revenues from generation and transmission do not include revenue accrual for pass-through charges during the periods that do not have ERC-approved recovery mechanism. This portion of pass-through charges becomes part of contingent assets [see Note 34a(1)]. In 2006, excess of revenues over purchased power of generation and transmission resulted from the approval by ERC of the Parent Company's applications for prior years' under-recoveries.

8. Information on Subsidiaries

a. Rockwell

Rockwell is engaged in real estate development, sale or lease of residential and commercial lots and units and lease of mall facilities.

Land and development costs (before adjustment to reverse the effect of revaluation on land held for future development) consist of:

	2008	2007
	<i>(Amounts in Millions)</i>	
Land held for future development (see Note 25)	₱475	₱1,569
Development costs - net of allowance for probable losses of ₱9 million and ₱170 million in 2008 and 2007, respectively	2,116	1,758
	₱2,591	₱3,327

In 2008, land held for future development represents 9,026 square meters of land within the Rockwell Center. In 2007, land held for future development represents 9,026 square meters of land within the Rockwell Center and 54,279 square meters of land in Pasig City. Rockwell will develop the land in Pasig City into a mid-rise residential condominium community similar to the Rockwell Center. The Company has started the development of the land in Pasig City into a mid-rise residential condominium community ("The Grove") similar to the Rockwell Center.

Total cash received from pre-selling activities of "The Grove" amounted to ₱36 million as of December 31, 2008 and of "One Rockwell" amounted to ₱2,411 million as of December 31, 2007, and is presented as "Deposits from pre-selling of condominium units" account in the consolidated balance sheets.

Development costs include allocated cost of the land and construction costs incurred related to the following projects:

	Balance		Estimated Cost to Complete	
	2008	2007	2008	2007
	<i>(Amounts in Millions)</i>			
Project:				
The Grove	₱1,183	₱—	₱10,251	₱—
One Rockwell	826	1,257	4,475	5,581
Joya	—	172	—	394
Meralco BPO	—	256	—	2,257
Others	107	73	—	—
	₱2,116	₱1,758	₱14,726	₱8,232

In March 2008, the Parent Company and Rockwell signed a joint venture agreement to construct a three-tower Meralco BPO Building project at the Meralco Compound, Ortigas Center, Pasig City. As agreed, the Parent Company contributed the use of the land while Rockwell will contribute to the development cost of the property. The joint venture agreement provides that the sharing between the parties shall be 70% for Rockwell and 30% for the Parent Company.

Condensed financial information for Rockwell, before intercompany elimination and adjustment to reverse the effect of revaluation on land held for future development, follows:

	2008	2007
	<i>(Amounts in Millions)</i>	
Current assets	₱5,531	₱6,638
Noncurrent assets	6,829	5,648
Current liabilities	(3,222)	(1,787)
Noncurrent liabilities	(2,156)	(3,869)
Net assets	₱6,982	₱6,630
Revenue	₱3,514	₱3,467
Costs and expenses	2,911	2,991
Net income	₱603	₱476

Certain assets of Rockwell were used to secure loans from various local banks (see Note 20).

b. RSIC and LOIL

In March 2007, the Parent Company acquired 100% interest in RSIC as the vehicle to underwrite its risk exposures and address its insurance needs. Investment in RSIC, which was valued at ₱141 million, was accounted for using the purchase method of accounting. The cost of acquisition comprised cash payments and costs directly attributable to the acquisition. The purchase method of accounting involves allocating the cost of the business combination to the fair value of the assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. Accordingly, the consolidated financial statements include the results of RSIC from its acquisition in March 2007. The effect of inclusion of RSIC to the consolidated financial position and results of operations is not material. From the date of the acquisition, the Parent Company's share in RSIC's net income amounted to ₱2 million in 2007.

The fair values of the assets and liabilities of RSIC as of the date of acquisition are as follows:

	Recognized at Acquisition	Carrying Value
	<i>(Amounts in Thousands)</i>	
Assets:		
Cash and cash equivalents	₱65,455	₱65,455
Other financial assets	41,722	41,722
Deferred tax asset	126	126
Other assets	1,192	1,192
	108,495	₱108,495
Liabilities:		
Trade and other payables	165	₱165
Other financial liabilities	2,819	2,819
Deferred tax liability	320	320
	3,304	₱3,304
Fair value of net assets	105,191	
Goodwill arising on acquisition (see Note 13)	35,275	
Total acquisition cost	₱140,466	
Net cash outflow from acquisition	₱75,011	

Notes to Consolidated Financial Statements

Carrying value of the financial assets and liabilities and other assets approximate their fair values due to the short-term nature of the transactions and because other financial assets and liabilities are already stated at fair values.

On August 24, 2007, the Parent Company established LOIL, a wholly-owned subsidiary domiciled in the British overseas territory of Bermuda. LOIL obtained its license to operate in the territory in March 2008. With an initial capital of ₱12 million, this offshore company serves as the Company's captive reinsurer, which is the vehicle to minimize the Company's major catastrophic risk exposures.

RSIC acts, as a domestic writing company and serves as the official resident agent of LOIL. RSIC, together with LOIL, completes the Company's Business Risk Management Model following a standard model being used by many global companies.

c. CEDC

The Parent Company had a receivable from MIESCOR amounting to ₱136 million as of December 31, 2007. As settlement, on January 30, 2008, MIESCOR paid the receivable in exchange of 561,500 shares of stock equivalent to 65% ownership in CEDC. The equity interest in CEDC is based on the net book value of CEDC as of September 30, 2007.

Previously, CEDC was indirectly owned by the Parent Company and the accounts of the former are consolidated through MIESCOR but as a result of this transaction, the ownership interest of the Parent Company over CEDC is direct and its accounts are now directly consolidated.

9. Utility Plant and Others

The movements of utility plant and others as of December 31, 2008 and 2007 are as follows:

2008							
	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment		Total
					Transportation Equipment	Others	
(Amounts in Millions)							
Cost:							
Beginning of year	₱107,716	₱15,621	₱4,309	₱5,661	₱4,062	₱1,810	₱1,857
Transfers from CIP (see Note 10)	4,888	-	204	145	589	190	144
Additions	122	-	-	102	52	43	310
Disposals/retirements	(586)	-	(1)	(504)	(30)	(87)	(19)
Reclassification and others	(38)	1	(1)	(70)	(4)	-	(173)
End of year	112,102	15,622	4,511	5,334	4,669	1,956	2,119
Accumulated depreciation:							
Beginning of year	36,973	-	1,588	3,336	3,341	1,120	982
Charge for the year	3,503	-	107	448	172	39	36
Disposals/retirements	(432)	-	-	(504)	(15)	(72)	(13)
End of year	40,044	-	1,695	3,280	3,498	1,087	1,005
Net book value	₱72,058	₱15,622	₱2,816	₱2,054	₱1,171	₱869	₱1,114
2007							
	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment		Total
					Transportation Equipment	Others	
(Amounts in Millions)							
Cost:							
Beginning of year	₱103,218	₱15,568	₱4,410	₱5,691	₱3,760	₱1,596	₱1,667
Transfers from CIP (see Note 10)	5,298	-	75	221	265	135	236
Additions	16	-	68	32	43	35	132
Disposals/retirements	(944)	-	(28)	(193)	(4)	(16)	(5)
Reclassification and others	128	53	(216)	(90)	(2)	60	(173)
End of year	107,716	15,621	4,309	5,661	4,062	1,810	1,857
Accumulated depreciation:							
Beginning of year	34,412	-	1,500	3,143	3,088	1,103	948
Charge for the year	3,505	-	116	386	257	33	39
Disposals/retirements	(944)	-	(28)	(193)	(4)	(16)	(5)
End of year	36,973	-	1,588	3,336	3,341	1,120	982
Net book value	₱70,743	₱15,621	₱2,721	₱2,325	₱721	₱690	₱875
							₱93,696

Notes to Consolidated Financial Statements

Previously, substantially all of the utility plant assets were subject to a first mortgage lien relating to the First Mortgage Bonds issued under an indenture as primary obligation and those issued as collateral for all the other secured loans. The said lien is in favor of a local bank, as trustee, for the benefit of all bondholders. In December 2006, the Parent Company raised ₱12,000 million from the local banking system consisting of fixed-rate and floating-rate corporate notes. The note proceeds were utilized to prepay substantially all of the Parent Company's secured loans. The trustee issued a release and discharge of the lien under the indenture last January 29, 2007 (see Note 20).

10. Construction in Progress

	2008	2007
	<i>(Amounts in Millions)</i>	
Balance at beginning of year	₱2,811	₱2,909
Additions	8,573	6,469
Transfers to utility plant and others (see Note 9)	(6,160)	(6,230)
Reclassification to advance payments to suppliers and others (see Note 17)	(75)	(337)
Balance at end of year	₱5,149	₱2,811

Parent Company

Construction in progress of the Parent Company includes borrowing costs incurred in connection with the construction of subtransmission and distribution facilities. Borrowing costs capitalized amounted to ₱53 million and ₱58 million in 2008 and 2007, respectively.

Rockwell

On March 18, 2008, Rockwell entered into a Project Development Agreement with the Parent Company to construct a BPO building at the Meralco Compound in Ortigas Center. The Parent Company, the landowner, agreed to contribute the use of the land and ₱3 million, which in aggregate shall be equivalent to 30% of the project contribution while Rockwell agreed to shoulder the construction cost and contribute ₱7 million, which in aggregate shall be equivalent to 70% of the project contribution. Upon completion of the construction, the Parent Company and Rockwell shall divide and allocate ownership of the BPO building in proportion to their respective contribution. Construction and allocation of the building is expected to be completed by end of March 2009.

As of December 31, 2008, construction costs incurred by Rockwell amounted to ₱1,445 million. General borrowing costs capitalized as part of construction in progress amounted to ₱75 million and ₱2 million in 2008 and 2007, respectively. Capitalized accretion of interest expense on retention payable related to this development amounted to ₱2 million as of December 31, 2008.

Consolidated capitalization rates in 2008 and 2007 ranges from 7.7% to 8.5% and 8.2% to 9.4%, respectively.

11. Investments in Associates and Joint Venture

Investments in the following associates and joint venture are accounted for under the equity method:

	Country of Incorporation	Principal Activities	Percentage of Ownership
Associates			
First Private Power Corporation and Subsidiary (FPPC)	Philippines	Power Generation	40
Batangas Cogeneration Corporation (Batangas Cogen)*	Philippines	Power Generation	38
General Electric Philippines Meter and Instrument Company, Inc. (GEPMICI)	Philippines	Sale of metering products and services	35
Joint Venture			
Soluziona	Philippines	Management and information technology consultancy	50

* Ceased operations in 2004.

The details and movements of investments in associates and joint venture follow:

	2008	2007
	<i>(Amounts in Millions)</i>	
Acquisition costs	P459	P459
Accumulated equity in net earnings:		
Balance at beginning of year	876	643
Equity in net earnings for the year	199	324
Depreciation on share in revaluation increment	169	169
Dividends received	(456)	(260)
Balance at end of year	788	876
Share in revaluation increment of an associate:		
Balance at beginning of year	298	467
Depreciation on share in revaluation increment	(169)	(169)
Balance at end of year	129	298
Share in cumulative translation adjustment of an associate	2	2
	P1,378	P1,635

The carrying values of investments in associates and joint venture follow:

	2008	2007
	<i>(Amounts in Millions)</i>	
FPPC	P1,180	P1,450
GEPMICI and Soluziona	198	185
	P1,378	P1,635

In October 2007, the Company received from FPPC P190 million representing a return of capital.

Condensed financial information for FPPC (before the adjustment to reflect the revaluation on property, plant and equipment) and GEPMICI follow:

	2008		2007	
	FPPC	GEPMICI	FPPC	GEPMICI
	<i>(Amounts in Millions)</i>			
Current assets	P1,379	P230	P3,472	P251
Noncurrent assets	4,617	15	1,789	15
Current liabilities	(447)	(58)	(420)	(37)
Noncurrent liabilities	(2,530)	—	(2,167)	—
Net assets	P3,019	P187	P2,674	P229
Revenues	P1,210	P396	P2,458	P518
Costs and expenses	(786)	(359)	(1,357)	(489)
Net income	P424	P37	P1,101	P29

The aggregate amounts of the Parent Company's proportionate share in the assets, liabilities, income and expenses related to its 50% interest in Soluziona follows:

	2008	2007
	<i>(Amounts in Millions)</i>	
Current assets	P549	P204
Noncurrent assets	76	42
Current liabilities	(322)	(112)
Noncurrent liabilities	(41)	(30)
Net assets	P262	P104
Revenue	P832	P325
Costs and expenses	(777)	(306)
Net income	P55	P19

Notes to Consolidated Financial Statements

12. Investment Properties

2008			
	Land	Buildings and Improvements	Total
<i>(Amounts in Millions)</i>			
Cost:			
Balance at beginning of year	₱2,551	₱3,895	₱6,446
Additions/reclassifications	—	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

2007			
	Land	Buildings and Improvements	Total
<i>(Amounts in Millions)</i>			
Cost:			
Balance at beginning of year	₱1,698	₱3,737	₱5,435
Additions/reclassifications	853	158	1,011
Balance at end of year	2,551	3,895	6,446
Accumulated depreciation:			
Balance at beginning of year	—	712	712
Charge for the year	—	156	156
Balance at end of year	—	868	868
Net book value	₱2,551	₱3,027	₱5,578

Investment properties consist of real properties held for capital appreciation and real properties which are being leased to related and third parties. Generally, charges for leases to related parties are made at market rates. Lease income earned from investment properties amounted to ₱542 million, ₱516 million and ₱473 million in 2008, 2007 and 2006, respectively. Direct operating expenses incurred amounted to ₱208 million, ₱195 million and ₱195 million in 2008, 2007 and 2006, respectively.

As of December 31, 2008 and 2007, unamortized borrowing costs capitalized as part of investments in real properties amounted to ₱281 million and ₱291 million, respectively.

Due to absence of an active market, the fair values of the investment properties of the Parent Company are not readily available. However, management believes that the fair values are not lower than the carrying values of the investment in real properties as of December 31, 2008 and 2007.

The aggregate fair value of Rockwell's mall amounted to ₱5,115 million and ₱4,956 million as of December 31, 2008 and 2007, respectively. As of December 31, 2008, the aggregate fair value of other investment properties held for lease within the Rockwell Center and land held for appreciation amounted to ₱1,775 million and ₱1,778 million, respectively.

Investment properties were valued by independent professionally qualified appraisers. 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 and 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." Market data approach is based on the assumption that no prudent purchaser will buy more than what it will cost him to acquire an equally desirable substitute parcel or site. This approach is primarily based on sales and listings, which are adjusted for time of sale, location, and general characteristics of comparable lots in the neighborhood where the subject lot is situated.

13. Deferred Pass-Through Fuel Costs and Other Noncurrent Assets

Deferred Pass-Through Fuel Costs

Deferred pass-through fuel costs represent the billed amounts for the quantity and cost of natural gas that was contracted for but not consumed by the Parent Company's major IPPs, FGPC and FGP Corp., collectively referred to as "First Gas" [see Notes 25, 26 and 35(c)], due to First Gas plants' dispatch below their stipulated capacity factors.

In 2005, First Gas had billed the Parent Company for a total of US\$231 million [equivalent to 44 million Giga Joules in Gross Calorific Value (GJGCV)], representing unconsumed gas for the years 2002-2004.

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 (GSPA) between First Gas and the Gas Sellers. On March 22, 2006, First Gas and the Gas Sellers signed settlement agreements that became effective on May 31, 2006. Payment obligations of First Gas under the settlement agreements were passed on to the Parent Company in accordance with its power purchase agreements with First Gas.

Under the terms of the settlement agreements, the total claim of US\$231 million was reduced to US\$148 million effective October 1, 2005, less a recognized credit on January 31, 2006 of US\$13 million corresponding to gas consumption in excess of take-or-pay quantities for 2005. Further, the Parent Company paid interest on the reduced amount equivalent to 1-month USD LIBOR + 2% from the time these amounts were originally due until May 31, 2006. The remaining liabilities are settled through quarterly payments starting in 2006 until 2009. Interest under the settlement agreement is 3-month USD LIBOR + 4% starting October 1, 2005.

In 2006, the Parent Company received from First Gas provisional invoices representing the Gas Sellers' bill for the take-or-pay quantity which gas plants failed to consume in 2006 amounting to US\$9.38 million. First Gas informed the Parent Company that it is formally disputing the aforementioned amount and that payment of such provisional invoices is not due until the dispute has been resolved. The dispute is currently in arbitration under the International Chamber of Commerce (ICC) Rules of Arbitration pursuant to the terms of the GSPA, and First Gas expects the tribunal to render its decision on the disputes within 2009. First Gas' position is that First Gas plants actually consumed more than their respective take-or-pay quantities in 2006 as the Gas Sellers' calculation did not account for force majeure events. The Parent Company recognized the billing from First Gas for 2006 amounting to US\$9.38 million (equivalent to ₱446 million in 2008 and ₱387 million in 2007, shown as part of "Current portion of liability arising from deferred pass-through fuel costs" included under the "Trade and other payables" account in the consolidated balance sheets). There was no additional billing for unconsumed gas in 2008 and 2007.

Based on the Payment Deferral Agreement between First Gas and the Gas Sellers, First Gas is allowed to consume the banked gas until year 2014. Consumption of the banked gas requires that the First Gas plants exceed the required take-or-pay fuel volume for the current year and any gas consumption above the required volume is credited against the banked gas. Based on the latest operating data of the plants, the Parent Company believes that the banked gas will be consumed within the prescriptive period up to December 2014, allowed by the settlement agreements.

As of December 31, 2008 and 2007, the banked gas recoveries amounted to US\$45 million (equivalent to 9 million GJGCV) and US\$16 million (equivalent to 3 million GJGCV), respectively.

Interest expense in 2008, 2007 and 2006 amounted to ₱141 million, ₱320 million and ₱542 million, respectively, and is shown as part of "Interest and other financial expenses" account in the consolidated statements of income (see Note 28).

Deferred pass-through fuel costs, representing the remaining unconsumed gas, amounted to ₱3,792 million and ₱4,896 million as of December 31, 2008 and 2007, respectively.

The noncurrent portion of the liability for unconsumed gas, amounting to ₱692 million as of December 31, 2007 is shown as "Liability arising from deferred pass-through fuel costs" account. There is no noncurrent portion of the liability as of December 31, 2008. Current portion amounting to ₱1,242 million and ₱2,043 million as of December 31, 2008 and 2007, respectively, is shown as part of "Trade and other payables" account in the consolidated balance sheets (see Note 25).

Notes to Consolidated Financial Statements

Other Noncurrent Assets

	2008	2007
	<i>(Amounts in Millions)</i>	
Deferred input VAT (see Notes 2 and 25)	₱4,789	₱3,801
Unbilled generation cost [see Note 2II(a)]	2,250	9,683
SC GRAM case refund amount [see Note 2II(b)]	780	780
Receivable from Bureau of Internal Revenue (BIR) - net of current portion [see Note 34a(2)]	577	577
AFS investments (see Note 31)	403	351
Noncurrent trade receivables of a subsidiary (see Note 15)	115	49
Noncurrent derivative assets - net of current portion of ₱19 million in 2008 and ₱117 million in 2007 (Notes 17, 20, 30 and 31)	102	183
Goodwill (see Note 8)	35	35
Others	614	426
	₱9,665	₱15,885

a. Unbilled Generation Cost

Unbilled generation cost represents purchased power costs incurred by the Parent Company which will be billed over collection periods approved by the ERC. Based on these collection periods, the current and noncurrent portion of the unbilled generation cost are as follows:

	2008	2007
	<i>(Amounts in Millions)</i>	
Current [(shown as part of "Trade and other receivables - Unbilled" account (see Note 15)]	₱20,078	₱17,189
Noncurrent*	3,030	10,463
	₱23,108	₱27,652

*Includes GRAM case refund amount of ₱780 million in 2008 and 2007.

On September 1, 2006, following the SC's denial of the MR of the ERC and the Parent Company on the GRAM case, the ERC ordered the Parent Company to stop collecting from its customers adjustments in the generation charge authorized under an automatic mechanism. Subsequently, the Parent Company filed ten separate applications to fully recover generation costs incurred for the supply months of August 2006 to May 2007 [see Note 2II(a)].

On June 7, 2007, the Joint Congressional Power Commission approved an amendment by the Department of Energy (DOE) of Section 3, Rule 4e of the Implementing Rules and Regulations (IRR) of EPIRA. The amendment exempted the adjustment of pass-through electric bill components from the jurisdictional and hearing requirements of the IRR. Soon after, the ERC lifted its September 1, 2006 Order and again allowed the Parent Company to automatically update the Generation and System Loss Charges beginning on the July 2007 bills to customers. This prevented a further accumulation of unbilled generation costs by the Parent Company.

Also included in unbilled receivables is the remaining amount for collection under the Deferred PPA/GRAM Deferred Accounting Adjustment (DAA) as of January 2007 amounting to ₱88 million.

b. SC GRAM Case Refund Amount

Following the SC's ruling on the GRAM case [see Note 2II(b)], the Parent Company was directed to refund affected customers the amount of ₱0.1327 per kWh "reckoned from when the same was charged and collected," equivalent to a total amount of ₱780 million. As of December 31, 2008 and 2007, the Parent Company has refunded ₱746 million and ₱698 million, respectively, to its customers. The balance of ₱34 million in 2008 and ₱82 million in 2007 is shown as part of "Trade and other payables" account in the consolidated balance sheets (see Note 25). 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 SC Resolution dated August 16, 2006, and the corresponding carrying charges.

c. AFS Investments

AFS investments mainly consist of investment in Rockwell Leisure Club, Inc. amounting to ₱244 million as of December 31, 2008 and 2007. Other AFS investments are investments in golf and club shares which are carried at cost less allowance for impairment. Unrealized fair value gain (loss) on AFS investments, net of tax effect, amounted to ₱47 million and ₱68 million as of December 31, 2008 and 2007, respectively.

d. Goodwill

For the impairment testing of goodwill, the difference between the recoverable amount and the carrying amount of the cash-generating unit was compared. The recoverable amount of the cash-generating unit is its value-in-use. Value-in-use was determined using cash flow projections, which were based on a five-year financial budget approved by the subsidiary's management. The discount rate applied to the cash flow projections was 12.80%.

Key Assumptions

Following are the key assumptions on which management has based its cash flow projections to undertake impairment testing of goodwill:

Gross Revenues. Gross revenues for 2009 are based on the annualized year-to-date results available at the time the budget was prepared in 2008. Gross revenues were assumed to grow at an average of 13% per annum.

Operating Expenses. General and administrative expenses were projected to rise at an inflationary pace. On the other hand, direct costs were forecasted to increase in line with revenue growth.

Gross Margins. Increased efficiencies over the next five years are expected to result to some improvements in gross margins.

Discount Rate. The discount rate used to arrive at the present value of future cash flows was the Parent Company's WACC. WACC was based on the appropriate weights of debt and equity, which were multiplied with the assumed costs of debt and equity.

Based on the impairment testing performed, no impairment loss was recognized in 2008 and 2007.

14. Cash and Cash Equivalents

	2008	2007
	(Amounts in Millions)	
Cash on hand and in banks	₱3,601	₱2,641
Cash equivalents	1,801	2,235
	₱5,402	₱4,876

Cash in banks earn interest at fixed rates based on prevailing bank deposit rates. Cash equivalents are short-term investments which are made for varying periods of between one and thirty days depending on the immediate cash requirements of the Company, and earn interest at the respective short-term investment rates.

15. Trade and Other Receivables

	2008	2007
	(Amounts in Millions)	
Trade Receivables:		
Billed		
Residential	₱5,779	₱7,588
Commercial	7,179	5,200
Industrial	3,491	2,930
Flat streetlights	421	60
Unbilled [see Notes 21(a) and 13]	20,078	17,189
Trade receivables of subsidiaries - net of noncurrent portion of ₱115 million and ₱49 million as of December 31, 2008 and 2007, respectively	1,376	3,216
Others (see Note 26)	1,204	1,063
	39,528	37,246
Less allowance for doubtful accounts	2,019	1,376
	₱37,509	₱35,870

Trade receivables of the Company are receivables from customers representing the Parent Company's charges and pass-through costs. Billed receivables are generally due ten days after bill date. Unbilled receivables represent pass-through costs incurred by the Parent Company which will be billed to customers in the succeeding months. The Parent Company's trade receivables are noninterest-bearing and are secured by bill deposits.

Trade receivables of subsidiaries include long-term receivables from sale of condominium units with terms ranging from 2 to 5 years (see Note 13). As of December 31, 2008 and 2007, the gross undiscounted trade receivables from sale of the "Joya Lofts and Towers" (Joya) condominium project amounting to ₱481 million and ₱343 million, respectively, have been assigned as security for interest-bearing loans and borrowings (see Note 20).

Notes to Consolidated Financial Statements

For terms and conditions relating to related party receivables, refer to Note 26.

Movements of allowance for doubtful accounts follow:

2008					
	Beginning	Provisions (see Note 28)	Recoveries (see Note 28)	Write-Off	Ending
<i>(Amounts In Millions)</i>					
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
2007					
	Beginning	Provisions (see Note 28)	Recoveries (see Note 28)	Write-Off	Ending
<i>(Amounts In Millions)</i>					
Billed trade receivables:					
Residential	₱272	₱339	(₱94)	(₱200)	₱317
Commercial	503	173	(5)	(36)	635
Industrial	167	99	(4)	(101)	161
Flat streetlights	12	3	(1)	(5)	9
	954	614	(104)	(342)	1,122
Other receivables	241	132	(66)	(53)	254
	₱1,195	₱746	(₱170)	(₱395)	₱1,376

As of December 31, 2008, billed trade receivables amounting to ₱1,520 million and ₱15,350 million were subjected to specific and collective impairment testing, respectively. As of December 31, 2007, billed trade receivables amounting to ₱151 million and ₱15,627 million were subjected to specific and collective impairment testing, respectively.

16. Inventories

	2008	2007
<i>(Amounts in Millions)</i>		
Materials and supplies - at cost in 2008 and at net realizable value in 2007	₱1,563	₱1,525
Condominium units for sale - at cost	85	13
	₱1,648	₱1,538

The cost of materials and supplies amounted to ₱1,563 million and ₱1,680 million as of December 31, 2008 and 2007, respectively.

No provision for inventory obsolescence was recognized in 2008, 2007 and 2006.

17. Other Current Assets

	2008	2007
<i>(Amounts in Millions)</i>		
Advance payments to suppliers (see Note 10)	₱957	₱37
Creditable withholding tax	652	360
Prepaid creditable withholding taxes (see Note 23)	431	1,037
Prepaid cost	306	308
Tax credit certificates	90	140
Derivative assets (see Notes 13, 20, 30 and 31)	19	117
Others	78	295
	₱2,533	₱2,294

Prepaid creditable withholding taxes represent remittances to the BIR in advance for the refunds expected to be made during the years 2005 up to 2007 relative to the refund of Phase IV (see Note 23). These will be applied against the withholding tax due to the BIR upon actual refund of Phase IV. As of December 31, 2008, ₱71 million and ₱677 million have been remitted and applied, respectively. As of December 31, 2007, ₱737 million and ₱578 million have been remitted and applied, respectively.

18. Equity

a. Common Stock

	2008	2007
	<i>(Amounts in Millions)</i>	
Common stock - ₱10 par value		
Authorized - 1,250,000,000 shares	₱12,500	₱12,500
Issued	₱11,038	₱11,033

Movement of common stock follows:

	Number of Shares	
	2008	2007
Issued:		
Balance at beginning of year	1,103,342,882	998,812,167
Issuance of shares	425,130	104,530,715
Balance at end of year	1,103,768,012	1,103,342,882

On February 26, 2007, the BOD approved a resolution increasing the Parent Company's authorized capital stock from ₱13,800 million, consisting of 1,080 million common shares and 300 million preferred shares, both with par value of ₱10, to ₱15,500 million, consisting of 1,250 million common shares and 300 million preferred shares, both with par value of ₱10.

Also on February 26, 2007, the BOD approved a resolution removing the classification of the capital stock into Class "A" and Class "B" shares. The declassification of shares will effectively remove the restriction on the ownership of Class "A" shares by Filipino citizens, corporations or associations only and will make the shares available for subscription by foreigners. In 2006, the authorized shares of common stock of the Parent Company which are listed at the Philippine Stock Exchange (PSE) were divided into two classes:

- Class "A" — Comprising sixty percent (60%) of the common stock (648 million shares), can be subscribed by Filipino citizens or corporations or associations organized under the laws of the Philippines at least sixty percent (60%) of whose capital is owned by Filipino citizens; and
- Class "B" — Comprising forty percent (40%) of the common stock (432 million shares), can be subscribed by, transferred to and owned by either Filipino citizens or by aliens.

On August 22, 2007, the SEC approved the Parent Company's application for increase in authorized capital stock and declassification of Class "A" and Class "B" shares effective September 3, 2007.

Share Ownership Schemes

The Parent Company has a stock purchase plan under which, awards to subscribe for the Parent Company's shares have been granted to employees and retirees (see Note 19).

b. Appraisal Increase in Utility Plant and Others and Share in Revaluation Increment of an Associate

Prior to adoption of PFRS on January 1, 2005, the asset revaluation reserve was used to record increases in the fair value of land and buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognized in equity. The reserve could only be used to pay dividends in limited circumstances. Upon adoption of PFRS on January 1, 2005, there are no further increases in the reserve as the Company opted to value its utility plant and others using the deemed cost. This reserve is reduced by the amount of depreciation on appraisal increase charged to operations, net of tax effect, amounting to ₱366 million in 2008, ₱407 million in 2007, and ₱424 million in 2006, until the disposal of an item of utility plant and others.

The Parent Company also recognizes its share in the revaluation increment of an associate on its property and equipment. The share in the revaluation increment is decreased by the proportionate share of the depreciation expense charged by the associate to operations (see Note 11).

Notes to Consolidated Financial Statements

c. Retained Earnings

On December 18, 2006, the BOD approved the declaration of cash dividend of ₱1 per common share to all shareholders of record as of January 10, 2007, and paid on February 5, 2007.

On May 21, 2007, the BOD declared a stock dividend equivalent to 10% of the Parent Company's outstanding common stock. For this purpose, the SEC approved on August 22, 2007 the issuance of 100,256,130 shares at the par value of ₱10 per share, amounting to ₱1,006 million, to common shareholders as of record date September 10, 2007.

On March 17, 2008, the BOD approved the dividend policy that, "As a public utility, it is the Parent Company's policy to annually declare dividends out of its unrestricted retained earnings taking into account operating results, cash flows, debt covenants, capital expenditure levels, and liquidity. The BOD shall determine, by resolution, the exact amount, date and shareholders entitled to such dividend."

On the same date, the BOD likewise approved the declaration of cash dividends to common shareholders of record as of April 16, 2008 at the rate of ₱0.50 per share payable on May 13, 2008. Furthermore, another tranche of cash dividends was approved to common shareholders of record as of September 25, 2008 at the rate of ₱0.5025 per common share. The cash dividends were paid on October 21, 2008.

On December 15, 2008, the BOD approved the appropriation of unrestricted retained earnings amounting to ₱4,198 million for contingencies in relation to under-recoveries, the final disposition of which is still pending with the ERC.

19. Share-Based Payment Plan

The Parent Company's Share-Based Payment Plan (Plan) entitles regular employees of the Parent Company and its subsidiaries and retirees of the Parent Company to purchase shares of common stock of the Parent Company on offering period at a purchase price, and payment and other terms to be defined at the time of offering in accordance with the Plan. The purchase price per share shall not be less than 80% of the weighted average daily closing market price at the PSE during a 30-day calendar period that ends two weeks before the start of the offering year. The terms of the Plan include, among others, a two to three-year holding period of the purchased shares and option to cancel the purchase prior to full payment of the purchase price. It has been the policy of the Parent Company to re-offer cancelled shares to qualified participants in subsequent offerings.

The details of the Parent Company's share-based payment plan follows:

a. Employees Stock Option Plan (ESOP) 12th Offering ("Centennial Offering")

During the ESOP 12th Offering ("Centennial Offering"), 8.5 million common shares were initially subscribed by employees and retirees of the Parent Company. The grant date is December 31, 2003 and vesting date, as defined in Note 5, is February 28, 2007. Exercise price has been fixed at ₱13 per share. The payment period is 5 years starting March 2003 to February 2009.

The following table shows the movements in shares subscribed for the ESOP 12th offering:

	2008	2007
Outstanding at the beginning of the year	3,170,060	7,439,008
Redeemed during the year	(381,029)	(4,256,411)
Cancelled during the year	—	(12,537)
Outstanding at the end of the year	2,789,031	3,170,060

The fair value of equity-settled share options granted is estimated as at the date of grant using the Black-Scholes Option Model, taking into account the terms and conditions upon which the options were granted.

The following table lists the inputs to the model:

Historical volatility (%)	50.00
Weighted average share price on grant date (₱)	18.70
Risk-free interest rate (%)	10.28
Expected life of option (years)	3.17
Dividend yield (%)	—

The expected life of the awards is based on the vesting period. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome. No other features of options grant were incorporated into the measurement of fair value.

Total expense arising from the 12th Offering amounted to ₱5 million and ₱23 million in 2007 and 2006.

b. 13th Employees Stock Purchase Plan (ESPP) Offering

On March 26, 2007, the BOD approved the allocation of additional 15 million common shares for the MERALCO ESPP, formerly ESOP, increasing the total common shares allocated to the Plan to 20 million shares.

On April 23, 2007, the BOD approved the “13th ESPP Offering” with the following terms:

Participants	:	Regular employees of the Parent Company, including probationary employees qualified for regular employment as of April 1, 2007
Grant date	:	May 31, 2007
Offering price	:	₱62 per share, based on the weighted average daily closing prices from April 1 to 30, 2007 discounted by 10%
Offering period	:	May 16 to 31, 2007
Payment period	:	5 years starting in August 2007
Vesting date	:	July 31, 2010

A total of 7.3 million shares were initially subscribed out of the remaining allocation of 20 million common shares to the Plan. Exercise price has been fixed at ₱62 per share.

The following table shows movement in shares subscribed for the 13th ESPP offering in 2008:

	2008	2007
Outstanding at beginning of year	7,212,477	7,265,048
Cancelled during the year	(232,263)	(52,571)
Redeemed during the year	(1,594)	—
Outstanding at end of year	6,978,620	7,212,477

There were no exercisable shares as of December 31, 2008 and 2007.

The fair value of equity-settled share options granted is estimated as at the date of grant using the Black-Scholes Option Model, taking into account the terms and conditions upon which the options were granted.

The following table lists the inputs to the model:

Historical volatility (%)	52.62
Weighted average share price on grant date (₱)	62.00
Risk-free interest rate (%)	4.67
Expected life of option (years)	3.16
Dividend yield (%)	—

The expected life of the awards is based on the vesting period. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome. No other features of options grant were incorporated into the measurement of fair value.

Total expense arising from the 13th Offering amounted to ₱116 million in 2008 and ₱68 million in 2007.

Notes to Consolidated Financial Statements

20. Interest-Bearing Loans and Other Borrowings

The details, terms and maturities of the Company's interest-bearing loans and other borrowings including the value of the embedded call option are as follows:

	Interest Rate (%)	Maturity	2008	2007
<i>(Amounts In Millions)</i>				
Parent Company				
Philippine peso loan payable in quarterly installments evidenced by fixed rate corporate notes*	9%	2013	₱5,633	₱6,140
Philippine peso loan payable in quarterly installments evidenced by floating rate corporate notes	3-month PDST-F plus 2%	2013	5,520	6,000
Euro availment under the Master Credit Agreement payable in equal semi-annual installments	5.56%	2010	71	98
US dollar availment under the Master Credit Agreement payable in semi-annual installments	6-month LIBOR plus 0.65%	2009	22	58
CHF availment under the Master Credit Agreement payable in equal semi-annual installments	6-month LIBOR plus 0.7%	2010	38	48
Philippine peso loans payable to government entities payable in quarterly installments	3.5%	2011	2	3
			11,286	12,347
Rockwell - Secured by Rockwell Assets				
(see Note 8)				
Corporate notes	8.5% fixed in 2008 and 8.2% fixed in 2007	2009-2014	2,000	1,000
Loans from various local banks:				
Peso Denominated	3-month PDST-F plus 2%; 1-yr PDST-F plus 2.25%	2008-2009	398	521
Dollar-Denominated	3-month LIBOR plus 2%	2009	91	236
			2,489	1,757
Total long-term debt (a)			13,775	14,104
Less unamortized debt issuance costs (b)			80	91
			13,695	14,013
Preferred stock (c)			1,798	2,278
			15,493	16,291
Less current portion			2,265	2,122
			₱13,228	₱14,169

*Includes value of embedded call option

a. Long-term Debt

▪ Parent Company

The Company's current loan agreements contain restrictions with respect to, among others, encumbrances on assets; payments of dividends subject to certain conditions; disposition of a significant portion of the Company's assets; incurrence of additional borrowings; and maintenance of certain financial ratios. As of December 31, 2008 and 2007, the Company has met these loan covenants.

In December 2006, the Parent Company raised ₱12,000 million from the local banking system through a corporate notes consisting of ₱6,000 million fixed-rate and ₱6,000 floating-rate notes. The fixed rate tranche was priced at 9% while the floating-rate tranche, was priced at 2% over the 3-month PDST-F rate. The proceeds were utilized to prepay substantially all of the Company's secured loans (see Note 9).

The Company has an embedded call option (prepayment option) in its ₱6,000 million 9% Tranche A Fixed rate corporate notes which gives the 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.

On inception date, the Company recognized separately the fair value of the embedded call option on Tranche A Note amounting to ₱167 million (see Note 31) as required by PAS 39.

As a result, the Company recognized the Tranche A Note at its fair value of ₱6,167 million in the 2006 parent company balance sheet.

The embedded derivative is measured at FVPL. As of December 31, 2008 and 2007, the embedded option's fair value gain is ₱102 million and ₱173 million, respectively, and the net adjustment to interest expense for the amortization of loans premium was ₱27 million in 2008 and ₱25 million in 2007.

The estimated schedule of repayments of long-term debt of the Parent Company, excluding the value of the embedded call option, is as follows:

Year	Amount in Original Currency				Total
	US Dollar	Euro	Swiss Franc	Philippine Pesos	Peso Equivalent
<i>(Amounts in Millions)</i>					
2009	\$0.47	€0.54	CHF0.44	₱960	₱1,037
2010	—	0.54	0.44	960	1,014
2011	—	—	—	960	960
2012	—	—	—	960	960
2013	—	—	—	7,200	7,200
Total	\$0.47	€1.08	CHF0.88	₱11,040	₱11,171
In peso equivalent	₱22	₱71	₱38	₱11,040	₱11,171

▪ Rockwell

Peso Denominated

On July 19, 2007, Rockwell entered into a Fixed Rate Corporate Notes Facility Agreement ("the 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 ("the Notes") for the purpose of financing the development of the Meralco BPO Building to be located in the Meralco compound (see Note 8). The Notes are comprised of 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 ₱0.5 billion. As of December 31, 2008, corporate notes amounting to ₱2.0 billion is payable in twenty quarterly payments starting August 2009 with the ₱0.6 billion balance payable lump sum at maturity in August 2014. Interest is fixed up to maturity at 75 bps over the 7-year PDST-F.

The Agreement contains provisions regarding the maintenance of certain financial ratios such as debt service coverage ratio and debt-to-equity ratio. As of December 31, 2008, Rockwell has complied with these ratios.

Peso denominated loans from various local banks consist of bridge facilities mostly payable by the end of 2008 and a term loan that is expected to be fully settled in August 2009.

Loans from various local banks consist of bridge facilities mostly payable by the end of 2008 and a term loan payable in 9 quarterly payments commencing in April 2007.

Dollar-Denominated

Dollar-denominated loans amounting to US\$1.9 million as of December 31, 2008 are payable in two quarterly payments and will be fully paid by April 2009.

Loans outstanding as of December 31, 2008 and 2007 are secured by assignment of Joya receivables with gross undiscounted amounts of ₱481 million and ₱343 million, respectively and Mortgage Participation Certificates amounting to ₱2,500 million and ₱1,500 million, respectively, on a Mortgage Trust Indenture and its amendments and supplements over the Power Plant Mall.

Repayments of loans based on existing terms are scheduled as follows:

	Amount
	<i>(In Millions)</i>
2009	₱629
2010	280
2011	280
2012 and after	1,300
	₱2,489

- b. As of December 31, 2008 and 2007, the balance of unamortized debt issuance costs, relating to the long-term debt, amounted to ₱80 million and ₱91 million, respectively, and is deferred and reflected as a reduction of the debt. The unamortized balance of the debt issuance costs, related to the secured debt that was prepaid in December 2006, amounted to ₱1,216 million and was written off and charged to "Interest and other financial expenses" account in the 2006 consolidated statement of income (see Note 28).

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Movements of unamortized debt issuance costs related to the long-term debt follow:

	2008	2007
	<i>(Amounts in Millions)</i>	
Balance at beginning of year	₱91	₱104
Additions during the year	7	8
	98	112
Less amortization during the year	18	21
Balance at end of year	₱80	₱91

c. Redeemable, Nonconvertible Preferred Shares

Preferred stock, with a par value of ₱10, is nonparticipating, nonconvertible and, like common stock, has no preemptive right to subscribe to any or all issues or other disposition of preferred stock. Preferred stock is 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.

Preferred stock should be issued serially in blocks of not less than 100,000 shares. Shares of preferred stock comprising one series shall have the same rights and restrictions.

Series B preferred stock is redeemable five years from date of issue at the option of the Parent Company or holder upon 90 days notice. In cases where a service application would require extension or new distribution facilities, the "Terms and Conditions of Service" of the Parent Company, which was approved by the then ERB, requires applicants for electric service to subscribe to preferred stock with 10% dividend a year to cover the costs. The Parent Company ceased requiring the customers to subscribe to preferred shares effective April 8, 2005. This has since been amended by the Magna Carta for Residential Electricity Consumers (Magna Carta) and the Distribution Services Open Access Rules (DSOAR), which allows the customers to purchase preferred shares of the utility only when the same is available.

As of December 31, 2008 and 2007, dividend cheques of certain preferred stockholders remained outstanding. The cumulative amount approximates ₱307 million and ₱411 million, respectively. These are shown as part of "Trade and other payables" account in the consolidated balance sheets (see Note 25).

Movement of preferred stock follows:

	Number of Shares	
	2008	2007
Balance at beginning of year	243,415,560	251,911,810
Reclassification	42,396,341	—
Redemption of shares	(19,447,517)	(8,496,250)
Balance at end of year	266,364,384	243,415,560

Interest expense on interest-bearing loans and borrowings in 2008, 2007 and 2006 amounted to ₱1,358 million, ₱1,288 million and ₱1,959 million, respectively (see Note 28).

21. Customers' Deposits

	2008	2007
	<i>(Amounts in Millions)</i>	
Meter deposits	₱1,538	₱1,578
Accrued interest on meter deposits	1,341	1,296
	2,879	2,874
Less current portion (see Note 25)	457	237
	2,422	2,637
Bill deposits	14,448	13,060
Accrued interest on bill deposits	7,733	6,981
	22,181	20,041
Less current portion (see Note 25)	1,160	1,255
	21,021	18,786
	₱23,443	₱21,423

Meter Deposits

Meter deposit is intended to guarantee provision of metering equipment.

On June 17, 2004, the ERC issued the Magna Carta for Residential Customers. The Guidelines to implement Articles 7, 8, 14 and 28 of the Magna Carta were issued on October 27, 2004. Under the Magna Carta, residential customers are now exempt from the payment of meter deposits. Prior to the effectivity of Magna Carta, meter deposits covered 50% of the cost of the metering equipment.

On January 18, 2006, the DSOAR was issued by the ERC. Under the DSOAR, non-residential customers are now also exempt from the payment of meter deposit.

On June 4, 2008, the ERC released its Resolution No. 8, Series of 2008, approving the “Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers.” These were finalized after the ERC’s deliberation of the draft rules and the completion of a public consultation on March 26, 2008. The rules aim to provide the DUs with parameters for the refund of meter deposits and interests. The related accrued interest on meter deposits was updated based on this ruling.

Among the salient features of the rules are:

- a. Start of Refund — The refund will commence not later than six (6) months upon effectivity of the rules.
- b. Duration of Refund Period — The refund should be completed not longer than sixty-six (66) months from the effectivity of the rules.
- c. Mode of Refund — The customer has the option of receiving his refund through cash, credit to his future monthly billings, or as an offset to other due and demandable claims that the private utilities may have against him.
- d. Amount of Interest

Residential Customers

- For those paying meter deposit before effectivity of Resolution No. 95-21 or September 22, 1995:
 - From date of payment to date prior to September 22, 1995 6%
 - From September 22, 1995 to date prior to the effectivity of the Guidelines to Implement Articles 7,8,14 and 28 of the Magna Carta 10%
 - From effectivity of the Magna Carta Guidelines to the start of refund 6%
- For those paying meter deposit on or after September 22, 1995 10%

Non-residential Customers

- For those paying meter deposit before September 22, 1995:
 - From date of payment to date prior to September 22, 1995 6%
 - From September 22, 1995 to date prior to the effectivity of DSOAR 10%
 - From effectivity of DSOAR until day prior to the start of refund 6%
- For those paying meter deposit on or after September 22, 1995 10%

The rules were published on June 20, 2008 in a newspaper of general circulation and took effect fifteen (15) days after or on July 5, 2008.

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 ₱1,507 million. The actual refund of meter deposit commenced on November 3, 2008.

As of December 31, 2008, the Parent Company has already refunded ₱309 million in principal and interests.

Bill Deposits

Bill deposit serves to guarantee payment of bills by a customer which is estimated to equal one month’s consumption or bill of the customer.

Both the Magna Carta and DSOAR also provide that residential and non-residential customers, respectively, must pay a bill deposit to guarantee payment of bills equivalent to their estimated monthly billing. The amount of deposit shall be adjusted after one year to approximate the actual average monthly bills. 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

Notes to Consolidated Financial Statements

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.

With regard to the interest rate on customer deposits, while the Implementing Guidelines of the Magna Carta provided that the interest rate on meter deposits shall be at 6% for contracts of service entered into prior to the effectivity of the ERB Resolution No. 95-21, it was silent on the corresponding interest rate for bill deposits of residential customers for the same period. ERB Resolution No. 95-21 was issued by the then ERB on August 3, 1995 adopting a 10% interest on customers' deposits. The Parent Company's legal counsel opined that the same interest rate of 6% should apply to bill deposits as such rate was agreed upon in the service contract. Pursuant to the Magna Carta, the rate of interest on bill deposit shall be equivalent to the interest incorporated in the WACC, otherwise, the rate shall be "based on the prevailing interest rate on savings deposit as approved by the Bangko Sentral ng Pilipinas (BSP)." In the case of non-residential customers, the DSOAR likewise provides that the Parent Company shall pay interest on bill deposits at the rate equivalent to the prevailing interest rate for savings deposits as approved by the BSP.

The DSOAR superseded ERB Resolution No. 95-21, as amended, in its entirety. In the letter of the ERC to the Parent Company dated November 3, 2006, it was clarified that the "currently prevailing interest rate for savings deposits is one percent (1%) since this is the interest rate used by two of the largest commercial banks and Land Bank of the Philippines, as government bank." The Parent Company wrote a letter to ERC on January 24, 2007 clarifying the Company's interpretation of the rules and regulations issued by the ERC, to mean that customers, whether residential or non-residential, with contracts of service executed prior to the effectivity of the DSOAR, can earn interest for both meter and bill deposits, at the rate of 6% or 10% depending on contract effectivity. Further, in the case of bill deposits, the rate of interest becomes 10% as incorporated in the Parent Company's WACC, starting from the June 2003 effectivity of the Parent Company's unbundling decision as approved by the ERC.

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 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 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.

In response to the Company's letter dated January 24, 2007, the ERC, in its letter in April 2007, said that the interest rate on bill and meter deposits of residential customers shall be governed by the Magna Carta for Residential Electricity Consumers and its Implementing Guidelines while the interest rate for the bill deposits of non-residential customers shall be either 10% or 1% depending on the date of contract effectivity.

With respect to the interest rate on bill deposits of non-residential customers, the ERC has maintained that the interest rate of 6% should be raised to 10%, regardless of contract date, upon effectivity of ERB Resolution No. 95-21 in September 1995. The Parent Company, without necessarily conceding its position, argued that the same principle should be applied upon the effectivity of DSOAR, in as much as the ERC has retained the 10% interest rate, for contract date before the Parent Company's unbundling decision, even after DSOAR effectivity. Further, the Parent Company emphasized that the DSOAR has already reduced the interest rate from 10% to 1%, which is the prevailing interest rate of savings deposit. Conformably therewith, the Parent Company posits that the interest rate on bill deposits should be reduced from 10% to 1% starting with the effectivity of DSOAR, for contract dates prior to the Parent Company's unbundling decision.

The Parent Company strongly believes that certain legal impediments and inconsistencies with previous pronouncements of the ERC on the issue of interest on bill deposits still exist. 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 will follow the same principles adopted by the ERC in the Rules to Govern the Refund of Meter Deposits, insofar as the computation of interest for bill deposits is concerned. Accordingly, the Parent Company has computed the interest on bill deposits using the rates of interest as follows:

Residential Customers

- | | |
|---|-----|
| ▪ For those paying Bill Deposit before effectivity of Res. 95-21 or September 22, 1995: | |
| - 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 Deposit on or after September 22, 1995 | 10% |

Non-residential Customers

- For those paying Bill Deposit before effectivity of Res. 95-21 or September 22, 1995:
 - From date of payment to date prior to September 22, 1995 6%
 - From September 22, 1995 to date prior to the effectivity of DSOAR 10%
 - From effectivity of DSOAR until the day prior to the refund 1%
- For those paying Bill Deposit on or after September 22, 1995:
 - From September 22, 1995 to date prior to the effectivity of DSOAR 10%
 - From effectivity of DSOAR until the day prior to the refund 1%
- For those paying Bill Deposit on or after effectivity of DSOAR 1%

The above interest rates shall be subject to change to conform to the final interest rates that may be determined by the ERC upon its promulgation of separate rules or guidelines to govern the refund of bill deposits.

The Company has been accruing interest at 10% for all customers effective September 1995. In view of the final implementing guidelines issued by DSOAR in 2006, the Company reversed the excess accrued interest on bill and meter deposit amounting to ₱889 million (shown as part of "Interest and other income - Reversal of accrued interest" account in the 2006 consolidated statement of income). This pertains to the excess of the 10% interest accrual for bill and meter deposits which should have been accrued at 6% only.

Interests on meter and bill deposits are determined using the simple interest computation method. There is no expressed stipulation in its "Terms and Conditions of Service" that the interest due and unpaid shall be added to the principal and shall earn new interest; consequently, the interest on meter and bill deposits of the customers cannot be compounded, consistent with the law and jurisprudence on the matter. This is supported by the opinion of the Parent Company's external legal counsel.

Meter and bill deposits and related accrued interest which are currently being refunded, based on historical experience and the relevant ERC guidelines, are shown separately as part of "Trade and other payables" account in the consolidated balance sheets (see Note 25).

22. Provisions

Movements during the year are as follows:

	2008	2007
	<i>(Amounts in Millions)</i>	
Provisions for various tax assessments and claims against the Company (see Note 34):		
Balance at beginning of year	₱1,396	₱1,724
Provisions during the year	318	400
Settlement during the year	(69)	—
Reversals during the year	—	(728)
Balance at end of year	1,645	1,396
Provisions for probable losses from refund [see Note 6d(1)]	4,098	—
	₱5,743	₱1,396

Details on tax assessments and legal claims required by PAS 37 are not disclosed as these may prejudice the Company's positions in relation to the cases pending before the courts or quasi-judicial bodies.

23. Customers' Refund

This account refers to the refund discussed in Note 2III(b) and consists of:

	2008	2007
	<i>(Amounts in Millions)</i>	
Gross refund amount	₱11,385	₱14,396
Less present value effect	780	1,626
	10,605	12,770
Less current portion	7,925	4,904
	₱2,680	₱7,866

Notes to Consolidated Financial Statements

PAS 39 requires financial liabilities to be recognized initially at fair value and subsequently carried at amortized cost using the effective interest rate method. Accordingly, the present value effect on refund liability was recorded to comply with PAS 39. The Parent Company will continue to pay the full refund (originally ₱30,055 million, of which ₱18,670 million has been paid as of December 31, 2008) based on the SC decision dated April 30, 2003 wherein it did not provide for the payment of interest.

Movements of unamortized discount related to the present value effect on refund liability follow:

	2008	2007
	<i>(Amounts in Millions)</i>	
Balance at beginning of year	₱1,626	₱2,722
Less interest accretion during the year	846	1,096
Balance at end of year	₱780	₱1,626

The Parent Company implemented the refund in four phases:

- Phase I, which involves refunds to residential and general service customers who consumed 100 kWh or less of electricity in April 2003 (or in their last complete month's bill for services whose contracts with the Parent Company have been terminated).
- Phase II, which involves refunds to residential and general service customers who consumed 101 to 300 kWh in 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.
- Phase III, which involves refunds to residential and general service customers who consumed more than 300 kWh of electricity in April 2003, was implemented by the Parent Company over a period of twelve months starting January 2004.
- For Phase IV, involving refunds to commercial and industrial customers and all other customers not covered by Phases I - III, the refund covers two sub-phases.

In February 2005, the BIR issued Revenue Regulation 8-2005 issued by the BIR which stated that the refunds to Phase IV customers are income payments subject to creditable withholding tax. The creditable withholding tax is withheld on the gross amount of the refund at the following rates: 25% for customers with active contracts and 32% for customers with terminated contracts.

The BIR implementing guidelines on the imposition of creditable withholding tax on the Phase IV refund were released in August 2005. To comply with the guidelines, customers are required to submit complete documents to the Parent Company prior to the latter's release of their refund either through checks or monthly credit to bill. Once the customer is able to comply with the requirements, he will receive the refunds due him from the original start dates as approved by the ERC.

As discussed in Note 17, the Parent Company has remitted in advance a portion of the withholding tax for Phase IV refund, amounting to ₱431 million and ₱1,037 million as of December 31, 2008 and 2007, respectively.

The Parent Company is currently implementing Phase IV in accordance with the ERC-approved scheme.

As of December 31, 2008, the balance of the refund (inclusive of the present value effect) for each of the four phases is as follows:

Phase	Beginning Balance	Cash Payments	Application against Billings	Balance
	<i>(Amounts in Millions)</i>			
I	₱343	(₱1)	(₱4)	₱338
II	295	—	—	295
III	337	(1)	(2)	334
IV	13,421	(2,425)	(578)	10,418
	₱14,396	(₱2,427)	(₱584)	₱11,385

Based on the Parent Company's implementation, customers' refunds estimated to be made the following year amounting to ₱7,925 million (₱8,480 million, gross of present value effect) is shown as part of current liabilities in the 2008 consolidated balance sheet.

24. Notes Payable

Notes payable represents unsecured peso-denominated interest-bearing short-term loans obtained from various local financial institutions to meet the Company's monthly payment obligations to power suppliers and other working capital requirements. Annual interest rates ranged from 6.50% to 10.50% in 2008 and 4.75% to 13.5% in 2007. Interest expense on notes payable amounted to ₱595 million, ₱260 million and ₱47 million in 2008, 2007 and 2006, respectively (see Note 28).

25. Trade and Other Payables

	2008	2007
	<i>(Amounts in Millions)</i>	
Trade accounts payable (see Note 26)	₱9,836	₱14,615
Output VAT - net	2,890	2,430
Advances for construction	2,325	1,432
Excess collections over recognized receivables (see Note 5)	1,578	—
Current portion of liability arising from deferred pass-through fuel costs (see Notes 13 and 26)	1,242	2,043
Accrued taxes	956	992
Current portion of CERA I and II over recoveries, including carrying charges	917	3,092
Preferred stock redemption payable	866	156
Current portion of bill deposits (see Note 21)	629	484
Accrued expenses	588	457
Current portion of interest on bill deposits (see Note 21)	531	771
Accrued dividends on preferred stock (see Note 20)	307	411
Current portion of meter deposits (see Note 21)	267	69
Current portion of interest on meter deposits (see Note 21)	190	168
Universal charges	178	177
Accrued development cost	149	340
Payable to customers	134	237
Current portion of retention payable	94	1
Current portion of security deposit	87	111
Current portion of derivative liability (see Note 31)	35	—
GRAM refund [see Notes 21(b) and 13]	34	82
Current portion of deferred lease income	32	37
Dividends payable	14	—
Other current liabilities	1,875	2,180
	₱25,754	₱30,285

Trade payables are noninterest-bearing and are normally settled on 60-day terms. Other payables are noninterest-bearing and have an average term of six months.

Trade Accounts Payable

Trade accounts payable includes obligations to power suppliers such as NPC, TransCo, PEMC, First Gas (a related party), Quezon Power Philippines Limited Company (QPPL) and Philpodeco for cost of power purchased. This also includes other payables to local and foreign suppliers for goods and services needed to ensure normal operations.

NPC and TransCo claimed an over deduction by the Parent Company of amounts related to the 3½ percent discount on the NPC basic charge for power delivered at the Balintawak substation. Total claims of NPC and TransCo amounted to ₱1,173 million as of December 31, 2004 and are payable in three years starting February 2005. Total claims of TransCo were paid in full in 2005 while claims of NPC were paid in full in 2008.

Trade accounts payable also includes transmission line fee charges in connection with the Parent Company's Transmission Line Agreement (TLA) with QPPL. In an order dated September 20, 2004, the ERC disallowed the recovery of a portion of the transmission line fee, the bulk of which was for "scheduled extension costs," which the ERC believed "were caused by management inefficiency on the part of NPC."

On February 21, 2008, the Parent Company and QPPL amended their TLA to conform its terms to those already approved by the ERC. Based on the amendment, the Parent Company and QPPL acknowledge and confirm that all claims that each may have against the other are resolved as of date of the amendment. Accordingly, the Parent Company derecognized its liability to QPPL pertaining to the disallowed transmission line fee amounting to ₱839 million and is shown as part of "Recovery of probable losses on disallowed receivables" account in the 2007 consolidated statement of income.

Notes to Consolidated Financial Statements

CERA I and II

After the Parent Company substantially settled all of its foreign currency-denominated debt in 2006, the Parent Company made a final accounting of the amount of CERA I and II that have been billed to the customers. Based on the Parent Company's final accounting of the CERA I and II billings, the Parent Company has an over-recovery of ₱3,092 million from June 2003 to December 2006. The over-recovery of CERA I amounting to ₱1,928 million was shown as a reduction of revenues in the 2006 consolidated statement of income, while the over-recovery of CERA II amounting to ₱1,164 million was deducted from the "Others - Deferred CERA" account in the 2006 consolidated balance sheet.

On October 22, 2008, the ERC released an order that directed the Parent Company to implement a refund of over-recoveries in the CERA mechanism.

The ERC directed the Parent Company to refund the CERA over-recoveries, along with carrying charges estimated at ₱833 million, over a period of twelve months, equivalent to ₱0.1461 per kWh. On December 4, 2008, the Parent Company filed a Motion which asked the ERC to defer the CERA refund. In asking for a deferment, the Parent Company cited financial constraints due to, among others, the accumulation of substantial generation cost under-recoveries and the servicing of the ERC-mandated meter deposit refund.

In its order dated February 16, 2009, the ERC granted (with modification) the Parent Company's Motion to defer the CERA refund. In granting this Motion, the ERC said that "...the Commission is cognizant of the fact that requiring Meralco to refund the amount of ₱3,925 million would result in substantial and tremendous impact on its financial resources. Thus, the Commission deems it reasonable to recalculate the amount and the period of CERA refund in order to cushion its impact on Meralco's financial viability." Accordingly, the ERC directed the Parent Company to refund the total refund amount of ₱3,925 million, equivalent to ₱0.0400 per kWh starting the March 2009 billing cycle until such time that the full amount shall have been refunded.

Total amount estimated to be refunded within the next twelve months amounted to ₱917 million, shown as part of "Trade and other payables" account and the remaining balance of ₱3,008 million, shown as "CERA I and II over recoveries, including carrying charges - net of current portion" account in the 2008 consolidated balance sheet.

Payable to Customers

On October 1, 2004, the ERC released an Order on the Parent Company's Motion for Clarification/Reconsideration on ERC Case Nos. 2001-646 and 2001-900 dated July 1, 2003, resulting in 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 potential liability to customers estimated at ₱1,085 million. In 2006, the Parent Company commenced the refund of this minimum charge. As of December 31, 2008 and 2007, the outstanding liability amounted to ₱134 million and ₱237 million, respectively. The estimated amount of the refund has been incorporated in the application for collection of Transmission Charge under-recoveries [see Note 34a (1)].

Advances for Construction

In June 2005, the Parent Company offered a financing option for residential customers located beyond thirty (30) meters serving distance from the nearest voltage facilities of the utility, thus, requiring a project for the extension of lines and facilities which is in accordance with the Article 14, "Right to Extension of Lines and Facilities of the Magna Carta for Residential Customers." The cash advance scheme is the approximate cost of the project and is non-interest bearing.

To recover their aforementioned expenditures, the customers are entitled to an annual refund at the rate of twenty five percent (25%) of the gross distribution revenue derived from all customers connected to the line extension for the refund year (12 months from the date of energization of the service and the succeeding year thereafter until such amounts are fully refunded or for five years whichever period is shorter, the "refund period").

The gross distribution revenue is comprised of distribution charge, metering charge, supply charge and CERA. The refund period covers the five-year cap based on the Article 2.6.2 of the DSOAR which also applies to residential developers.

After the lapse of five (5) years from the date of energization of the project, the unpaid advances would be considered as a reduction to the Parent Company's plant in service or asset base.

Cash advance collections from customers amounted to ₱898 million and ₱802 million for the year ended December 31, 2008 and 2007, respectively. Refund to customers amounted to ₱5 million and ₱1 million for the period ended December 31, 2008 and 2007, respectively.

Others

On July 19, 2007, Rockwell signed a Term Sheet for the purchase of a parcel of land situated at Barrio Ugong, Pasig City, for a total cost of ₱1,094 million (shown as part of "Land and development cost" account - see Note 8). On August 17, 2007, Rockwell entered into an Escrow Agreement for the purpose of receiving and holding the Escrow Documents. As of December 31, 2007, Rockwell has paid ₱945 million. The remaining balance of ₱149 million is

shown as part of "Other current liabilities" account and was fully paid on January 21, 2008. The Deed of Absolute Sale was signed on January 23, 2008 and the Transfer Certificate of Title was issued on February 20, 2008.

26. Related Party Transactions

The following table provides the total amount of transactions, which have been entered into by the Company with related parties for the relevant financial year. Outstanding balances at the year-end are unsecured, interest free [except those relating to deferred pass-through fuel costs (see Note 13)] and settled in cash. There have been no guarantees provided or received for any related party receivables or payables.

Related Party	Relationship with Company	Year	Purchases from Related Parties	Deferred Pass-Through Fuel Costs (see Note 13)	Amounts Owed by Related Parties (see Note 15)	Amounts Owed to Related Parties (see Notes 13 and 25)
<i>(Amounts in Millions)</i>						
FGPC (see Notes 13 and 35)	Affiliate	2008	₱36,849	₱2,541	₱—	₱2,033
		2007	30,110	3,809	—	1,779
		2006	33,138	5,450	—	7,825
FGP Corp. (see Notes 13 and 35)	Affiliate	2008	18,434	1,251	—	924
		2007	14,866	1,087	—	4,605
		2006	16,538	1,613	—	3,279
Soluzionia	Joint Venture	2008	493	—	6	5
		2007	403	—	6	17
		2006	5	—	—	5
GEPMICI	Associate	2008	129	—	—	—
		2007	356	—	4	2
		2006	31	—	—	139
Philippine Electric Corp. (PHILEC)	Affiliate	2008	876	—	—	34
		2007	786	—	—	26
		2006	—	—	—	18
Others*	Affiliates	2008	193	—	—	1
		2007	208	—	—	3
		2006	—	—	—	—
		2008	₱56,974	₱3,792	₱6	₱2,997
		2007	₱46,729	₱4,896	₱10	₱6,432
		2006	₱49,712	₱7,063	₱—	₱11,266

*Consist of transactions with MML Development Center, Inc. and FEDCOR

FGPC, FGP Corp., and PHILEC are subsidiaries of First Philippine Holdings Corporation (FPHC), a shareholder of the Parent Company.

Revenues

In the ordinary course of business, the Parent Company provides electricity to related parties within its franchise area. These related parties are regular customers whose rates are the same as those from unrelated parties. Revenues from related parties are not significant.

Purchases

Purchases from related parties consist of purchases of power and deferred pass-through fuel costs (FGPC and FGP Corp.), information systems technology services (Soluzionia), transformers (PHILEC) and meters (GEPMICI). Purchases from related parties amounted to ₱56,974 million, ₱46,729 million and ₱49,712 million in 2008, 2007 and 2006, respectively.

The assessment to determine provision for doubtful accounts is undertaken at each financial year through the examination of the financial position of the related party and the market in which the related party operates.

Compensation of Key Management Personnel of the Company

	2008	2007	2006
<i>(Amounts in Millions)</i>			
Short-term employee benefits	₱275	₱288	₱223
Long-term and retirement benefits	71	84	55
Share-based payment	25	9	2
Total compensation paid to key management personnel	₱371	₱381	₱280

Notes to Consolidated Financial Statements

27. Revenues and Purchased Power

In compliance with Section 36 of RA No. 9136, the Parent Company was required to unbundle its billing charges to customers effective June 2003. Below is the breakdown of revenues for the years ended December 31, 2008, 2007 and 2006:

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Generation charge	₱120,445	₱126,816	₱126,018
Transmission charge	25,512	27,227	21,591
Distribution charge	17,594	17,435	17,295
System loss charge	16,139	17,316	16,447
Supply charge	5,753	5,707	5,517
Metering charge	2,923	2,894	2,807
Power act reduction	(814)	(584)	(740)
Inter-class, lifeline subsidy and others	(488)	(427)	(258)
CERA I and II (see Note 25)	—	4	(1,928)
	187,064	196,388	186,749
Less intersegment sales (see Note 7)	65	217	173
	₱186,999	₱196,171	₱186,576

Actual purchased power costs, which are pass-through costs and are revenue-neutral to the Company, for the period follows (see Note 35):

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Generation charge	₱131,863	₱144,388	₱136,382
Transmission charge	25,009	28,449	24,881
	₱156,872	₱172,837	₱161,263

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 ₱21,592 million, ₱17,107 million and ₱19,916 million in 2008, 2007 and 2006, respectively, and are presented as part of purchased power account in the consolidated statements of income. These also include unrecoverable system loss charges representing system loss charges over the 9.5% cap amounting to ₱260 and ₱969 million in 2007 and 2006, respectively. In 2008, however, the Parent Company's system loss rate was below the 9.5% cap.

Thus, net revenue (expense) from pass-through costs for the period follows:

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Generation charge	₱120,445	₱126,816	₱126,018
Transmission charge	25,512	27,227	21,591
System loss charge	16,139	17,316	16,447
Power act reduction	(814)	(584)	(740)
Recoverable purchased power	(156,872)	(172,577)	(160,294)
Net over (under)-recoveries for the year	₱4,410	(₱1,802)	₱3,022

For the year ended December 31, 2008, net over-recoveries in pass-through costs is mainly attributable to transmission charges as discussed in Note 6d (1). Net under-recoveries for the year ended December 31, 2007 is attributable to generation charges.

The status of the accumulated over and under-recoveries in pass-through costs are discussed in Notes 6(b) and 34a(1).

28. Expenses and IncomeOperations and Maintenance

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Salaries, wages and employee benefits (see Notes 19, 26 and 29)	₱7,282	₱7,999	₱6,426
Contractors' services	3,283	2,954	2,446
Provision for doubtful accounts, net of recoveries (see Note 15)	1,566	576	612
Materials and supplies	338	360	353
Supervision and regulation fees	328	198	218
Corporate expenses	306	300	48
Transportation and travel	272	379	318
Property insurance	92	70	86
Others	160	344	401
	₱13,627	₱13,180	₱10,908

Salaries, Wages and Employee Benefits

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Wages, salaries and benefits	₱4,986	₱4,882	₱4,432
Pension cost (see Note 29)	1,892	2,858	1,797
Post-employment benefits other than pensions (see Note 29)	184	87	93
Expense of share-based payments (see Note 19)	116	73	23
Social security costs	104	99	81
	₱7,282	₱7,999	₱6,426

Cost of Contracts and Services

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Salaries, wages and employee benefits	₱584	₱563	₱514
Contractors' services	517	437	430
Materials and supplies	163	294	173
Others	192	121	39
	₱1,456	₱1,415	₱1,156

Interest and Other Financial Expenses

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Interest expense on interest-bearing loans and other borrowings (see Note 20)	₱1,358	₱1,288	₱1,959
Interest expense on bill deposits (see Note 21)	925	864	858
Interest expense on notes payable (see Note 24)	595	260	47
Interest expense on deferred pass-through fuel costs (see Notes 13 and 26)	141	320	542
Interest expense on meter deposits (see Note 21)	89	99	102
Amortization of loans premium (see Note 20)	(27)	(25)	—
Amortization of debt issue costs (see Note 20)	18	21	1,216
Others	223	153	380
	₱3,322	₱2,980	₱5,104

Interest and Other Income

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Amortization of unearned interest on trade receivables of subsidiaries (see Note 15)	₱450	₱574	₱339
Interest income on cash and cash equivalents	321	369	634
Mark-to-market gains (losses) from derivative instruments (see Note 31)	(167)	187	59
Reversal of accrued interest (see Note 21)	—	—	889
Others	1,502	998	937
	₱2,106	₱2,128	₱2,858

Notes to Consolidated Financial Statements

Foreign Exchange Losses (Gains) - Net

This account includes foreign exchange gains and losses arising from monetary assets and liabilities other than foreign currency-denominated long-term debt. Foreign exchange loss related to CERA II amounted to ₱1,719 million in 2006 and none in 2008 and 2007.

29. Retirement Plan

The Company has a funded, noncontributory defined benefit retirement plan covering substantially all of its regular and permanent employees. The retirement plan of the Parent Company is held in trust by the Board of Trustees of the Meralco Pension Fund and is overseen by the Retirement Fund Committee of the Board of Directors.

The Parent Company also provides certain additional post-employment benefits upon retirement.

On January 22, 2007, the BOD approved the Retirement Benefits Conversion Plan (RBCP) which would buyout at present value the monthly pension and retirement benefits of qualified retirees as of January 2, 2007. This was offered on a voluntary basis and, initially, 1,022 retirees availed of the RBCP. On November 26, 2007, the BOD approved the extension offer of the RBCP and 205 retirees availed of the offer until December 31, 2007.

The following tables summarize the components of net pension and other post-employment benefit expense of the Company recognized in the consolidated statements of income and the funded status and amounts recognized in the consolidated balance sheets for the respective plans.

Net Pension Cost (included as part of "Operations and maintenance expenses - Salaries, wages and employee benefits" account)

2008				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Interest cost on benefit obligation	₱1,730	₱6	₱4	₱1,740
Current service cost	964	9	4	977
Expected return on plan assets	(826)	(4)	(1)	(831)
Past service cost	1	1	2	4
Actuarial loss	—	—	2	2
Net pension cost	₱1,869	₱12	₱11	₱1,892
Actual return (loss) on plan assets	(₱1,695)	(₱6)	₱1	(₱1,700)

2007				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Interest cost on benefit obligation	₱1,915	₱5	₱5	₱1,925
Current service cost	1,104	8	4	1,116
Expected return on plan assets	(373)	(2)	(1)	(376)
Past service cost	1	—	—	1
Actuarial loss	609	—	2	613
Settlement gain	(419)	—	—	(419)
Net pension cost	₱2,837	₱11	₱10	₱2,858
Actual return (loss) on plan assets	₱5,889	₱5	₱—	₱5,894

2006				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Interest cost on benefit obligation	₱1,542	₱3	₱3	₱1,548
Current service cost	486	5	3	494
Expected return on plan assets	(245)	—	(1)	(246)
Past service cost	1	—	—	1
Net pension cost	₱1,784	₱8	₱5	₱1,797
Actual return on plan assets	₱3,419	₱2	(₱3)	₱3,418

Pension Liability (Asset)

2008				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Defined benefit obligation	₱22,594	₱50	₱59	₱22,703
Fair value of plan assets	(10,309)	(82)	(18)	(10,409)
Unrecognized net actuarial gains (losses)	(421)	11	(23)	(433)
Unrecognized past service cost	(5)	(7)	—	(12)
Pension liability (asset)	₱11,859	(₱28)	₱18	₱11,849

2007				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Defined benefit obligation	₱24,714	₱57	₱54	₱24,825
Fair value of plan assets	(11,800)	(47)	(10)	(11,857)
Unrecognized net actuarial losses	(1,618)	(1)	(22)	(1,641)
Unrecognized past service cost	(6)	(8)	—	(14)
Pension liability	₱11,290	₱1	₱22	₱11,313

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

2008				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Opening defined benefit obligation	₱24,714	₱57	₱54	₱24,825
Interest cost	1,730	6	4	1,740
Current service cost	964	9	4	977
Benefits paid	(1,096)	—	(6)	(1,102)
Actuarial losses (gains) due to:				
Changes in assumptions	(3,886)	(19)	3	(3,902)
Experience adjustments	168	(3)	—	165
Closing defined benefit obligation	₱22,594	₱50	₱59	₱22,703

2007				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Opening defined benefit obligation	₱27,360	₱60	₱53	₱27,473
Interest cost	1,915	5	5	1,925
Current service cost	1,104	8	4	1,116
Benefits paid	(1,024)	—	(2)	(1,026)
Actuarial losses (gains) due to:				
Changes in assumptions	(2,038)	(17)	(6)	(2,061)
Experience adjustments	(749)	1	—	(748)
Effect of settlement	(1,854)	—	—	(1,854)
Closing defined benefit obligation	₱24,714	₱57	₱54	₱24,825

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

2008				
	Parent	Rockwell	MIESCOR	Total
<i>(Amounts in Millions)</i>				
Opening fair value of plan assets	₱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	13	1,354
Closing fair value of plan assets	₱10,309	₱82	₱18	₱10,409

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	2007			
	Parent	Rockwell	MIESCOR	Total
	(Amounts in Millions)			
Opening fair value of plan assets	₱5,925	₱29	₱10	₱5,964
Expected return on plan assets	373	2	1	376
Actuarial gains (losses)	5,516	3	(1)	5,518
Benefits paid	(2,338)	—	(2)	(2,340)
Contributions by employer	2,324	13	2	2,339
Closing fair value of plan assets	₱11,800	₱47	₱10	₱11,857

The Parent Company expects to contribute ₱1,300 million to its defined benefit pension plan in 2009.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2008	2007
	(Percentage)	
Marketable equity securities	49	18
Bonds and commercial notes	25	5
Government securities	18	70
Real properties	7	6
Receivables	1	1
	100	100

The overall expected rate of return on assets is determined based on the market prices prevailing on that date, applicable to the period over which the obligation is to be settled.

Other Post-employment Benefits Expense (included as part of "Operations and maintenance expenses - Salaries, wages and employee benefits" account)

	2008	2007	2006
	(Amounts in Millions)		
Interest cost	₱92	₱92	₱5
Current service cost	33	29	78
Actuarial loss	59	49	10
Settlement gain	—	(83)	—
Net other post-employment benefit expense	₱184	₱87	₱93

Other Post-employment Benefits Liability (recorded as part of "Other noncurrent liabilities" account)

	2008	2007
	(Amounts in Millions)	
Other post-employment benefit obligation	₱1,115	₱1,321
Unrecognized net actuarial losses	(488)	(811)
Benefit liability at end of year	₱627	₱510

Changes in the present value of the other post-employment benefit liability are as follows:

	2008	2007
	(Amounts in Millions)	
Balance at beginning of year	₱1,321	₱1,305
Interest cost	92	92
Current service cost	33	29
Benefits paid	(67)	(63)
Actuarial losses (gains)	(264)	162
Effect of settlement	—	(204)
Balance at end of year	₱1,115	₱1,321

The principal assumptions used as of January 1, 2008, 2007 and 2006 in determining pension and other post-employment benefits obligations are shown below:

	2008	2007	2006
		(Percentage)	
Discount rate	7.0–10.15	7.0–8.29	11.0–13.4
Expected rate of return on assets	7.0	7.0	6.3
Future range of salary increases	5.0–10.0	5.0–10.0	8.0–12.0

Amounts for 2008, 2007 and 2006 are as follows:

	2008	2007	2006
		(Amounts in Millions)	
Present value of defined benefit obligation	₱22,703	₱24,825	₱27,473
Fair value of plan assets	10,409	11,857	5,964
Excess of present value of defined benefit obligation over fair value of plan assets	12,294	12,968	21,509
Experience adjustments on plan liabilities	165	(748)	233
Experience adjustments on plan assets	(2,531)	5,518	3,176

In addition to its defined benefit retirement plan, MIESCOR also has a defined contribution retirement plan on which it contributes to a Provident Fund annually an amount equal to 6% of the current monthly basic salaries of the covered employees. The Provident Fund is maintained primarily for the purpose of establishing periodically the amounts of the benefits pertaining to the covered employees. 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. Pension expense under this plan amounted to ₱2 million in 2008, 2007 and 2006.

30. Financial Risk Management Objectives and Policies

The Company's principal financial instruments, other than derivatives, are composed of bank loans and cash and cash equivalents. The main purpose of these financial instruments is to finance the Company's operations. The Company has various other financial assets and liabilities such as trade receivables, trade payables and other liabilities, which arise directly from its operations.

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 BOD reviews and approves policies for managing each of these risks which 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 30 days or less to coincide with the Company's monthly payment obligations.

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, 2008 and 2007, approximately 72% and 50% of the Company's borrowings are at a fixed rate of interest, respectively.

Rockwell's policy is to source loans with fixed interest rates whenever available.

The following table sets out the maturity profile of the Parent Company, Rockwell and MIESCOR's bank loans and the amounts that are exposed to interest rate risk (exclusive of debt issuance costs):

	Within 1 Year	1–2 Years	2–3 Years	3–4 Years	4–5 Years	More than 5 Years	Total
(Amounts in Millions)							
2008 Fixed Rate							
Parent Company	₱10,286	₱516	₱480	₱480	₱3,714	₱–	₱15,476
Rockwell	140	280	280	1,300	–	–	2,000
2008 Floating Rate							
Parent Company	521	499	480	480	3,600	–	5,580
Rockwell	489	–	–	–	–	–	489

Notes to Consolidated Financial Statements

	Within 1 Year	1–2 Years	2–3 Years	3–4 Years	4–5 Years	More than 5 Years	Total
<i>(Amounts in Millions)</i>							
2007 Fixed Rate							
Parent Company	11,014	513	513	480	480	3,741	16,741
Rockwell	–	70	140	790	–	–	1,000
MIESCOR	248	–	–	–	–	–	248
2007 Floating Rate							
Parent Company	535	515	496	480	480	3,600	6,106
Rockwell	608	149	–	–	–	–	757

Interest on bank loans classified as floating rate is repriced at intervals of less than one year. Interest on bank loans classified as fixed rate is fixed until the maturity of the instrument. The other financial liabilities of the Company that are not included in the above table are noninterest-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.

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's December 31, 2008 profit before tax (through the impact on floating rate borrowings). There is no other impact on the Parent Company and Rockwell's equity other than those already affecting the profit and loss.

	Increase (Decrease) in Basis Points	Effect on Profit Before Tax
<u>Parent Company</u>		
Floating rate loans from various banks	+100	(P56 million)
	-100	56 million
<u>Rockwell</u>		
Floating rate loans from various banks	+100	(P2 million)
	-100	2 million

Interest expense on floating rate borrowings 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

a. Parent Company

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.

Presented below are the Parent Company's foreign currency-denominated financial assets and liabilities as of December 31, 2008 and 2007, translated in Philippine peso at the following exchange rates:

	2008	2007
US Dollar (\$)	P47.5200	P41.2800
Japanese Yen (¥)	0.5221	0.3642
Euro (€)	66.2463	60.5572
Swiss Francs (CHF)	43.6644	36.3326

December 31, 2008					
	Foreign Currency				Peso Equivalent
	US Dollar	Japanese Yen	Euro	Swiss Franc	
(Amounts in Millions)					
Financial assets:					
Cash and cash equivalents	\$6	¥—	€—	CHF—	₱285
Trade receivables	1	—	—	—	24
Advance payments to suppliers	—	15	—	—	20
	7	15	—	—	329
Financial liabilities:					
Trade and other payables	\$66	¥15	€1	CHF—	₱3,207
Liability arising from deferred pass-through fuel cost	26	—	—	—	1,242
Interest-bearing loans and other borrowings	—	—	1	1	131
	92	15	2	1	4,580
	(\$85)	¥—	(€2)	(CHF1)	(₱4,251)
December 31, 2007					
	Foreign Currency				Peso Equivalent
	US Dollar	Japanese Yen	Euro	Swiss Franc	
(Amounts in Millions)					
Financial assets:					
Cash and cash equivalents	\$53	¥—	€—	CHF—	₱2,183
Trade receivables	1	—	—	—	25
Advance payments to suppliers	—	6	—	—	31
	54	6	—	—	2,239
Financial liabilities:					
Trade and other payables	111	7	1	—	4,648
Liability arising from deferred pass-through fuel cost	66	—	—	—	2,735
Interest-bearing loans and other borrowings	2	—	1	1	203
	179	7	2	1	7,586
	(\$125)	(¥1)	(€2)	(CHF1)	(₱5,347)

The Parent Company's exposure to foreign currency risk on long-term debt principal payments, but not interest payments, is somewhat mitigated by the CERA. Currently, substantially all of the Parent Company's debt is denominated in peso and the Parent Company suspended collection of the CERA in January 2007. Thus, the impact of a one peso movement of the US\$/PHP exchange rate will not have a significant impact on the Parent Company's principal and interest payments. Further, PBR assumes a forecast level of foreign currency movement 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. Rockwell

As a result of Rockwell's marketing operations in the United States, its balance sheet can be affected significantly by movements in the US\$ exchange rates. Rockwell's foreign-currency denominated assets and liabilities are as follows:

	2008		2007	
	US\$	Peso Equivalent	US\$	Peso Equivalent
<i>(Amounts in Millions)</i>				
Assets:				
Cash and cash equivalents	\$3	₱132	\$2	₱73
Trade and other receivables	1	70	10	417
Liabilities:				
Trade and other payables	4	178	—	1
Interest-bearing loans and borrowings	2	91	6	236
Net foreign currency-denominated assets (liabilities)	(\$2)	(₱67)	\$6	₱253

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It is Rockwell's policy to limit its US\$-denominated receivables just to match the estimated US\$-denominated component of its development costs as well as its US\$-denominated borrowings. Also, Rockwell enters into deliverable currency forward contracts to hedge its foreign currency exposure should there be an excess in US\$-denominated assets over the US\$-denominated liabilities.

The following table demonstrates the sensitivity to a reasonably possible change in the US\$ exchange rate with respect to Peso, with all other variables held constant, of Rockwell's December 31, 2008 profit before tax (due to changes in the fair value of financial assets and liabilities). There is no other impact on Rockwell's equity other than those already affecting the profit and loss.

	Increase (Decrease) in US\$ Rate (in %)	Effect on Profit Before Tax
Foreign currency-denominated financial assets and liabilities	+5%	(P14 million)
	-5%	14 million

Foreign exchange gain (loss) is computed for the year based on management's best estimate of a +/-5 percent change in the closing Peso-US\$ conversion rate using the year end balances of dollar-denominated cash and cash equivalents, accounts receivable, loans, and forward contracts. There has been no change in the methods and assumptions used by the management in the above analysis.

Commodity Price Risk

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

The Company trades only with recognized, creditworthy third parties. The Company only places its excess cash in financial institutions that meet the Company's accreditation standards based on liquidity and solvency ratios and the bank's credit rating. The Company will only transact derivatives with similarly accredited financial institutions. 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.

Trade receivable from sale of condominium units are secured with pre-completed condominium units the legal title and ownership of which will only be transferred to the customers upon full payment of the contract price. Receivables from lease are assured by security deposits, while receivables from sale of club shares are guaranteed by the shares held by the Company. For other receivables, since the Company trades only with recognized third parties, there is no requirement for collateral.

There are no significant concentrations of credit risk within the Company.

With respect to credit risk arising from the other financial assets of the Company, which comprise cash and cash equivalents, trade and other receivables, available-for-sale financial assets and certain derivative instruments, the Company's exposure to credit risk arises from default of the counterparty.

The table below shows the maximum exposure to credit risk for the components of the consolidated balance sheets, 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	
	2008	2007
	(Amounts in Millions)	
Cash and cash equivalents	P5,402	P4,876
Trade and other receivables - current and noncurrent:		
Billed:		
Residential	5,005	7,271
Commercial	6,571	4,565
Industrial	3,224	2,769
Flat streetlights	143	51
Trade receivables of subsidiaries:		
Sale of condominium-gross	757	2,514
Lease	77	61
Sale of club shares	4	4
Others	538	446
Other receivables	1,112	1,049
AFS investments	403	351
Derivative assets	121	300
Refundable deposits (included under "Other current assets" account)	13	11
	P23,370	P24,268

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:

2008						
	Neither Past Due nor Impaired			Past Due but not Impaired	Impaired Financial Assets	Total
	High Grade	Standard Grade	Sub-standard Grade			
(Amounts in Millions)						
Cash and cash equivalents	P4,023	P–	P–	P–	P–	P4,023
Trade receivables -						
Billed:						
Residential	1,290	1,294	1,908	513	774	5,779
Commercial	1,265	1,436	2,118	1,752	608	7,179
Industrial	1,483	597	882	262	267	3,491
Flat streetlights	2	3	4	134	278	421
	4,040	3,330	4,912	2,661	1,927	16,870
Other receivables	829	–	–	283	49	1,161
Derivative assets	121	–	–	–	–	121
AFS investments	28	118	–	–	–	146
	P9,041	P3,448	P4,912	P2,944	P1,976	P22,321

December 31, 2007						
	Neither Past Due nor Impaired			Past Due but not Impaired	Impaired Financial Assets	Total
	High Grade	Standard Grade	Sub-standard Grade			
(Amounts in Millions)						
Cash and cash equivalents	P4,062	P–	P–	P–	P–	P4,062
Trade receivables - Billed:						
Residential	2,730	2,258	369	1,914	317	7,588
Commercial	1,246	987	962	1,370	635	5,200
Industrial	1,231	762	306	470	161	2,930
Flat streetlights	1	6	4	40	9	60
	5,208	4,013	1,641	3,794	1,122	15,778
Other receivables	209	1	–	363	49	622
Derivative assets	256	–	–	–	–	256
AFS investments	28	118	–	–	–	146
	P9,763	P4,132	P1,641	P4,157	P1,171	P20,864

Credit ratings were 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 before due date (1 to 9 days after billed date).

- “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.

Notes to Consolidated Financial Statements

The credit quality of financial assets is managed by Rockwell using internal credit ratings. The table below shows the credit quality by class of asset:

	2008		
	A Rating	B Rating	Total
	(Amounts in Millions)		
Cash and cash equivalents	P456	P—	P456
Trade receivables from:			
Sale of condominium units	252	283	535
Lease	42	29	71
Advances to officers and employees	7	—	7
AFS investments:			
Quoted	240	—	240
Unquoted	3	—	3
	1,000	312	1,312
Less unrecognized portion of trade receivable from sale of condominium units due to percentage of completion and PAS 39	9	10	19
	P991	P302	P1,293
	2007		
	A Rating	B Rating	Total
	(Amounts in Millions)		
Cash and cash equivalents	P112	P—	P112
Trade receivable from:			
Sale of condominium units	1,408	1,653	3,061
Lease	24	29	53
Advances to officers and employees	8	—	8
Other receivables	3	—	3
AFS investments:			
Quoted	241	—	241
Unquoted	3	—	3
Derivative assets	44	—	44
Refundable deposits	2	—	2
	1,845	1,682	3,527
Less unrecognized portion of trade receivable from sale of condominium units due to percentage of completion and PAS 39	295	346	641
	P1,550	P1,336	P2,886

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 lease 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 Parent Company and Rockwell:

	2008						
	Neither Past Due nor Impaired	Past Due But Not Impaired				Impaired Financial Assets	Total
		Less than 30 days	31 to 60 Days	61 to 90 Days	More than 90 Days		
	(Amounts in Millions)						
Cash and cash equivalents	P4,479	P–	P–	P–	P–	P–	P4,479
Trade receivables -							
Billed:							
Residential	4,492	–	344	84	85	774	5,779
Commercial	4,819	–	638	268	846	608	7,179
Industrial	2,962	–	123	35	104	267	3,491
Flat streetlights	9	–	78	44	12	278	421
Trade receivables of subsidiaries:							
Sale of condominium-gross	535	180	3	11	55	–	784
Lease	71	5	1	–	–	–	77
Sale of club shares	–	–	–	–	4	–	4

(Forward)

2008							
	Neither Past Due nor Impaired	Past Due But Not Impaired				Impaired Financial Assets	Total
		Less than 30 days	31 to 60 Days	61 to 90 Days	More than 90 Days		
(Amounts in Millions)							
Other receivables:							
Parent Company	P829	P—	P6	P1	P276	P49	P1,161
Rockwell	7	22	1	2	5	—	37
AFS investments:							
Parent Company	146	—	—	—	—	—	146
Rockwell:							
Quoted	240	—	—	—	—	—	240
Unquoted	3	—	—	—	—	—	3
Derivative assets -							
Parent Company	121	—	—	—	—	—	121
Refundable deposits	—	1	—	—	12	—	13
	18,713	208	1,194	445	1,399	1,976	23,935
Less unrecognized portion due to percentage of completion and effect of discounting	19	6	—	—	2	-	27
	P18,694	P202	P1,194	P445	P1,397	P1,976	P23,908
2007							
	Neither Past Due nor Impaired	Past Due But Not Impaired				Impaired Financial Assets	Total
		Less than 30 days	31 to 60 Days	61 to 90 Days	More than 90 Days		
(Amounts in Millions)							
Cash and cash equivalents	P4,174	P—	P—	P—	P—	P—	P4,174
Trade receivables -							
Billed:							
Residential	5,357	—	357	129	1,428	317	7,588
Commercial	3,195	—	470	231	669	635	5,200
Industrial	2,299	—	154	49	267	161	2,930
Flat streetlights	11	—	4	3	33	9	60
Trade receivables of subsidiaries:							
Sale of condominium-gross	3,061	61	12	8	37	—	3,179
Lease	53	2	1	2	2	—	60
Sale of club shares	—	—	—	—	4	—	4
Other receivables:							
Parent Company	210	—	1	17	345	49	622
Rockwell	11	—	—	—	6	—	17
AFS investments:							
Parent Company	146	—	—	—	—	—	146
Rockwell:							
Quoted	241	—	—	—	—	—	241
Unquoted	3	—	—	—	—	—	3
Derivative assets:							
Parent Company	256	—	—	—	—	—	256
Rockwell	44	—	—	—	—	—	44
Refundable deposits	2	—	—	—	9	—	11
	19,063	63	999	439	2,800	1,171	24,535
Less unrecognized portion due to percentage of completion and effect of discounting	(641)	(13)	(2)	(2)	(8)	—	(666)
	P18,422	P50	P997	P437	P2,792	P1,171	P23,869

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. The Company also maintains accounts with several relationship banks to avoid significant concentration of cash with one institution.

Notes to Consolidated Financial Statements

The following table sets out the maturity profile of the Company's financial liabilities based on contractual undiscounted payments:

	2008				
	Less than 3 Months	3–12 Months	1–5 Years	More than 5 Years	Total
	(Amounts in Millions)				
Notes payable*	P–	P9,976	P–	P–	P9,976
Trade and other payables:					
Parent Company	11,428	668	2,325	–	14,421
Rockwell	196	35	25	–	256
CERA I and II over-recoveries, including carrying charges	87	830	3,008	–	3,925
Derivative financial instruments:					
Parent Company	28	–	–	–	28
Rockwell					
Derivative payments	59	24	114	–	197
Derivative receipts	(54)	(23)	(111)	–	(188)
Interest-bearing loans and borrowings*:					
Floating rate borrowings:					
Parent Company	–	958	6,315	–	7,273
Rockwell	403	93	–	–	496
Fixed rate borrowings:					
Parent Company	–	996	6,448	–	7,444
Rockwell	43	267	2,359	–	2,669
Preferred stock	–	906	1,199	–	2,105
Liability arising from deferred pass-through fuel costs - current and noncurrent*	933	325	–	–	1,258
Meter deposits*	114	343	2,422	–	2,879
Customers' refund	726	7,754	2,905	–	11,385
Security deposits	197	–	–	–	197
Retention payable	12	76	31	–	119
Total undiscounted financial liabilities	P14,172	P23,228	P27,040	P–	P64,440

* Principal plus interest payments

	2007				
	Less than 3 Months	3–12 Months	1–5 Years	More than 5 Years	Total
	(Amounts in Millions)				
Notes payable*	P5,034	P5,834	P–	P–	P10,868
Trade and other payables:					
Parent Company	17,056	–	1,432	–	18,488
Rockwell	455	33	29	–	517
CERA I and II over-recoveries, including carrying charges	–	3,092	–	–	3,092
Derivative financial instruments - Rockwell:					
Derivative payments	45	126	142	–	313
Derivative receipts	(56)	(149)	(159)	–	(364)
Interest-bearing loans and borrowings*:					
Floating rate borrowings:					
Parent Company	–	959	3,394	3,784	8,137
Rockwell	–	608	149	–	757
Fixed rate borrowings:					
Parent Company	–	1,015	3,610	3,805	8,430
Rockwell	–	–	1,000	–	1,000
Preferred stock	–	876	1,813	–	2,689
Liability arising from deferred pass-through fuel costs - current and noncurrent*	486	1,395	1,315	–	3,196
Customers' refund	726	5,054	8,616	–	14,396
Security deposits	82	29	53	–	164
Retention payable	–	1	161	–	162
Total undiscounted financial liabilities	P23,828	P18,873	P21,555	P7,589	P71,845

* Principal plus interest payments

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 P1,160 million, will be refunded in 2009. This is shown as part of "Trade and other payables" account in the 2008 consolidated balance sheet.

Capital Management

The primary objective of the Parent 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 ensure 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 Parent Company manages its level of long-term debt versus equity ratio, as well as its gearing, based on levels with comparable electric utilities.

The Parent Company monitors capital using a gearing ratio, which is net debt divided by total capital plus net debt. The Parent Company includes within net debt the interest-bearing loans and borrowings, preferred shares less cash and cash equivalents.

	2008	2007
	<i>(Amounts In Millions, except Gearing Ratio)</i>	
Interest-bearing loans and borrowings	₱11,219	₱12,264
Notes payable	9,770	10,500
Preferred shares	1,798	2,278
Cash and cash equivalents	(4,023)	(4,062)
Net debt (a)	18,764	20,980
Capital	49,894	48,803
Capital and net debt (b)	₱68,658	₱69,783
Gearing ratio (a/b)	27%	30%

Rockwell monitors its capital adequacy using the debt-to-equity ratio, which is interest-bearing loans and borrowings divided by equity. Rockwell's policy is to limit the debt-to-equity ratio to 0.40x.

As of December 31, 2008 and 2007, Rockwell is required to maintain certain financial ratios as set forth in the Fixed Rate Corporate Notes Facility Agreement, including debt-to-equity ratio (see Note 20). The Agreement provides for a higher ratio than the internal limit set by Rockwell's management.

	2008	2007
Interest-bearing loans and borrowings	₱2,476	₱1,749
Equity	6,984	6,630
Debt-to-equity ratio	0.35	0.26

31. Financial Instruments

Fair Values

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the consolidated financial statements.

	Carrying Amount		Fair Value	
	2008	2007	2008	2007
	<i>(Amounts in Millions)</i>			
Financial Assets				
Cash and cash equivalents	₱5,402	₱4,876	₱5,402	₱4,876
Trade and other receivables - current and noncurrent - Billed:				
Residential	5,005	7,271	5,005	7,271
Commercial	6,571	4,565	6,571	4,565
Industrial	3,224	2,769	3,224	2,769
Flat streetlights	143	51	143	51
Trade receivables of subsidiaries:				
Sale of condominium - gross	757	2,514	894	2,659
Lease	77	61	77	61
Sale of club shares	4	4	4	4
Other receivables:				
Parent Company	1,106	1,049	1,106	1,049
Rockwell	37	17	37	17
Others	507	429	507	429
AFS investments	403	351	403	351
Derivative assets - current and noncurrent	121	300	121	300
Refundable deposits (included under "Other current assets" account)	13	11	13	11
	₱23,370	₱24,268	₱23,507	₱24,413

Notes to Consolidated Financial Statements

	Carrying Amount		Fair Value	
	2008	2007	2008	2007
	(Amounts in Millions)			
Financial Liabilities				
Notes payable	₱9,828	₱10,748	₱9,828	₱10,748
Trade and other payables	14,645	18,960	14,645	18,960
CERA I and II over-recoveries, including carrying charges - current and noncurrent	3,925	3,092	3,925	3,092
Derivative liabilities - current and noncurrent	49	—	49	—
Interest-bearing loans and other borrowings*:				
Floating rate borrowings	6,054	6,821	6,349	7,351
Fixed rate borrowings	7,641	7,192	7,835	7,217
Preferred stock	1,798	2,278	1,798	2,278
Liability arising from deferred pass-through fuel costs - current and noncurrent	1,242	2,735	1,242	2,735
Bill deposits - current and noncurrent	22,181	20,041	22,181	20,041
Meter deposits - current and noncurrent	2,879	2,874	2,406	2,874
Customers' refund - current and noncurrent	10,605	12,770	10,464	8,716
Deferred lease income - current and noncurrent	68	62	68	62
Security deposits - current and noncurrent	197	164	197	151
Retention payable - current and noncurrent	119	162	98	150
	₱81,231	₱87,899	₱81,085	₱84,375

* Carrying amounts are net of debt issuance costs.

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 and Others, Refundable Deposits, Trade and Other Payables, 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 balance sheet date. The value of "Trade and other payables" includes the value of bifurcated embedded currency forwards.

Trade Receivables of Subsidiaries. The fair values of trade and other receivables were calculated by discounting the expected future cash flows at prevailing credit adjusted PDEX interest rates ranging from 7.1% to 8.7% in 2008 and 6.4% to 8.2% in 2007.

Bifurcated Foreign Currency Forward and Foreign Currency Forward (Rockwell). 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 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 options; contractual future cash flows, exercise price of ₱105, interest rate volatility of 13.02%, interest rate spot curves ranging from 7.72% to 8.82% and forward curves ranging from 7.73% to 8.87%.

AFS Investments. The fair values were determined by reference to market bid quotes as of balance sheet date. The unquoted equity securities were valued at cost.

Interest-bearing Loans and Other Borrowings. 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 1.75% to 8.135% in 2008 and 2.80% to 6.28% in 2007 and PDEX interest rate ranging from 6.5% to 7.7% in 2008 and 4.9% to 8.05% in 2007.

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 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 and 6.19% to 7.86% in 2007.

Preferred Stock. The fair values of preferred stock are not determinable since the timing of each redemption is not reasonably predictable. Preferred stock are 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 6.4% to 7.5% in 2008 and 6.4% to 8.2% in 2007.

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, 2008 and 2007, these agreements represent only around 56% and 40% of the Parent Company's trade payables, respectively. As of December 31, 2008, the US\$ and Euro-denominated agreements amounted to US\$27 million (equivalent to ₱1,274 million) and EUR 8 million (equivalent to ₱519 million), respectively. As of December 31, 2007, the US\$ and Euro-denominated agreements amounted to US\$37 million (equivalent to ₱1,534 million) and EUR 5 million (equivalent to ₱305 million), respectively. These are part of "Trade and other payables" account in the consolidated balance sheets. Net fair value (loss) gain of these derivatives are (₱9 million) and ₱83 million as of December 31, 2008 and 2007, respectively.

Embedded Call Option. As discussed in Note 20, the Parent Company has an embedded call option (prepayment option) in its ₱6,000 million 9% Tranche A Fixed rate and ₱6,000 million Tranche B Floating rate corporate notes 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 ₱167 million. As of December 31, 2008 and 2007, net fair value gain of this derivative is ₱102 million and ₱173 million, respectively.

The net movements in fair value changes of the Parent Company's derivative instruments as of December 31, 2008 and 2007 are as follows:

	2008	2007
	(Amounts in Millions)	
Balance at beginning of year	₱256	₱190
Net changes in fair value of derivatives not designated as accounting hedges	(123)	143
Fair value of settled instruments	(40)	(77)
Balance at end of year	₱93	₱256

Currency Forward (Rockwell). Rockwell enters into deliverable currency forward contracts to hedge its foreign currency exposure arising from its US\$-denominated receivables. As of December 31, 2008 and 2007, Rockwell has outstanding currency forward contracts to sell US\$ with an aggregate notional amount of US\$4.2 million and US\$7.6 million, respectively, and weighted average contracted forward rate of ₱45.30 to US\$1.00 and ₱47.96 to US\$1.00, respectively. Outstanding derivatives will mature in the years 2009 until 2010. The net fair value loss on the outstanding currency forward contracts as of December 31, 2008 amounted to ₱44 million and the net fair value gain on the outstanding currency forward contracts as of December 31, 2007 amounted to ₱44 million.

The net movements in fair value changes of Rockwell's derivative instruments as of December 31, 2008 and 2007 are as follows:

	2008	2007
	(Amounts in Millions)	
Balance at beginning of year	₱44	₱15
Net changes in fair value of derivatives not designated as accounting hedges	(44)	44
Fair value of settled instruments	(21)	(15)
Balance at end of year	(₱21)	₱44

The fair value change of the Company's derivative instruments as of December 31, 2008 and 2007 are presented as follows:

	2008	2007
	(Amounts in Millions)	
Derivative assets:		
Current portion (see Note 17)	₱19	₱117
Noncurrent portion (see Note 13)	102	183
Derivative liabilities:		
Current portion (see Note 25)	(35)	—
Noncurrent portion (included as part of "Other noncurrent liabilities" account)	(14)	—
	₱72	₱300

Notes to Consolidated Financial Statements

32. Categories of Financial Instruments

The following tables set forth the categories of financial instruments of the Company as of December 31, 2008 and 2007:

	2008						
	Loans and Receivables	Held to Maturity	Held for Trading	Assets Designated at FVPL	Derivatives	Available for Sale	Total
	(Amounts in Millions)						
ASSETS							
Other noncurrent assets (see Note 13)	P115	P—	P—	P—	P102	P403	P620
Cash and cash equivalents (see Note 14)	5,402	—	—	—	—	—	5,402
Trade and other receivables - net (see Note 15)	17,316	—	—	—	—	—	17,316
Other current assets (see Note 17)	13	—	—	—	19	—	32
	P22,846	P—	P—	P—	P121	P403	P23,370

	2007						
	Loans and Receivables	Held to Maturity	Held for Trading	Assets Designated at FVPL	Derivatives	Available for Sale	Total
	(Amounts in Millions)						
ASSETS							
Other noncurrent assets (see Note 13)	P49	P—	P—	P—	P183	P351	P583
Cash and cash equivalents (see Note 14)	4,876	—	—	—	—	—	4,876
Trade and other receivables - net (see Note 15)	18,681	—	—	—	—	—	18,681
Other current assets (see Note 17)	11	—	—	—	117	—	128
	P23,617	P—	P—	P—	P300	P351	P24,268

	2008				2007		
	Liabilities at FVPL	Derivatives	Other Liabilities	Total	Liabilities at FVPL	Other Liabilities	Total
	(Amounts in Millions)						
LIABILITIES							
Interest-bearing loans and borrowings (see Note 20)	P—	P—	P 15,493	P15,493	P—	P16,291	P16,291
CERA I and II over-recoveries, including carrying charges (Note 25)	—	—	3,925	3,925	—	3,092	3,092
Bill deposits (Note 21)	—	—	22,181	22,181	—	20,041	20,041
Meter deposits (Note 21)	—	—	2,879	2,879	—	2,874	2,874
Customers' refund (Note 23)	—	—	10,605	10,605	—	12,770	12,770
Liability arising from deferred pass-through fuel costs (see Note 25)	—	—	1,242	1,242	—	2,735	2,735
Other noncurrent liabilities	—	—	171	171	—	239	239
Notes payable (Note 24)	—	—	9,828	9,828	—	10,748	10,748
Trade and other payables (Note 25)	—	—	14,858	14,858	—	19,109	19,109
Derivative liabilities (Note 25)	—	49	—	49	—	—	—
	P—	P49	P81,182	P81,231	P—	P87,899	P87,899

33. Income and Franchise Taxes

a. Income Tax

The major components of provision for (benefit from) income tax for the years ended December 31 are as follows:

	2008	2007	2006
	(Amounts in Millions)		
Current income tax -			
Current income tax charge	P5,122	P2,729	P3,649
Deferred income tax -			
Relating to origination and reversal of temporary differences	(3,055)	(672)	4,396
Income tax expense reported in the consolidated statements of income	P2,067	P2,057	P8,045

Certain income and expenses are not taxable or deductible for purposes of computing income tax. As a result, the Company reported a taxable income of P14,634, P7,797 million and P10,426 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Deferred Income Tax

Deferred income tax as of December 31 relates to the following:

	2008	2007
	<i>(Amounts in Millions)</i>	
Deferred tax liabilities:		
Appraisal increase in utility plant and others (see Note 18)	₱8,432	₱8,628
Depreciation method differential	2,812	2,873
Capitalized interest	843	875
Capitalized duties and taxes deducted in advance	741	779
Present value of customers' refund	234	530
Net book value of capitalized/realized foreign exchange losses	133	161
Excess of effective interest rate amortization over straight-line amortization of debt issue costs	6	1
Others	140	242
	13,341	14,089
Deferred tax assets:		
Unfunded pension cost and unamortized past service cost	4,039	4,025
Provision for probable losses from refund (see Note 22)	1,229	—
Unrealized foreign exchange loss due to change in base rate	795	795
Allowance for nonrecovery of receivables	758	—
Allowance for doubtful accounts	602	415
Provisions (see Note 22)	494	419
Decrement of fixed assets	348	348
Employee share-based payment plan	81	36
Allowance for inventory obsolescence	26	54
Others	161	134
	8,533	6,226
	₱4,808	₱7,863

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

A reconciliation between the provision for (benefit from) income tax computed at statutory income tax rate using tax rates of 35% in 2008, 2007 and 2006, and 32% for period starting from January 1 to October 31 and 35% for period starting from November 1 to December 31 in 2005, and provision for (benefit from) income tax as shown in the consolidated statements of income is as follows:

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
Income tax computed at statutory tax rate	₱1,820	₱2,133	₱7,674
Income tax effects of:			
Interest income subjected to a lower final tax rate	(105)	(113)	(207)
Nondeductible interest expense	77	60	228
Equity in net earnings of associates and joint venture	(70)	(113)	(102)
Nondeductible expenses	65	92	226
Nontaxable income	(4)	(273)	—
Others	284	271	226
	₱2,067	₱2,057	₱8,045

NOLCO applied as deduction from normal taxable income amounted to ₱5 million and ₱8 million in 2007 and 2006, respectively. Expired MCIT amounting to ₱2 million was written off in 2008.

The following are MIESCOR's temporary differences for which deferred tax assets have not been recognized since management believes that it is not probable that taxable income will be available against which the deductible temporary differences and carryforward benefit of MCIT can be utilized:

	2008	2007
Allowance for doubtful accounts	₱41	₱37
Unfunded pension cost and unamortized past service cost	17	17
MCIT	6	6
Unrealized foreign exchange loss	1	1
	₱65	₱61

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As of December 31, 2008, MIESCOR has MCIT that can be claimed as deductions from future taxable income and as deductions from tax due, respectively, as follows:

Year Incurred	Expiry Date	MCIT
<i>(Amounts in Millions)</i>		
2006	2009	₱2
2007	2010	2
2008	2011	2
		₱6

On May 24, 2005, the President signed into law RA No. 9337 amending certain provisions of the NIRC of 1997, as amended, which took effect on July 1, 2005, introducing the following changes:

- i. Regular Corporate Income Tax (RCIT) rate for domestic corporations and resident and non-resident foreign corporations is increased to 35% (from 32%) beginning November 1, 2005 and the rate will be reduced to 30% beginning January 1, 2009. RCIT rate shall be applied on the amount computed by multiplying the number of months covered by the new rate within the fiscal year by the taxable income of the corporation for the period, divided by 12 months.
- ii. Power of the President upon the recommendation of the Secretary of Finance to increase the rate of value added tax (VAT) to 12% (from 10%), after any of the following conditions has been satisfied:
 - VAT collection as a percentage of gross domestic product (GDP) of the previous year exceeds two and four-fifth percent (2⁴/₅%); or
 - National government deficit as a percentage of GDP of the previous year exceeds one and one-half percent (1¹/₂%).

On January 31, 2006, a Revenue Memorandum Circular No. 7-2006 was issued approving the recommendation of the Secretary of Finance to increase VAT to 12% (from 10%) effective February 1, 2006.

- iii. Input VAT on capital goods should be spread evenly over the useful life or 60 months, whichever is shorter, if the acquisition cost, excluding the VAT component thereof, exceeds ₱1.0 million.
- iv. Input VAT credit shall not exceed output VAT, otherwise, VAT liability before withholding VAT credits shall be computed equivalent to 30% of output VAT.

On November 21, 2006, RA No. 9361 was approved removing the 70% cap on input taxes. This means that VAT-registered taxpayers are allowed to carry-over the excess input taxes to the succeeding quarter or quarters. This new ruling took effect on December 13, 2006.

b. Franchise Tax

Based on the March 20, 2003 Decision on ERC Case Nos. 2001-646 and 2001-900 on the Parent Company's consolidated petitions, franchise tax should be 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.

In an Order dated March 8, 2004, the ERC directed the Parent Company to modify the franchise tax component of its billings to customers to comply with Rule 7 of the IRR of RA No. 9136. The said IRR provides that a distribution utility shall pay franchise taxes 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.

In accordance with RA No. 9337, the Parent Company no longer collected the national franchise tax of 2% on electricity consumptions starting November 1, 2005. The same law prescribes the collection of VAT on electricity generation, transmission, distribution, and supply. Implementation of the VAT on customers' bills is in accordance with ERC Resolution No. 20, Series of 2005 which prescribes the Guidelines Implementing the Recovery of Value Added Tax (VAT) and Other Provisions of RA No. 9337 Affecting the Electric Power Industry.

34. Contingencies

a. Contingent Assets

(1) Advances in Pass-Through Costs

As of December 31, 2008, the Parent Company has contingent assets related to pass-through costs amounting to ₱9,354 million consisting of under-recoveries for Lifeline and Inter-class Subsidy of ₱1,918 million, Transmission Charge of ₱6,631 million, and for System Loss Charges of ₱805 million. These under-recoveries accumulated in the absence of an adjustment mechanism for these charges when the unbundled rates were implemented.

For lifeline subsidy, the Parent Company has a pending application with the ERC filed on February 19, 2008, to recover ₱864 million for the under-recoveries incurred by the Parent Company in the implementation of the lifeline subsidy system, along with a corresponding carrying cost. Hearings on this application have been completed and the Parent Company is awaiting the decision of the ERC.

For inter-class subsidy, the Parent Company has a pending application before the ERC filed on November 14, 2007, to recover ₱1,054 million in under-recoveries incurred in implementing the inter-class subsidy system, along with a corresponding carrying cost. Similarly, hearings on this application have been completed and the Parent Company is awaiting the decision of the ERC.

In the case of transmission charge, the Parent Company has a pending application before the ERC filed on September 26, 2007, to recover ₱5,554 million in transmission charge under-recoveries accumulated over the period June 2003 to July 2007, along with a corresponding carrying cost. The evidentiary hearings on the said case are already completed and the case is already submitted for decision by the ERC. An October 1, 2004 ERC Order, which revised the computation of the Transmission Charge component of the minimum charge, resulted to a liability to customers estimated at ₱1,085 million, of which ₱951 million had been refunded to customers as of December 31, 2008. Since the amount being refunded forms part of the total transmission cost recoverable from customers, the estimated amount of the refund has been incorporated in the application for collection of transmission charge under-recoveries. As of December 31, 2008, the Parent Company has accumulated gross transmission charge under-recoveries of ₱6,631 million.

For system loss charges, the ERC also approved on November 23, 2005, the Guidelines for the Calculation of the Over or Under Recovery in the Implementation of the System Loss Rate by Distribution Utilities. Following this guideline, the Parent Company implemented the recovery of ₱284 million in unbilled system loss charges starting with the February 2006 billing month. The recovery is being implemented over a period of 17 months or until such time that the amount has been collected. However, in ERC's Decision dated June 4, 2008 on the ten consolidated generation cost under-recovery cases, the Parent Company was directed 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 [see Note 21(a)].

(2) Overpayment in Income Taxes

The Parent Company also has a contingent asset for overpaid income taxes for the years 1994 to 1998 and 2000 to 2001 estimated at ₱7,107 million as a result of SC's Decision ordering the Parent Company to refund ₱0.167 per kWh to affected customers in April 2003. The Parent Company has filed its claim for the recovery of the excess income taxes for the said taxable years. The BIR has issued the letters of authority for the examination of the Parent Company's books during the said period, including submission of the documents. The BIR audit established that the refundable amount is ₱6,690 million but denied the same on ground of prescription of claim, except the claim amount of ₱894 million for the year 2001 which was recognized by the BIR as having been filed on time. The BIR is refunding this amount to the Parent Company through issuance of Tax Credit Certificate (TCC) proportionate to its actual refund to utility customers. Unissued TCCs as of December 31, 2008 and 2007 amounted to ₱577 million (see Note 13).

To avoid the setting in of prescription to file claim in the Court of Tax Appeals (CTA), the Parent Company filed a Petition in the CTA assailing the denial by the BIR of its tax refund claim in the same amount of ₱7,107 million. The Parent Company amended the petition to reflect the refundable amount audited by BIR of ₱6,690 million less the ₱894 million granted by the BIR for the year 2001. The Solicitor General filed the answer for the BIR. The Petition is now on trial stage in which the Parent Company is presenting evidence in support of its claim for tax refund.

On February 3, 2006, the Parent Company 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, are deductible from gross income as ordinary and necessary business expenses under Section 34(A) (1) of the National Internal Revenue Code (NIRC) of 1997. In the event that the ruling is favorable to the Parent Company, it will perforce withdraw the petition filed with the CTA corresponding to the amounts that will be allowed as business expense deduction.

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Likewise, the Parent Company has another contingent asset for overpaid income taxes for the years 1987 and 1988 amounting to ₱107 million. The Parent Company's claim was granted by the CTA in its decision dated August 23, 1995 and the same was affirmed by the Second Division of the SC on October 10, 2007. The Commissioner of Internal Revenue filed a Motion for Reconsideration on November 9, 2007 but was denied by the SC with finality on February 4, 2008.

b. Contingent Liabilities

(1) Real Property Tax Assessments

The Parent Company is being assessed by six (6) local governments units (LGUs) for real property taxes on certain properties of the Parent Company such as its electric poles, wires, insulators, and transformers.

Of the 6 LGUs, only one has secured a favorable decision from the CA, in which the appellate court directed the LGU concerned to make a new assessment of the subject properties and collect the tax liabilities in accordance with the Local Government Code of 1991. In other words, no specific amount of real property tax liability of the Parent Company has been determined by the court. This decision is not yet final as it is the subject of pending petition for review with the SC. The other cases are still pending before the court, Administrative bodies, or government offices concerned. An adverse decision on any of these cases may result to tax assessments by all LGUs within the franchise areas of the Parent Company. To date, there are 114 cities and municipalities under the Parent Company's franchise.

To address the possible liabilities for realty taxes, the Parent Company filed on December 23, 2004 an application with the ERC for a mechanism to recover all types of tax assessments by LGUs, excluding the local franchise tax. The first and only hearing on the application was conducted on May 23, 2005. This application was, however, overtaken by the issuance by the ERC of the Final Determination of the Parent Company's application for the approval of the annual revenue requirements under ERC Case No. 2006-045, where the ERC has removed, as part of the forecast operating and maintenance expenditures, the provision for real property taxes currently being challenged in court by the Parent Company, considering that "uncertainty exists around whether expenditure will occur at all." According to the ERC, "Article XI of the Rules for the setting of the Distribution Wheeling Rates allows for a tax event pass-through. However, in terms of the definition of Relevant Tax Events covered under this Article, most of the expenses covered under license fees, levies, duties and other taxes would not qualify. The ERC recognizes that uncertainty exists with regard to the current taxes discussed above, and that new taxes or levies could potentially arise that are not currently foreseen. It is therefore prepared to consider amending Article XI, after following due process, if material unforeseen expenses in this regard arise – including those currently recommended for exclusion."

On December 8, 2008, the ERC promulgated Resolution No. 20, Series of 2008, entitled "Resolution Modifying the Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Entering Performance Based Regulation (RDWR)." In the modified RDWR, the ERC has re-defined the term "Relevant Tax" to include any tax levied or imposed by the National Government or a Local Government, or any agency, department or instrumentality or other authority of the National Government or a Local Government, except those specified therein. Thus, real property taxes are now included in the definition of "Relevant Tax." Pursuant to the modified RDWR, a change in a Relevant Tax or the way in which a Relevant Tax is calculated, or 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 but for that event in the distribution of electricity, where the change in the relevant costs exceeds 1% of the total forecast operating and maintenance expenditure of the Regulated Entity, shall qualify as a Tax Change Event, which allows the pass-through of the Relevant Tax incurred by the Regulated Entity.

Management believes that any impact of an adverse decision from these cases will be mitigated by the filing of the Parent Company of the appropriate application with the ERC, for the recovery of these costs under the recovery mechanisms approved by the ERC.

(2) Local Franchise Tax Assessment

The Parent Company was assessed by certain local governments for local franchise tax during the period. In the opinion of management and its legal counsel, the Parent Company has strong legal grounds to contest the assessments.

In 2007, a local franchise case between the Parent Company and an LGU was resolved in favor of the Parent Company (see Note 22).

(3) Income Tax Assessment

When the SC's Decision ordering the Parent Company to refund ₱0.167 per kWh to affected customers became final in April 2003, it resulted to overpayment of income taxes estimated at that time at ₱8,900 million. The Parent Company exercised its option to amend its income tax return for the year 1999, which

was then pending for audit by the BIR, to reflect an overpayment of income tax for that year in the sum of ₱977 million. The ₱977 million was carried over and credited to income tax liabilities in 2002, since the books of accounts of the Parent Company for the years 2000 and 2001 have already been audited by the BIR and their corresponding returns cannot be amended.

On March 16, 2007, the Parent Company received from the BIR-Large Taxpayers Division a Preliminary Assessment Notice dated January 2, 2007 disallowing the carryover and crediting of overpaid income tax of ₱977 million for the year 1999 to the year 2002. The BIR's preliminary notice of assessment shows the amount of ₱2,208 million including surcharge and interests.

BIR has explained that it is disallowing the carry-over on the ground that the crediting of the 1999 overpayment of income tax was done beyond the two-year prescriptive period to ask for tax refund and that such carryover of tax credit can only be applied in the immediately succeeding year.

The Parent Company protested this assessment and is currently pending before the Office of the Commissioner of Internal Revenue. It strongly believes that it had acted properly when it credited the ₱977 million overpayment of income tax in 1999 to its tax liabilities for 2002. The two-year prescriptive period cited by the BIR applies only in tax refund claim and not in the amendment of income tax returns. As regards the contention that the carryover of tax credit can be applied only in the immediately succeeding year, the Parent Company believes that this may be true under the 1977 National Internal Revenue Code (NIRC). However, this has been superseded by Section 76 of the 1997 NIRC which states that, *"if the corporation is entitled to a tax credit or refund of the excess estimated quarterly income taxes paid, the excess amount shown in its final adjustment return may be carried over and credited against the estimated quarterly income tax liabilities for the taxable quarters of the succeeding taxable years."* Furthermore, the Parent Company argued that to prevent it from carrying over the amount of its overpaid income tax in 1999 directly to 2002 would be tantamount to unjust enrichment on the part of the government.

On March 5, 2008, the Parent Company availed of the tax amnesty program of the BIR implementing provisions of RA No. 9480. Subsequently, the Parent Company intends to seek relief invoking Section 6 (a) of the said Act which states that, *"The taxpayer shall be immune from the payment of taxes, as well as additions thereto, and the opportune civil, criminal or administrative penalties under the National Internal Revenue Code of 1977, as amended, arising from the failure to pay any and all internal revenue taxes for the taxable year 2005 and prior years."*

(4) NPC Settlement Agreement

On November 21, 1994, the Parent Company entered into a 10-year Contract for the Sale of Electricity (CSE) with the government-owned firm, NPC, commencing on January 1, 1995. One of the provisions of RA No. 9136 is for NPC to submit to the ERC for approval Transition Supply Contracts (TSC) with distribution utilities before year-end 2001. The Parent Company, in a September 8, 2001 letter, signified its intention to enter into a TSC with NPC. NPC did not respond to the letter. Instead, it assessed the Parent Company starting January 2002 with a monthly billing adjustment based on the contracted volumes under the CSE which should have been already superseded by the TSC. The Parent Company in a letter dated February 20, 2002 cited its reasons for its refusal to pay the billing adjustment and also served notice that it is exercising its right to terminate as provided in the CSE.

The disputed amount pertains to the difference between the cost of the contracted capacity and energy and the cost of the actual capacity and energy off-take from NPC. In October 2004, such disputed amount was allegedly estimated by NPC to accumulate to ₱42,000 million for the last three years of the CSE's term (January 2002 to December 2004). In the Settlement Agreement described below, in the event the Parent Company will be obliged to pay these amounts, these charges shall form part of the Parent Company's purchased power cost. The Parent Company did not pay the disputed amounts as the grounds for which the billing adjustments may be imposed did not arise, among other reasons. The Parent Company did not accrue for these disputed bills nor did it set up a corresponding receivable from its customers.

Meanwhile, on March 24, 2003, the Parent Company served a written demand to NPC for payment of claims amounting to ₱9,787 million for the following: NPC's failure to provide timely transmission service to the Parent Company's IPPs, recovery of the 50% penalty for excess imbalance charges, imbalance charge adjustments, back-up energy rates, no-credit over-deliveries, NPC's failure to turn over directly-connected customers to the Parent Company, and delay in the commissioning of QPPL's power plant.

Following a mediation process undertaken between March to June 2003, the Parent Company signed a Settlement Agreement with NPC on July 15, 2003. Under the Settlement Agreement, the Parent Company shall pay NPC ₱27,515 million, representing the value of the difference between the aggregate contracted energy for the years 2002 to 2004 and the total energy the Parent Company 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. This amount is subject to adjustment from the date of signing based on the energy that the Parent Company will purchase from NPC for the rest of 2003 and 2004. On the other hand, NPC shall credit the Parent Company for transmission delays as well as for energy corresponding to NPC's

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sales to directly-connected customers located in the Parent Company's existing franchise areas, totaling ₱7,465 million. The net payable of the Parent Company to NPC amounted to ₱20,050 million which the Parent Company expects to pass on to its customers (being generation costs) and settle with NPC based on the agreed terms of payment.

The Settlement Agreement shall take effect upon approval by the ERC for which both parties shall file a petition with the ERC. On November 24, 2003, the Parent Company and NPC filed with the ERC their respective applications for the approval of the Settlement Agreement. The following day, the Parent Company filed a motion for the consolidation of both cases.

On March 1, 2004, the Parent Company, TransCo and NPC entered into an Amendatory Dispatch Agreement whereby NPC warrants to reduce and/or accept a reduction of the nominated schedule of its IPPs to accommodate the Parent Company's own nominated schedule of its IPPs, thereby ensuring the dispatch of the Parent Company's IPPs to their respective MEQ levels up to midnight of December 31, 2004.

Through Motions filed on March 18 and 22, 2004 and granted by the ERC, the Parent Company and NPC, respectively, withdrew their separate applications for approval of the Settlement Agreement and re-filed it, along with the Amendatory Dispatch Agreement, through a joint petition on April 15, 2004.

In a joint compliance to the ERC dated January 20, 2006, the Parent Company and the NPC showed that since the Parent Company's actual off-take from NPC from the date of the signing and for the rest of 2003 and 2004 had been higher than the baseline quantities indicated in the Settlement Agreement, the net settlement amount payable to NPC and for collection from customers once approved by the ERC has been reduced from ₱20,050 million to ₱14,320 million. Since this amount forms part of the Parent Company's generation costs, it will be recognized as liability by the Parent Company only if the ERC or the Court, as the case may be, finally approves the Settlement Agreement and allows the pass-through of said amount to the customers.

As of July 10, 2006, hearings on the joint application have already been completed and the case is still pending resolution by the ERC.

On April 17, 2008, NASECORE wrote the Office of the Solicitor General(OSG) asking them to intervene in the case. In reaction thereto, on 8 May 2008, 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.

The Parent Company filed a Manifestation and Motion to Suspend Proceedings dated June 3, 2008 and Comment *Ad Cautelam* dated June 12, 2008 in reply thereto. In said Manifestation and Motion to Suspend Proceedings, the Parent Company informed the ERC of the need to suspend this case in order to allow the Parent Company to obtain a ruling from the regular court on the civil and corporate law issues, before the ERC resolves the joint application on the merits. These issues are:

- i. "Whether or not the Settlement Agreement, being a compromise of reciprocal claims between Meralco and NPC, should have been submitted to the OSG for approval;
- ii. Whether or not the NPC Board had authority to compromise the NPC claim mentioned in the Settlement Agreement between NPC and Meralco; and
- iii. Whether or not the Settlement Agreement between NPC and Meralco is grossly prejudicial to the government."

On December 9, 2008, the OSG filed a Motion to Resolve asking the ERC to finally resolve its motion for leave to intervene and to admit its opposition to the main case. The Parent Company, through external counsel, filed an opposition to the same, pointing out that before the OSG's motion can be resolved, the ERC must first resolve its motion to suspend proceedings because of the prejudicial issues raised. The Parent Company is awaiting the resolution of the ERC of these motions.

In the event the Settlement Agreement is disapproved, both Parties shall revert to their respective positions before the mediation. If this happens, the remedy available to both parties, pursuant to the 10-year contract, is arbitration. In such a case, the Parent Company will continue to dispute any liability to NPC arising from the CSE, including the amount subject of the Settlement Agreement. On the other hand, in the event the Settlement Agreement is approved, the Parent Company will recognize the liability to NPC with corresponding receivable from customers.

(5) Other Claims

The Parent Company is likewise contingently liable for lawsuits or claims filed by third parties, including labor related cases, which are pending decision by the courts, the outcome of which are not presently determinable. In the opinion of management and its legal counsel, the eventual total liability from these lawsuits or claims, if any, will not have a material effect on the consolidated financial statements.

Related provisions amounted to ₱318 million, ₱400 million and ₱452 million in 2008, 2007 and 2006, respectively, while reversal of provisions amounted to ₱728 million in 2007.

- c. MIESCOR and Rockwell have contingent liabilities with respect to claims, lawsuits and taxes which are either pending decision by the courts or under negotiation, the outcome of which are not presently determinable. Management, after consultations with outside counsels, believes that the probable resolution of these issues will not materially affect the Company's financial position and results of operations.

35. Significant Contracts and Commitments

Significant contracts and commitments include:

a. NPC

On November 16, 2006, NPC and the Parent Company signed a Transition Supply Contract (TSC) which shall expire at the end of five (5) years from effectivity date or, if open access is introduced within this 5-year period, at the end of one (1) year from the introduction of open access. The schedule of Contracted Energy in gigawatthours is 6,646 in 2007, 6,604 in 2008, 6,646 in 2009, 6,646 in 2010, and 6,646 in 2011 with the contract energy charge computed based on NPC's time-of-use (TOU) generation rate as approved by the ERC, plus adjustment in the NPC's tariff such as, but not limited to, DAA and the ICERA, the RA No. 9136 Mandatory Rate Reduction Adjustment, and an adjustment to reflect the incremental increase or decrease in the actual transmission line cost (charged in the WESM line rental cost) from the transmission line cost embedded in the ERC-approved TOU rate. Pursuant to the TSC, the Parent Company shall submit to NPC its month-ahead nomination of 720 hourly energy quantities in kilowatt hours but the commitment to buy shall be based on day-ahead nomination of 24-hourly energy quantities in kilowatt hours.

Among the salient features of the TSC are the following: (1) NPC will not impose any form of security deposit upon the Parent Company; (2) the Parent Company can increase its monthly contracted energy if the increase is due to the non-availment by the Parent Company's customers of the ODPS and/or Customer Choice Program (CCP); (3) the Parent Company can reduce its monthly contracted energy if this is due to the transfer by the Parent Company's customer 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; (4) NPC may assign or transfer part or all of its rights and obligations to any entity after providing a written notice to the Parent Company at least 30 days prior to such assignment; (5) the Parent Company may assign, sell or transfer a part of or all its Contract Energy after the Parent Company has obtained prior clearance from TransCo and the Parent Company has submitted necessary proof that the buyer, assignee or transferee has no outstanding obligation to NPC; (6) the Parent Company may source power from NPC in excess of the Contract Energy by a quantity equivalent to not more than twenty percent (20%) of the Contract Energy subject to additional premium charge of twenty percent (20%) of TOU rates; and (7) upon request of the Parent Company within twenty four (24) hours from occurrence of shutdown or inability of any or all of the Parent Company's IPPs, NPC shall provide replacement power to the Parent Company priced at true cost of generating such replacement power plus ten percent (10%), in addition to all applicable ERC-approved charges and fees.

The Parent Company's energy off-take in excess of the TSC quantities shall be deemed to be taken from the WESM.

On July 20, 2007, the Parent Company and NPC signed an Addendum to the TSC, which increased the annual and monthly contract energy as specified in Annex 1 of the TSC, to address the load growth requirements of the Parent Company, and at the same time clarified section 5.6 of the TSC to mean the NPC may assign its TSC with the Parent Company or any portion of the contract energy, provided that if the Parent Company is prevented by any law, contract or competent authority to have a contractual relation with an assignee or successor generating company, no assignment of the TSC shall be made to such assignee. Accordingly, the schedule of Contracted Energy in gigawatthours was increased to 7,156 in 2007, 7,624 in 2008, 7,666 in 2009, 7,666 in 2010, and 7,666 in 2011. On October 1, 2007, the Parent Company and NPC filed a Joint Motion for the approval of the Addendum. The joint motion is now submitted for the decision of the ERC.

In a Decision dated November 10, 2008 issued by the ERC, in connection with the Petition filed by the Bureau of Trade Regulation and Consumer Protection- Department of Trade and Industry against the Company (ERC Case No. 2008-016 RC), the ERC directed the Parent Company to negotiate and contract with NPC for an increase in the TSC contracted volume for it to match its updated demand forecast less the quantities under its IPP contracts. NPC and the Parent Company are currently in discussions to address the directive of the ERC.

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Prior to the signing of the TSC, the Parent Company, on August 16, 2006, 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 twelve (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 CCP MOA exist.

The Parent Company also executed an MOA with the NPC on September 17, 2007 for the provision of special ecozone rates to high load factor PEZA-accredited industries. On September 21, 2007, the ERC gave clearance to the Parent Company to immediately proceed with the implementation of said MOA (see Note 35).

In the course of the implementation of the ecozone MOA, the Parent Company and NPC agreed on an additional contract volume of 90 GWh for contract year 2008 and 296 GWh for contract year 2009, to accommodate additional ecozone customer consumption.

Total purchased power from NPC amounted to ₱49,906 million, ₱54,998 million and ₱42,347 million for the years ended December 31, 2008, 2007 and 2006, respectively. Prior to the implementation of NPC's unbundled charges on September 26, 2002, NPC's charges were not segregated between generation and transmission charges.

b. TransCo

Pursuant to Section 8 of RA No. 9136, TransCo was created and assumed the electrical transmission function of NPC.

Total billings from TransCo for the years ended December 31, 2008, 2007 and 2006 amounted to ₱25,009 million, ₱28,449 million and ₱24,881 million, respectively, representing charges for transmission, ancillary, and other services starting September 26, 2002 upon the effectivity of the unbundled rate structure.

Beginning January 15, 2009, the National Grid Corporation of the Philippines (NGCP) assumed TransCo's operations from the government via a concession agreement and a franchise granted by Congress through RA No. 9511.

c. FGPC and FGP Corp.

The Department of Energy (DOE) in December 1994 asked the Parent Company to provide the 1,500 MW market for the expected 3,000 MW output of the Camago (Malampaya) gas field. The accelerated development of the field was in line with the government's energy self-reliance program and called for the simultaneous development of the field, the construction of the pipeline infrastructure, and the setting up of the downstream facilities (essentially gas-fired power plants) so that gas is landed in Luzon to supply a 2,000 MW market by 2000 and an additional 1,000 MW market by 2002. After a series of exchanges of communications, subject to certain conditions on the matter, the Parent Company in a letter to the DOE reiterated its commitment to absorb the 1,500 MW output of the Camago (Malampaya) field and nominated First Gas Holdings, Inc., a related party of the Parent Company, as the developer of the entire 1,500 MW capacity.

On March 14, 1995 and January 9, 1997, the Parent Company entered into power purchase agreements (Agreements) with IPPs, FGPC and FGP Corp. Under the terms of the Agreements, these IPPs are committed to sell and deliver electric power and energy to the Parent Company and the Parent Company is committed to buy electric power and energy from them, subject to certain terms and conditions specified therein. The Agreements shall individually terminate on the date of the 25th anniversary of the commercial operation dates of the power plants of these IPPs.

In compliance with Section 33 of EPIRA, which mandates distribution utilities to mitigate their potential stranded costs by making "reasonable best efforts" to reduce the costs of their existing contracts with IPPs, the Parent Company took the steps in renegotiating its contracts with QPPL, FGPC, and FGP Corp. To make the contract

review process transparent and ensure that the renegotiations were done at arm's-length, the Parent Company's Board of Directors created a three-man Independent Review Committee then composed of Messrs. Margarito Teves, Carlos Dominguez and Emilio Vicens.

On January 7, 2004, the Parent Company's IPP Independent Review Committee and FGPC/FGP Corp. signed the Amendment to the Power Purchase Agreement (Amendment) between the Parent Company and FGPC/FGP Corp. Concessions with immediate value include FGPC shouldering local business and community taxes, while conditional concessions include increasing discounts on excess generation, paying higher penalties for non-performance, and until 2011, not charging the Parent Company the capacity fee and fixed operations and maintenance fee for energy delivered beyond the contracted amount but within the 90% capacity factor level. The signed Amendment was submitted to the ERC for approval on March 12, 2004. After the conduct of public hearings, the ERC approved the Amendment on May 31, 2006.

The Parent Company entered into a Substation Interconnection Agreement with NPC and FGPC for: (a) the construction, ownership, operation and maintenance of a dedicated 35-kilometer transmission line from the power plant of FGPC to the NPC substation; (b) the interconnection of the power plant to the NPC Grid System; and (c) the receipt and delivery of energy and capacity from the power plant of FGPC to the Parent Company's point of receipt. Similarly, the Parent Company entered into an Interim Interconnection Agreement with NPC and FGP Corp. whereby NPC will be responsible for the delivery and transmission of all energy and capacity from the power plant of FGP Corp. to the Parent Company's point of receipt.

Total purchased power from both FGPC and FGP Corp. amounted to ₱55,283 million, ₱44,976 million and ₱49,676 million for the years ended December 31, 2008, 2007 and 2006, respectively.

d. QPPL

The Parent Company entered into a Purchase Power Agreement (PPA) with QPPL on August 12, 1994 and amended the same on December 1, 1996. Under the terms of the amended PPA, QPPL is committed to sell and deliver electric power and energy to the Parent Company and the Parent Company is committed to buy electric power and energy from QPPL, subject to certain terms and conditions specified therein. The PPA shall terminate on the date of the 25th anniversary of the commercial operation date of the power plant (Plant) of QPPL.

The Parent Company also entered into a Transmission Line Agreement (TLA) with QPPL on June 13, 1996 (amended on December 1, 1996). Pursuant to the PPA and the TLA, QPPL is responsible for obtaining all necessary rights-of-way for, and for the siting, design, construction, operation and maintenance of the Transmission Line while the Parent Company is obligated to pay all costs and expenses incurred by QPPL in connection with the siting, design and construction, operation and maintenance of the Transmission Line (including unforeseen cost increases, such as those due to new regulations or taxes) through payment of periodic transmission charges.

The term of the TLA will extend to the duration of the term of the PPA, commencing on the date of execution of the TLA and expiring on the 25th anniversary of the commercial operations date. The term of the TLA is subject to renewal on mutually acceptable terms in conjunction with the renewal of the term of the PPA. Under the TLA, the Parent Company is obligated to make a Monthly Capital Cost Recovery Payment and a Monthly Operating Payment to QPPL.

In mid 2001, the Parent Company and QPPL were in discussions regarding the amendment of certain provisions of the PPA. The changes to the PPA primarily relate to the reallocation of risks relating to the performance and dispatch of the Plant of QPPL. Pursuant to the amended terms of the PPA, the Parent Company will, in general, bear risks relating to the dispatch of the Plant of QPPL while QPPL, in general, will bear risks relating to the technical performance of its Plant. These negotiations led to the filing of an application for approval of the amendment to the PPA (Amendment No. 3) at the ERC. However, due to certain concerns raised by the ERC, this petition was withdrawn by the Parent Company on March 4, 2003. Thus, the amendment No. 3 to the PPA did not take effect.

On February 21, 2008, the Parent Company and QPPL amended their TLA to conform its terms to those already approved by the ERC. Based on the amendment, the Parent Company and QPPL acknowledge and confirm that all claims that each may have against the other are resolved as of date of the amendment. Accordingly, the Parent Company derecognized its liability to QPPL pertaining to the disallowed transmission line fee amounting to ₱839 million and is shown as part of "Recovery of probable losses on disallowed receivables" account in the 2007 consolidated statement of income.

On the same date, the Parent Company and QPPL also signed a side letter agreement to the PPA relating to excess generation arrangements. This side letter agreement sets out an arrangement that allows the Parent Company to dispatch the Plant and increase QPPL's revenues based on sales of excess generation output at the discounted per kWh tariff for such generation. The Parent Company agreed to a base generation and a Target Excess Generation (TEG) of the plant from 2008 to 2017 (each a "Guarantee Year"). The TEG is equal to 74 million kWh per annum. The Parent Company will pay 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

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in a Guarantee Year, the Parent Company will pay QPPL an amount (an "Advance Payment") reflecting the difference in the TEG and actual excess generation (AEG).

If the AEG is greater than 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. Also, 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 of the AEG in a subsequent Annual Period.

During the annual periods ending 2018 to 2025, QPPL will repay the aggregate Advance Payments of the Parent Company in eight approximately equal annual installments without interest.

Total power purchased from QPPL amounted to ₱14,072 million, ₱12,813 million and ₱13,818 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Details of purchased power follow:

	2008	2007	2006
	<i>(Amounts in Millions)</i>		
FGPC and FGP Corp.	₱55,283	₱44,976	₱49,676
NPC	49,406	54,998	42,347
TransCo	25,009	28,449	24,881
QPPL	14,072	12,813	13,818
WESM	13,083	31,578	28,420
Duracom and others	19	23	2,121
	₱156,872	₱172,837	₱161,263

Total commitments for the purchase of power from FGPC, FGP Corp. and QPPL, including transmission line fees, are estimated as follows:

Year	Minimum Energy Quantity (MEQ) <i>(In Million Kilowatt Hours)</i>	Equivalent Amount* <i>(Amounts in Millions)</i>
2009	14,759	₱70,884
2010	14,759	70,884
2011 to 2015	221,390	1,063,259

e. Operating Lease Commitments

As Lessor

Rockwell has entered into commercial property leases on its investment property portfolio. These noncancellable leases have remaining terms of between 2 and 10 years. 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 amounted to as follows:

	Amount <i>(In Millions)</i>
2009	₱184
2010	99
2011	34
2012 and after	14
	₱331

As Lessee

The Parent Company leases substation sites, repeater station sites and extension and payment offices. Future minimum rental payable under noncancellable operating lease agreements amounted to ₱49 million as of December 31, 2008.

f. Capital Commitments

- (1) Rockwell entered into a contract with Hilmarc's Construction Corporation for the superstructure works of the Joya condominium project for a fixed sum of ₱2.3 billion, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all costs necessary for the proper execution of the work. Superstructure works started in November 2005 and is expected to be completed in June 2008. As of December 31, 2008, total payments related to this contract amounted to ₱2.1 billion.

- (2) Rockwell entered into a contract with DATEM Incorporated for the substructure works of the "One Rockwell" project. The contract amounted to a fixed fee of ₱310 million, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all cost necessary for the proper execution of the works. Substructure works commenced in July 2007 and was completed in June 2008. As of December 31, 2008, Rockwell incurred and has paid an amount equivalent to ₱229 million pertaining to substructure construction. In April 2008, the superstructure work package was awarded to the same contractor with total contract price of ₱2.5 billion. As of December 31, 2008, the substructure is 100% complete while the superstructure is 6.7% complete. As of December 31, 2008, ₱631 million has been incurred and was already paid.
- (3) Rockwell entered into contract covering superstructure works related to the Meralco BPO project with Hilmarc's Construction Corporation. The contract sum for the work amounted to ₱1.2 billion, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all cost necessary for the proper execution of the work. Rockwell expects to complete the project by March 2009. As of December 31, 2008, total amount paid related to this contract is ₱612 million.

36. Earnings Per Share

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 period.

For the purpose of calculating diluted earnings per share, the net income attributable to equity holders of the parent and the weighted average number of shares outstanding are adjusted for the effects of all dilutive potential common shares arising from the exercise of share options. The number of common shares is the weighted average number of common shares plus the weighted average number of common shares which would have been issued on the conversion of all the dilutive potential common shares into common shares. Share options are deemed to have been converted into common shares on the date when the options were granted.

	2008	2007	2006
	<i>(Amounts in Millions, Except Shares and Per Share Data)</i>		
Net income attributable to equity holders of the parent (a)	₱2,800	₱3,759	₱13,686
Shares:			
Common shares at beginning of year	1,103,342,882	998,812,167	998,529,142
Weighted average common shares - issuances	303,714	61,350,763	279,258
Weighted average common shares - basic (b)	1,103,646,596	1,060,162,930	998,808,400
Number of shares under option (see Note 19)	9,767,651	10,382,537	7,439,008
Weighted average number of shares that would have been issued at fair value	(7,738,824)	(5,931,999)	(4,264,042)
Adjusted weighted average common shares - diluted (c)	1,105,675,423	1,064,613,468	1,001,983,366
Per Share Amounts:			
Basic earnings per share (a/b)	₱2.5370	₱3.5457	₱13.7023
Diluted earnings per share (a/c)	₱2.5324	₱3.5309	₱13.6589

37. Other Matters

a. Revised System Loss Caps

On September 29, 2004, the ERC issued the "Guidelines for the Application and Approval of Caps 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.

On January 31, 2007, the Parent Company filed with the ERC, an Application for the approval of system loss cap, in accordance with the above-mentioned Guidelines. In the said Application, the Parent Company asked the ERC: (i) to retain the current method of recovering a consolidated rate of recoverable system loss for technical and non-technical losses and to fix the consolidated cap on the recoverable rate of distribution system losses at 11.27% for the years 2007 to 2011, based on the current practice of computing total distribution system loss where administrative loss is considered as part of sales, (ii) to retain the current method of recovering administrative losses (i.e., 1% of net system input or actual company usage in kWh, whichever is lower), and (iii) that in determining the non-technical system loss, the amount of pilferage recoveries, which are required to be returned to the customers in the form of a generation charge discount, in accordance with Rule 10, Section 2, of

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the Implementing Rules and Regulations of RA No. 7832, should not be deducted from the total distribution system loss.

On June 7, 2007, the ERC issued Resolution No. 19, Series of 2007, which dismissed all applications for approval of system loss caps filed by the DUs. According to the Resolution, the “ERC’s new policies on the treatment of system loss and the setting of new caps for private DUs shall be incorporated in the ERC’s evaluation of their respective applications as entrants to the PBR.” On August 6, 2007, the Parent Company filed a motion with the ERC seeking to clarify what would be the procedure for the setting of the cap for the system loss and what particular rules, guidelines or mechanism under the RDWR or any other ERC issuances, would govern the same. Said motion for clarification is still pending resolution by the ERC.

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 it resolved to lower the maximum rate of system loss (technical and non-technical) that a utility can pass on to its customers. In the said Resolution, the new system loss cap shall be the actual but not to exceed eight and a half (8.5%) percent for private utilities, effective starting January 2010 billing. This is one (1%) percentage point lower than the current system loss cap of nine and a half (9.5%) percent. 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 (PIS) under PBR.

b. Retail Competition

On February 9, 2007, through its Resolution No. 3, Series of 2007, the ERC set out its timeline for the implementation of retail competition and open access. According to the Resolution, retail competition shall commence upon the fulfillment of the preconditions of EPIRA’s Section 31 and of two other “vital requirements,” i.e., the establishment of necessary infrastructures (such as a customer switching system) and the promulgation of pertinent regulations. The ERC shall also announce the commencement of retail competition six months before its actual implementation.

Given the recent success of the Power Sector Assets and Liabilities Management Corporation (PSALM) in bidding out a number NPC’s generation assets, including the Masinloc and the Ambuklao-Binga hydroelectric plant system, the ERC announced during a forum last December 3, 2008 that retail competition and open access may begin in July 2010. However, with the withdrawal of Emerald Energy Corporation from the purchase of NPC’s 600MW coal-fired power plant, the fulfillment of EPIRA’s pre-conditions and, consequently, the start of retail competition and open access may be further delayed.

For its part, the ERC has already promulgated its “seven pillars of retail competition,” referring to a set of regulations that embody a framework for implementing retail competition and open access, as envisioned in EPIRA. These are the Retail Electricity Supplier (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 (SoLR) Rules, the Distribution Services and Open Access Rules, and the Uniform Business Practices (UBP). The UBP has since been renamed the Rules for Customer Switching (RCS).

The ERC also promulgated the Rules for Contestability, which would provide for more detailed guidelines on end-user eligibility for retail competition, and is working on the Guidelines of the Business-to-Business information system that would facilitate customer switching and similar procedures in a competitive environment. In accordance with EPIRA, retail competition will begin with end-users with an average peak demand of 1MW. After two years, the second phase of retail competition will begin with the threshold of contestability going down to 750kW, for both single and aggregated loads. Thereafter, the threshold will go down gradually until it reaches the household level within a period of seven years following the second phase of retail competition.

On May 23, 2008, the Parent Company, together with other industry players, filed a Petition with the ERC for the approval of Interim Open Access (IOA) in the Luzon and Visayas grids and its implementation in accordance with the proposed “Terms of Reference of the Interim Implementation of Open Access” which was adopted by the industry players and stakeholders during the Energy Summit 2008. The approval of the Petition would have allowed customers with an average peak demand of 1 MW and up to contract and purchase their electricity requirements from Eligible Generating Companies and Retail Electric Suppliers. Eligible Generation Companies are generation companies 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 implementation thereof subject to the following conditions:

- i. The distribution utilities shall act as the default supplier and be accountable for the accounting and settlement of imbalances.
- ii. The PSOP shall initially be implemented within the Luzon Grid.
- iii. The implementation of the PSOP shall commence from the transfer of the operation of the Calaca privatized NPC generation assets.

- iv. The PSOP shall cease to be operational upon commencement of actual Open Access and Retail Competition. All contracts and transactions related thereto shall automatically terminate once actual Open Access and Retail Commission is declared by the ERC.
- v. The PSOP shall be strictly implemented in accordance with the program rules to be promulgated and approved by the ERC.

In December 2008, the ERC released the draft Rules for the Power Supply Option Program. The said Rules were intended to provide the regulatory framework for the implementation of the PSOP. The said draft rules have not yet been finalized and promulgated by the ERC.

c. Philippine Economic Zone Authority (PEZA)-ERC Jurisdiction

On May 9, 2007, the Parent Company, together with the Private Electric Power Operators Association, Inc. (PEPOA), filed before the RTC-Pasig (Branch 71) a Petition for Declaratory Relief questioning the regulatory authority of PEZA over electric services in ecozones. Subsequently, the Parent Company converted its Petition to that of a "Complaint for the Declaration of Nullity of the PEZA Guidelines with Prayer for Temporary Restraining Order (TRO) 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."

The Parent Company and PEPOA believe that the said Guidelines are contrary to EPIRA and therefore null and void. The ERC likewise filed a motion to intervene in support of the complaint against PEZA.

PEZA's Guidelines effectively give PEZA franchising powers in ecozones. PEZA, thus, can potentially carve out ecozones from a DU's service coverage and allow entities other than the franchised DU to provide distribution service within ecozones. PEZA may also set the tariffs and operating parameters of such electric distribution service providers within ecozones. The situation may be aggravated by PEZA declaring additional ecozones in the DU's franchise areas.

On November 9, 2007, the Court granted the Parent Company's Motion for Conversion of the Petition into a Complaint for Injunction with TRO. It also issued a TRO and Preliminary Injunction restraining PEZA from implementing the Guidelines. The case is now pending hearing on the main case before the RTC-Pasig.

After a series of negotiations among PEPOA, the Parent Company and PEZA, the parties agreed to settle their differences which brought about the filing of the complaint before the Court. Thus, through a letter dated June 6, 2008 signed by PEZA Director General Lilia B. De Lima, PEZA has proposed the following to address the concerns of PEPOA and the Parent Company:

- i. "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.
- ii. 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.
- iii. Until such time that PEZA has fixed the appropriate Electric Power Distribution Charge, the current distribution and other distribution related charges shall prevail."

The aforesaid proposals were accepted by the Parent Company through a letter dated June 30, 2008 with clarification on item No. 3 thereof. In particular, the Parent Company proposed that item No. 3 be rephrased as follows:

"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 the ERC's guideline, shall apply."

In a response letter dated July 3, 2008, PEZA Director General Lilia De Lima stated that PEZA has no objection to the above-quoted counter-proposal of the Parent Company.

As a direct result of the agreement between the Parent Company and PEZA of the aforesaid terms contained in the above letters, the Parent Company decided to withdraw as plaintiff in the case filed before the RTC of Pasig, through a Motion to Withdraw filed on July 7, 2008. Thereafter, PEPOA, after considering the terms offered by PEZA, also filed its own Motion to Withdraw as plaintiff on August 1, 2008.

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Pending resolution of both motions, the Philippine Independent Power Producers Association (PIPPA) filed a Motion for Intervention, which was granted by the Court on September 2, 2008.

Currently, both motions to withdraw by the Parent Company and PEPOA are still pending resolution.

Since implementation of the Guidelines has been stopped by the Court, the Parent Company cannot ascertain or provide an estimate of the amount of revenues or income it stands to lose as a result of the Guidelines. Meantime, in support of the government's objectives, primarily of providing least cost power to ecozone consumers, the Parent 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 program was allowed for immediate implementation by the ERC.

d. 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. The construction of the said transmission line started in 1994 and was finished and energized in July 2000. This line will complete the 230kV line loop within Metro Manila to urgently address the congesting electricity traffic in the metropolis due to ever growing demand for electricity. The project has two main parts: (1) the Araneta to Balintawak leg; and (2) the Sucat to Araneta leg, which is near Dasmariñas Village, Makati.

Prior to 2001, the authority and responsibility to operate and develop the nationwide grid belongs to the NPC. Upon the effectivity of the EPIRA in June 2001, this authority and responsibility were transferred to TransCo.

The distribution lines of the Parent Company are "physically connected" to the transmission grid of TransCo. More importantly, the Parent Company's distribution facilities are configured to operate in synchronize with the lines of TransCo. The subject Sucat-Araneta-Balintawak 230kV Transmission Line is one of the significant lines of TransCo and is located in the heart of the Parent Company's franchise area. Thus, the unrestrained operation of the said line is very vital to Parent Company's operation to deliver continuous electricity to every household within its franchise area.

On March 10, 2000, the residents of Tamarind Road, Dasmariñas Village, Makati (plaintiffs) filed a case with the RTC-Makati against NPC to enjoin 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 trial court 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. On May 3, 2000, the Court of Appeals reversed the said orders of the trial court. On Appeal, the Supreme Court, in its Order issued on March 23, 2006, reinstated the orders of the trial court restraining NPC.

When the aforesaid Order of the Supreme Court became final, the plaintiffs then moved for the execution of the orders rendered by the trial court. Subsequently, the trial court issued a writ of execution on October 13, 2008. The Parent 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, the Parent Company manifested and argued that the shutdown of the 230 kV line would result to widespread and rotating brownouts affecting millions of its customers across its franchise area, including the major financial districts in Metro Manila. Likewise, as much as 505 MW capacity from power plants from the south would be prevented from running their full capacities, resulting in a much higher additional purchased power cost for the Parent Company which, in turn, would translate to significant increase in the price of electricity to be charged to its customers.

On November 28, 2008, the trial court issued an Order accepting the Parent Company's Omnibus Motion and holding in abeyance the writ of execution until after the trial court finally rules on the Parent Company's Omnibus Motion for intervention and other incidents.

e. Petition for Dispute Resolution

On September 9, 2008, the Parent Company filed a Petition for Dispute Resolution with the ERC, against PEMC, TransCo, NPC and PSALM. The filing of the case was brought about by the congestion of TransCo's transmission system resulting 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 Parent Company believes that said congestions adversely and materially affected the supply and prices of electricity and posed a significant threat to system security during the relevant period.

In said petition, the Parent Company asked the ERC to, among other things:

- i. direct PEMC to adjust the WESM price for the period of 26 June to 26 July 2008 by adopting the NPC-TOU rate as basis for its billing;

- ii. 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;
- iii. 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; and
- iv. impose appropriate fines and sanctions on TransCo, pursuant to section 46 of the EPIRA and the pertinent provisions of the EPIRA-IRR.

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.

The petition is currently undergoing hearings with the ERC.

f. PSALM versus PEMC and Meralco (Pending at the Court of Appeals)

Due to the significant increases in WESM prices during the third and fourth months of WESM operations, the Parent Company wrote two separate letters dated September 22, 2006 and November 14, 2006, addressed to Mr. Lassi-Matti A. Holopainen of the PEMC, requesting for an immediate investigation to determine whether there was a breach of the WESM rules or an anti-competitive behavior has occurred.

Acting on said letters, PEMC conducted an investigation of the third and fourth billing periods and came up with the findings that PSALM "behaved anti-competitively and abused its market power." As a consequence, PEMC, through a Resolution No. 2006-70 dated November 22, 2006, directed that the settlement amounts for the third and fourth WESM months be adjusted to the administered prices, which were below the NPC-TOU rates.

Upon receipt of PEMC's Resolution, NPC elevated the issue to the ERC and asked the latter to reconsider the price adjustments. In its Order dated December 13, 2006, the ERC provisionally ordered the adjustment of the third and fourth WESM month settlement amounts using the ERC-approved NPC-TOU rates.

On June 6, 2007, the ERC adopted the findings of its Investigatory Unit (IU), which found no prima facie case against PSALM for anti-competitive behavior or market power abuse. On August 14, 2007, the ERC issued its Decision confirming its earlier Order dated December 13, 2006 and declaring the action of the Philippine Electricity Market (PEM) Board in adjusting the WESM settlement prices for the third and fourth billing periods to have been carried out beyond the scope of its authority. It also directed the adjustment of the WESM settlement prices for the third and fourth billing months to be the resulting settlement prices.

Considering the impact of the ERC Decision dated August 14, 2007 to the consumers, the Parent Company filed a Motion for Reconsideration on September 17, 2007. In said Motion, the Parent Company emphasized that the use of WESM settlement prices would result in additional imposition of ₱6.00 per kWh, which would translate to an increase in the generation charge of its customers of about 90 centavos and ₱2.05 per kWh, for the supply months of September 2006 and October 2006, respectively. Thus, the Parent Company asked the ERC to exercise its authority to intervene for the greater interest of the industry and the consumers, and set the WESM settlement prices for the aforesaid period at NPC-TOU rates.

On January 30, 2008, the ERC issued a Decision granting the Parent Company's MR and set the WESM settlement prices for the third and fourth billing periods at the ERC-approved NPC-TOU rates.

On July 11, 2008, PSALM filed a Motion for Partial Reconsideration dated July 8, 2008, which was denied by the ERC in its Order dated October 20, 2008. As a result, PSALM elevated the case to the Court of Appeals impleading PEMC and the Parent Company as respondents. On January 28, 2009, the Parent Company received a copy of the Resolution of the Court of Appeals directing the respondents to file their respective Comment on the Petition. The Parent Company filed its Comment to the Petition of PSALM on March 9, 2009.