



Enabling Growth

2011 Annual Report

Our Cover

"Enabling Growth" resonates our Company's vision for a brighter and more progressive Philippines. It echoes in our business strategies as we strengthen our core distribution business and allied partnerships, help address the evergreen concern about high power rates, alleviate the tight power supply, and bring the benefits of electricity and innovation to the Filipino, the community and the country.



Contents

02	Who We Are
04	Financial and Operating Highlights
06	Message from the Chairman
10	Message from the President and Chief Executive Officer
14	Report of the Chief Operating Officer
18	Our Awards
19	Review of Operations
30	Corporate Social Responsibility
34	Corporate Governance Report
46	Board of Directors
50	Corporate Officers
54	Our Subsidiaries
58	Management's Discussion and Analysis
71	Audit and Risk Management Committee Report
72	Statement of Management's Responsibility
73	Independent Auditors' Report
74	Consolidated Financial Statements
154	Glossary of Terms
158	Investor Information





Who We Are

SCALE

- Largest distribution utility in the Philippines
 - Serves **25%** of the Philippine population
- Powers **5,026,543** customer accounts
- **9,337** km² footprint
 - Accounts for **50%** of Philippine Gross Domestic Product (GDP)
 - **60%** of Philippine manufacturing output generated within the franchise area
 - Generates **75%** of Luzon's and **55%** of Philippine electricity sales
 - Social, political, economic center of the Philippines
- Strong organic growth
- Sales revenues of **Php256.8 billion**, equivalent to **US\$5.9 billion**
- Market capitalization of **Php278.6 billion**, equivalent to **US\$6.4 billion** at the end of 2011



Driven to Efficiency

- All-time low system loss level
- Record levels of system availability, reliability and power quality
- Outperformed regulatory service standards
- Highly motivated and energized employees

Multi-faceted Business Opportunities and Strategies

- Core Electricity Distribution Service
- Power Generation
- Retail Electricity Supplier
- Franchise Expansion
- Subsidiaries' Growth



4 Financial and Operating Highlights

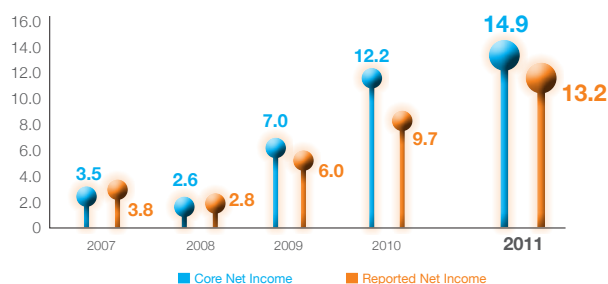
COMPARATIVE HIGHLIGHTS

	2007	2008	2009	2010	2011
FINANCIAL INFORMATION					
(In Million Pesos except per Share Data)					
Revenues					
Electric	196,171	186,999	178,686	239,077	253,989
Non-electric	4,522	4,776	2,072	1,856	2,819
Total	200,693	191,775	180,758	240,933	256,808
Cost and Expenses					
Purchased power cost	172,837	156,872	150,928	200,916	205,674
Operations and maintenance	14,595	14,807	14,634	16,462	19,133
Depreciation and amortization	4,492	4,426	4,831	5,911	5,504
Interest and other financial charges (income) - net	852	1,216	499	(1,044)	(819)
Others	1,824	9,254	1,811	5,370	8,617
Total	194,600	186,575	172,703	227,615	238,109
Net Income Attributable to Equity Holders of Parent	3,759	2,800	6,005	9,685	13,227
Core Net Income	3,532	2,605	7,003	12,155	14,887
EBITDA	12,047	11,021	13,169	18,841	24,602
Utility plant and others - net	96,507	100,853	101,858	103,250	105,510
Interest-bearing long-term financial liabilities	16,291	16,359	21,303	21,072	24,376
Notes payable	10,748	9,828	513	149	67
Equity attributable to equity holders of parent	51,680	52,607	57,369	58,969	63,788
Capital Expenditures	6,869	9,175	8,890	9,053	8,748
Market Price per Share at End of Year	82.50	59.50	205.00	228.00	247.20
Core Earnings per Share	3.32	2.36	6.32	10.78	13.21
Cash Dividends Declared per Common Share	-	1.00	2.50	6.95	7.80
Market Capitalization	91,026	65,674	231,091	257,018	278,625
Total Shareholder Return	52%	-27%	249%	15%	12%
OPERATING INFORMATION					
Number of Customers					
(In Thousands)					
Residential	4,047	4,144	4,277	4,412	4,580
Commercial	404	414	410	421	433
Industrial	10	10	10	10	10
Flat Streetlights	4	4	4	4	4
Total	4,465	4,572	4,701	4,847	5,027
Energy Sales					
(In GWh)					
Residential	8,655	8,620	8,904	9,540	9,344
Commercial	10,021	10,607	10,922	11,830	12,027
Industrial	7,405	7,682	7,548	8,734	9,080
Flat Streetlights	138	140	142	143	141
Total	26,219	27,049	27,516	30,247	30,592
System Loss					
(In Percent)					
Meralco	9.65	9.28	8.61	7.94	7.35
CEDC	4.81	4.76	3.86	3.81	3.96

Financial Highlights

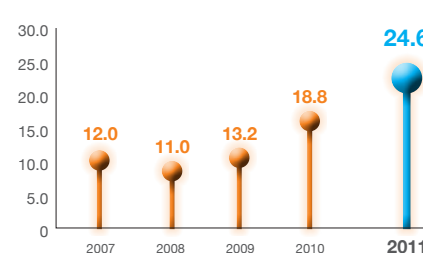
Reported/Core Net Income

(In Billion Pesos)



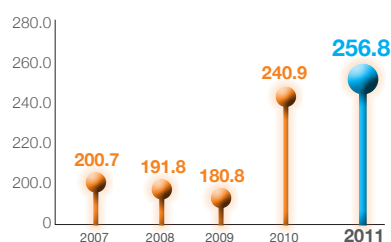
EBITDA

(In Billion Pesos)



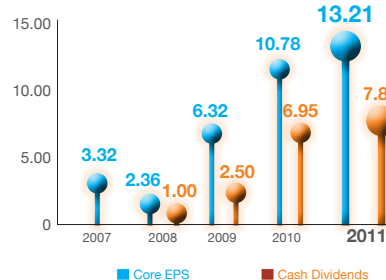
Total Revenues

(In Billion Pesos)



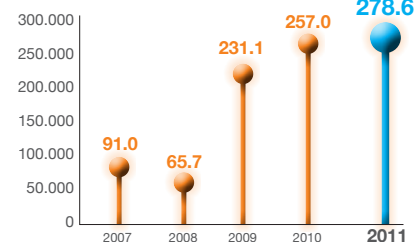
Cash Dividends and Core EPS

(In Pesos per Share)



Market Capitalization

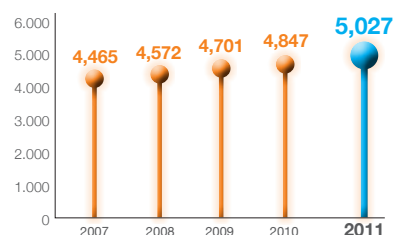
(In Billion Pesos)



Operating Highlights

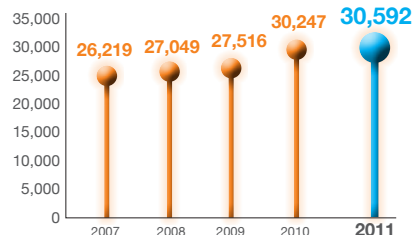
Number of Customers

(In Thousands)



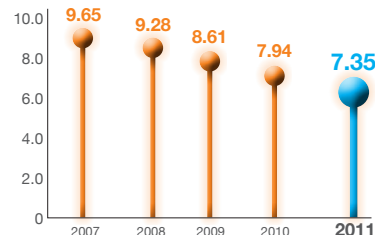
Energy Sales

(In GWh)



Meralco System Loss

(In Percent)





"We will meld customer needs and innovative leadership ideas while building a flexible and agile company in a highly-regulated environment."

Message from the

Chairman

TO OUR SHAREHOLDERS

Our commitment – to provide reliable and affordable electricity to our more than 5 million customers – remains steadfast as we ride on the growth opportunities in 2012 and beyond. Our re-energized workforce is keenly focused on delivering customer satisfaction at the highest level feasible by providing quality service that is driven by our core values.

The Philippine economy remained unscathed in 2011 despite the expanding global recession, successive natural calamities in Asia, benign government spending and the changing priorities of the Filipino consumer. Given this backdrop, how has Meralco fared?

Meralco's journey through the implementation of the Performance-Based Regulation has come a long way, given the more defined and stable regulatory environment. We executed well on our business plan as well as on our operational and financial goals in 2011. We continued to be relentless in our drive for greater efficiency on our distribution network and customer service infrastructure. We implemented several initiatives to ensure that we deliver and outperform the challenging performance metrics imposed by the Energy Regulatory Commission. Our strong financial standing with local and foreign institutions reinforces our ability to deliver on our strategic investment plans that will provide sustainable returns over the long-term. Our shared goal of reaching new heights every performance year was intrinsic to such achievement which I personally, have full confidence in. I have strong faith in this formidable institution that has seen more turbulent times in its 109-year history.

Electric distribution has provided your Company an impressive growth trajectory and will remain to be our core value driver, even as new businesses emerge for Meralco in the coming years. We will meld customer needs and innovative leadership ideas while building a flexible and agile company in a highly-regulated environment.



While catastrophic events, such as the devastating earthquake in Japan, have taken place close to our shores, opportunities continue to abound for us. It gladdens me to see so much confidence in the Philippines per se, the awareness of the country's economic and fiscal reforms, the interest in the Philippine electric and power industries, the recognition of vast potentials and, more prominently, the attention given to Meralco. Credit goes to the Company's selfless employees who not only excel in their jobs but continue to do even better each year. I would like to recognize our *Malasakit*-imbued workforce whose invincible efforts and social responsibility continue to help uplift the lives of our fellow Filipinos.

As we embark on another year of opportunities and challenges, we must be ever cognizant of our mission to raise the bar of service to the publics we serve. We have to be more focused and uncompromising in responding to our stakeholders' changing and exacting needs. We ascribe to the belief that in helping them succeed, we are also improving the well-being of our country and our people. We will, in 2012 and beyond, drive to achieve higher levels of performance and create increasing value to our customers and shareholders – a daunting aspiration but certainly achievable. That, after all, has been our story for more than a century.

As I step down as your Chairman, it is with a great sense of fulfillment and pride that I have seen the significant expansion of Meralco's franchise reach, the tremendous growth of our customer base and electricity sales volume, and the truly quality customer service and experience Meralco has been known for, since Meralco's transfer into Filipino ownership and management in 1962. It has been my distinct pleasure to have played a meaningful role in various capacities

with the Company and to have had the unique privilege to serve as Chief Executive since 1986 and Chairman for over 10 years. For all of these, I wish to express my deepest gratitude to you, our shareholders, our Board of Directors, our officers and employees for the confidence and support you have extended me through the years. The loyalty and dedication of the men and women of Meralco, especially during the most challenging of times, are hallmarks of the utmost *Malasakit* I have seen in any Philippine company. They have provided the impetus to continually improve the Meralco brand of service and prepare the organization for a most exciting, if often uncertain, future. Together, we overcame many challenges and setbacks, always recovering quickly and with grace; never losing our honor and always choosing to do right by our publics, especially our customers.

I thank again all our customers, employees and stakeholders for trusting our Company to serve their needs. The last 26 years following my return to Meralco in 1986 have been the most memorable of my professional and personal life. I trust that you will all extend the same support and *Malasakit* you have given me to the Company's management team under the leadership of our new Chairman, Manuel V. Pangilinan, whom I have only the deepest respect and admiration.

Sa Meralco, May Liwanag ang Buhay!



AMBASSADOR MANUEL M. LOPEZ
Chairman



"We are extremely gratified that Meralco had a year of exceptional results in financials and operations, outperforming an already stellar year in 2010."



Message from the

President and Chief Executive Officer

TO OUR SHAREHOLDERS

2011 was challenging by circumstance, yet it was by outcome, among the best – and a defining period for Meralco. The environment we found ourselves did not have the favorable backdrop of 2010 but it did present opportunities for us to explore, harness and nurture.

We are extremely gratified that Meralco had a year of exceptional results in financials and operations, outperforming an already stellar year in 2010.

Beyond this historic high performance, I am pleased to apprise you of how our plans laid out in the past year have progressed, particularly in the areas of strengthening the core distribution utility business, franchise expansion, power generation, retail electricity supply and subsidiaries.

Strengthening the Core Distribution Utility Business

The major electric capital projects our Company completed in 2011 not only expanded the electric system's capabilities but also further strengthened the infrastructure that is able to serve the increasingly higher and more sophisticated demand for quality power. At the same time, we continue to add to our customer count, which adds pressure for better delivery system. We are committed indeed to a continued upgrade of our core distribution utility business and provide quality, efficient and affordable service.

Franchise Expansion

Expanding Meralco's operational footprint fulfills our Company's mission to extend the benefits of quality electricity at an affordable rate to other consumers and capture growth outside of our traditional franchise area as well. We are working with various national agencies, local government units and private entities to develop solutions for sustainable distribution utility operations in these areas.



"We are committed indeed to a continued upgrade of our core distribution utility business and provide quality, efficient and affordable service."

As we are exploring what is possible locally, Meralco is also deliberately building its capability to participate in overseas power privatization initiatives. In 2012, we intend to keep the momentum going as opportunities in international operations open up, and as the demand for more responsive distribution utility capabilities locally become increasingly evident.

Power Generation

Meralco PowerGen Corporation (MGen), our Company's investment vehicle for our re-entry into power generation, continues to focus on developing a robust and competitive portfolio of new power generating plants. Redondo Peninsula Energy, Inc. (RP Energy) is a joint venture with Therma Power, Inc., an Aboitiz Power Corporation subsidiary, and Taiwan Cogeneration International Corporation - Philippine Branch. This joint venture for a 600 MW circulating fluidized bed (CFB) coal-fired power plant is in an advanced stage of development with site preparation nearing completion, and the grid impact study for transmission lines and interconnection well under way. The study seeks the most efficient way to interconnect the RP Energy Plant to the grid transmission system of the National Grid Corporation of the Philippines. We are in the process of securing an environmental compliance certificate, simultaneous with a sustained information campaign to address environmental and social concerns. We are scheduled to award the contract for the Engineering Procurement and Construction (EPC) in the third quarter of 2012. MGen is also working in a broad range of pre-development studies in other power generating projects using clean coal, natural gas, liquefied natural gas (LNG) and hydro as fuel sources.

Retail Electricity Supply

Our retail electricity supply group, formed early 2011, continues to build up its organization, hardware, software and processes with the first phase of Open Access and Retail Competition (OARC) expected to commence in the latter part of 2012. These preparations ensure that our retail electricity supply group will be able to effectively and profitably exist in an anticipated competitive environment.

Subsidiaries

We have affirmed and extended our full support to our subsidiaries, in particular the Meralco Industrial Engineering Services Corporation (Miescor) and CIS Bayad Center, Inc. to enable them to serve other companies and institutions better and indeed, to look at opportunities beyond our shores. We will continue to explore both local and international markets, and tap the competencies of other subsidiaries and affiliates, so that they too can play their part in contributing to the overall growth and profitability of Meralco.

Lighting the Way to a Brighter Philippines

Our Company has begun its journey towards a brighter, more energized future for the Philippines. A major enabler in this future will be a viable Smart Grid, a technological innovation that can supply multiple benefits for the customer, the community and the country. Smart Grid is a new-generation network, which significantly enhances service reliability because it possesses automation and intelligent capabilities at critical points in the network. It has been

proven to reduce outages significantly and hasten restoration turnaround time in other countries. Leveraged in tandem with power generation and transmission companies, the Smart Grid can shave peak levels, the benefits of which translate to reduced investments in power plants, and lower cost for customers.

Smart Grid will also be a platform for new services such as prepaid electricity and home area networks, and will support the entry of renewable energy and a “plug-and-play” experience for electric vehicles. Working with the Energy Regulatory Commission, Meralco will pilot prepaid electricity within 2012. This dovetails with the dominant use of prepaid mobile phone services and sachet practices and pricing in this country. It will further allow customers to have better control of their consumption spending.

Meralco is also working with the Mandaluyong City Government to pilot charging stations for electric tricycles in 2012.

Finally, during the year in review, our One Meralco Foundation, Inc. executed on its four pillars on its CSR work— Community Electrification, Grassroots Partnerships, Sports and Youth Advocacy, and Emergency Preparedness and Disaster Response. Activities of the Foundation, more aligned with our Company’s business mission, are extensively described in this Report.

In closing, I would like to extend my deep gratitude to all – to our Board of Directors, for their continued guidance as Meralco begins its quest towards a brighter Philippines; to our employees and staff whose commitment and dedication anchor this Company in the face of that brighter future; and, to our shareholders, for their continued faith and trust in Meralco and its Management.

Indeed we look forward to a brighter 2012.

Meralco Franchise Map



MANUEL V. PANGILINAN
President and Chief Executive Officer

"Our outstanding year-end results give us much satisfaction and provide the springboard upon which we will further serve our customers, the community and the country in 2012."



Record performance amidst challenges

Meralco sustained the gains from investments in its distribution network, customer service infrastructure, organization and people to register yet another record results in sales, operations and profitability. We did so even under a less conducive business environment of weaker GDP growth, the ripple effects of a financially-challenged Europe and North America, a tsunami-ravaged Japan and a flood-stricken Thailand, high oil and commodity prices, and much cooler temperatures compared with 2010.

Strong commitment, focus, and teamwork of Meralco's leadership group from superintendents and up, supported by the rest of our 6,071 strong workforce, enabled the excellent execution of our business plan. We ended the year 2011 with record customer satisfaction, record core and reported net income, and an even more robust balance sheet. We achieved these even

as we continued to build our future through new growth and profitability platforms of power generation, retail electricity supply, expansion our distribution service footprint, and scaling up of our subsidiaries. Our accomplishments extended our reach with respect to our Corporate Social Responsibility (CSR) initiatives through our One Meralco Foundation, Inc.

Report of the

Chief Operating Officer

One outstanding accomplishment was the successful closing of new long-term power purchased agreements, which will significantly help in containing the rising cost of electricity to the consumer. Since generation charge is the largest component of the customer's bill at 56%, we proactively and constructively worked with major generation companies to contract 2,380 MW of baseload and mid-merit generating capacity at very competitive prices. These will be a huge boost to our existing IPP contracts of 1,960 MW and will go a long way towards managing long-term electricity prices.

The business and environmental conditions in 2011 dampened the growth in energy sales. Adding to these factors was an estimated 65 GWh unrealized sales due to a destructive typhoon named *Pedring* (International Codename: Nesat).

Meralco and its employees responded to these trying conditions with appropriate measures and steered the Company towards realizing an exceptional performance year. The Company implemented major initiatives in all functional areas throughout 2011 to surpass the 2010 records in energy sales, system performance and financial results. These were most evident in the "all-time bests" achieved in various key performance areas - consolidated kWh sales, system loss rate, system reliability and availability, voltage quality, time-to-process and time-to-connect new customers, Call Center performance and funding rates. Targeted and faster customer acquisition by an innovative customer-centric organization, supported by

a borderless strategy approach by the key organizational units involved in the energy sales and delivery process were instrumental in preventing what could have otherwise been a reversal in our electricity sales trajectory. Providing a big boost to sales volume was our acquisition of self-generating and direct-connect customers (notably the Cavite Export Zone, Eagle Cement Corporation and ROHM Electronics Philippines, Inc.). The success of organizational enhancements at our Customer Retail Services group enabled closer focus and engagement with key customer segments – Corporate Business, Small & Medium Enterprises, and Home & Micro Business – and is reflected in an all-time high CSI of 7.65% for 2011.

Technology and innovation to enhance customer value and experience, and make available to the customer new viable product and service offerings, are high in Meralco's agenda. We are exploring the full potential of Smart Grid, including prepaid metering, outage management, demand response, and other applications. We will be piloting certain applications in due course. We are also supporting initiatives of certain local governments and a multilateral institution for the long-term development of the domestic e-vehicle industry, initially focused on smaller public utility vehicles, such as e-trikes.

Meralco achieved the record performance while managing its headcount and improving people productivity. Customer and sales per employee ratios stood at 828 customers and nearly 5 GWh per employee, respectively, the highest ever.

The Company undertook notable organizational future-proofing and CSR activities during the year. In February, Meralco launched the Meralco Power Camp, a special Apprenticeship Program for graduating university students with strong technical skills and who could be potential leaders of Meralco. Over 600 engineering students from five of the top universities in the country attended the roadshows for the first Meralco Power Camp held in their respective campuses.

In April, Meralco partnered with MyShelter Foundation, Inc. (MSFI) and the City of Manila, to launch the "Isang Litrong Liwanag" Project in Baseco Compound, Tondo, Manila. The project, replicated in other communities, presented an innovative way of reflecting light from the sun through an empty one-liter bottle filled with water. More than a CSR project, such undertaking has enhanced our relationship with the local governments.

Allow me to close by highlighting Meralco's commitment to helping address the concern of consumers with the level of electricity prices. In addition to developing our power generation portfolio to meet customer needs for adequate, reliable, quality power at affordable prices, Meralco has recently secured new long-term power supply agreements for 2,380 MW with South Premiere Power Corporation (1,180 MW), Masinloc Power Partners Co. Ltd. (up to 430 MW), Sem-Calaca Power Corporation (up to 420 MW) and Therma Luzon Inc. (350 MW). These are expected to translate into significant benefits

to the consumer. Meralco also has in place an experienced Retail Electricity Supply (RES) group focused on providing soon-to-be contestable customers with full Meralco service when the retail market becomes competitive upon the commencement of Retail Competition and Open Access.

We took off in 2011 cognizant of the many challenges in our midst. These rallied the Company and its employees to work much harder. Our outstanding year-end results give us much satisfaction and provide the springboard upon which we will further serve our customers, the community and the country in 2012.



OSCAR S. REYES
Chief Operating Officer



OUR AWARDS

- * Silver Awardee for "Best Community Programme" (Global CSR Awards)
- * Best Investor Relations Company by a Philippine Company (Corporate Governance Asia)
- * Asia's Best Chief Finance Officer (Investor Relations) – Treasurer and Investment Management Group and Treasury Head Rafael L. Andrada (Corporate Governance Asia)
- * Best Investor Relations for Philippine Company in the Singapore Market IR Magazine (Corporate Governance Asia)
- * 7 Anvil Awards

Award of Excellence (The Meralco Twitter Experience - Using Social Media to Address and Engage Customers on a Personal Level)

Awards of Merit:

- Bio-Intensive Gardening (environment/science and technology/sustainable development)
- Lighting Up Lives through the *Isang Litrong Liwanag* (social responsibility)
- Meralco's Water Lily for Life Project: Community Building for Wealth Creation (entrepreneurship/job generation)
- One Meralco Foundation, Inc. Launch (special events)
- "Two Days of Ultimate Basketball, One Magical Experience: A Fan's Upclose and Personal Account of the Ultimate All-Star Weekend"
- Powering Up to Success: Shaping the New Meralco Through Corporate Values and Employee Engagement

- * 13 Philippine Quill Awards

Award of Excellence (*Maliwanag ang Pasko* Christmas Campaign)

Awards of Merit:

- Employee/Member Communication (Powering Up to Success: Shaping the New Meralco Through Corporate Values and Employee Engagement)
- Social Media (The Meralco Twitter Typhoon Response Experience - Managing customer concerns during typhoon crisis situations)
- Community Relations (Meralco Community Electrification Program)

Recognition:

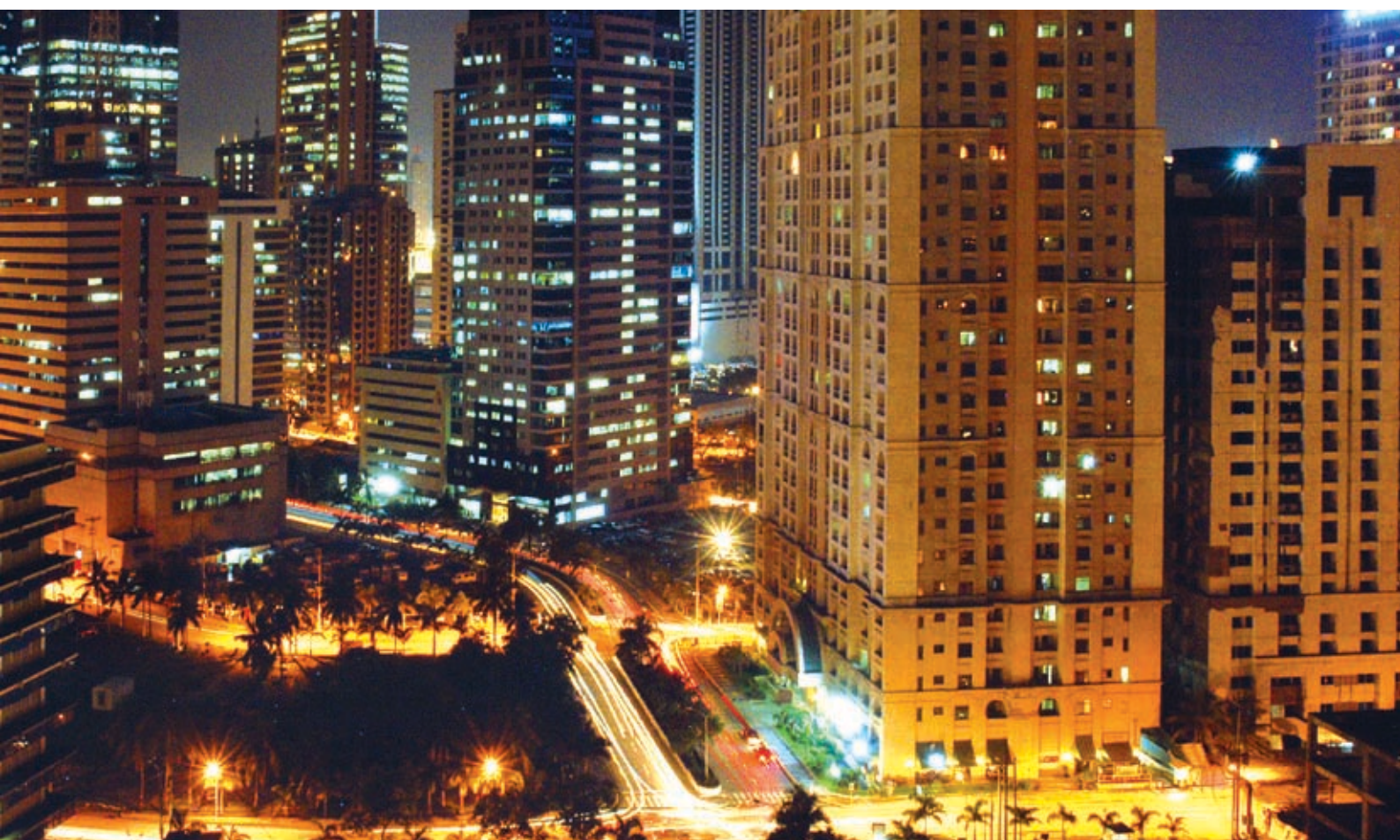
- Special Events (The Lighter Side of Meralco: Bringing Energy Efficiency Tips Closer to the Customer)
- Brand Communication (New Meralco Brand Architecture - Gearing Towards the Future)
- Media Relations (Empowering Partnerships: The Advantages Gained by Meralco's Corporate Business Group Through a Strategic Media Campaign)
- Media Relations (*Pailaw Naman!* How Meralco's Proactive Dissemination of Information on the Generation Charge is Helping Influence Media Reportage)
- Special Events, Internal or External (One Meralco Foundation, Inc. Launch)
- Community Relations (Bio Intensive Gardening)
- Community Relations (Meralco Sibol School Project: Providing Access to Education)
- Employee/Member Communication (*Makabayan* Employee Volunteerism)
- Economic, Social and Environmental Development (Meralco's Water Lily for Life)

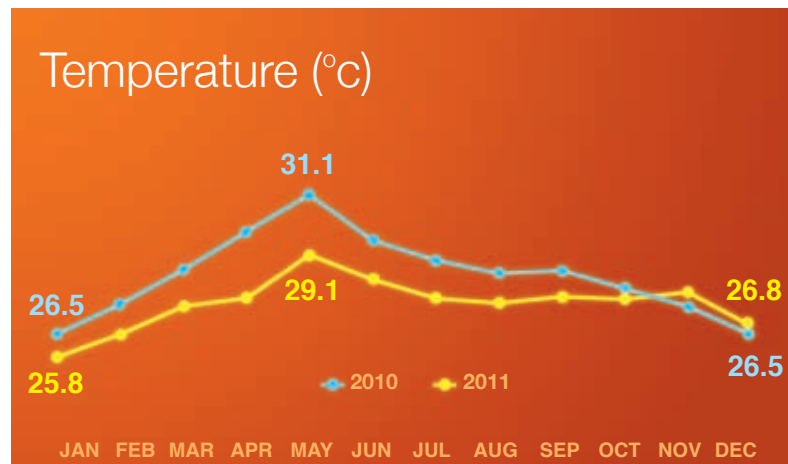


Review of Operations

Consolidated energy sales reached a new high of 30,592 GWh, surpassing the 2010 sales volume, which had already risen by a record 10% over preceding year. Sustained growth of industrial and commercial customers, more than offset the decline in residential demand, resulting in a 1% uplift in energy sales volume. The number of billed customers went up almost 4% to exceed 5.0 million at the end of 2011. Residential customers comprised 91% of the total customer count. Distribution system and customer service performance, measured in terms of system availability and reliability, system loss rate, power quality and customer satisfaction index, were at their all-time best, along with human resource productivity. Reported earnings per share amounted to Php11.73. Core earnings per share improved to Php13.21.

Revenues	▲	7%	<ul style="list-style-type: none"> to Php256.8 billion from Php240.9 billion attributable to the increase in volume over the record 2010 level, higher transmission charge and slightly higher distribution rate
Reported Net Income	▲	37%	<ul style="list-style-type: none"> to Php13.2 billion from Php9.7 billion
Core Net Income	▲	22%	<ul style="list-style-type: none"> to record Php14.9 billion from Php12.2 billion
Core EBITDA	▲	7%	<ul style="list-style-type: none"> to Php26.8 billion from Php25.1 billion
Consolidated Debt	▲	15%	<ul style="list-style-type: none"> at Php24.4 billion from Php21.2 billion debts are principally denominated in Philippine peso with maturities comfortably spread through 2022 with no maturities higher than Php5.0 billion in any given year current maturities amount to Php4.6 billion

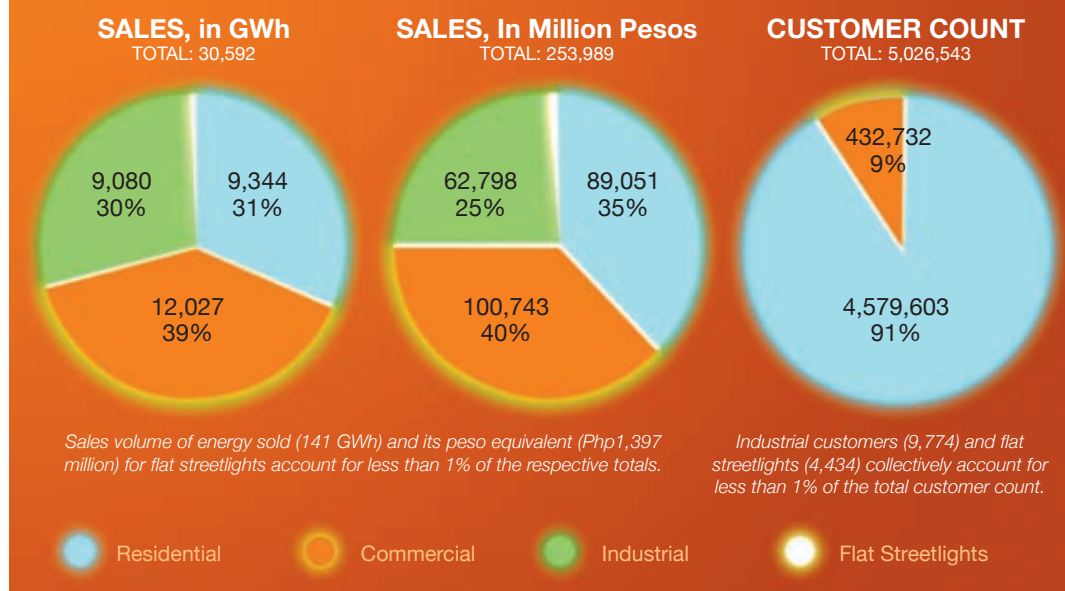




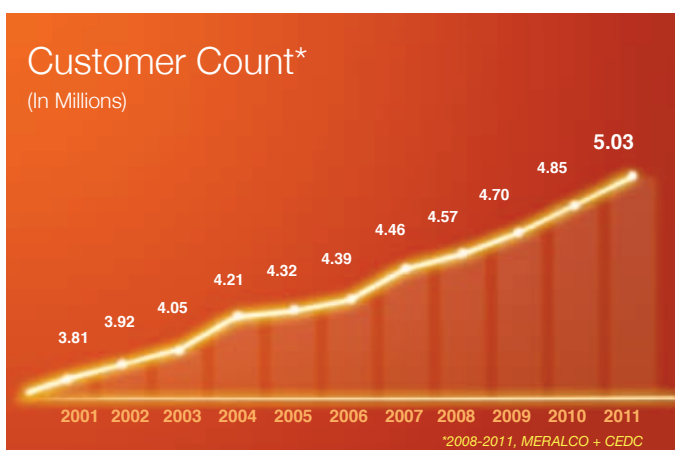
Sales Volume and Customer Count: Reaching New Highs

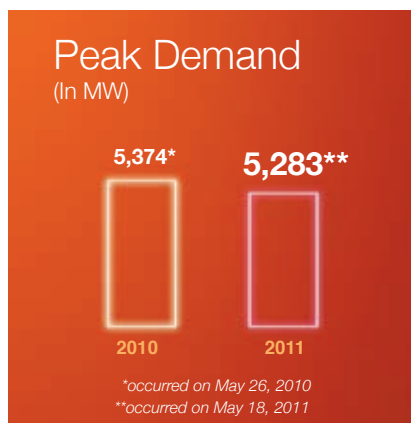
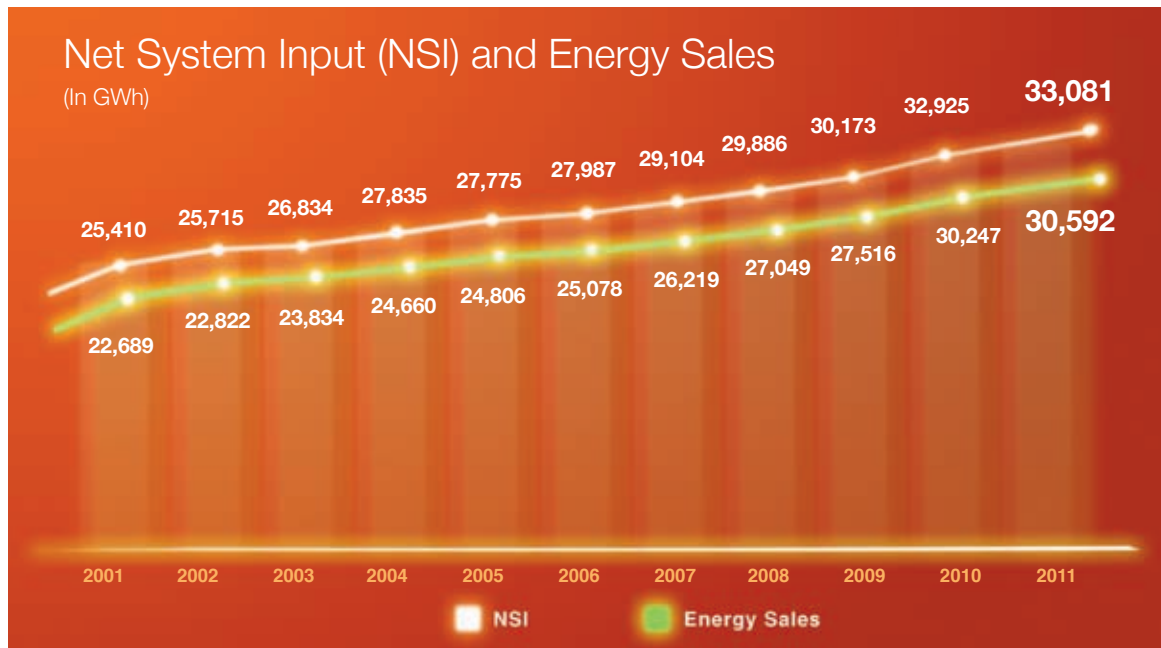
- Consolidated energy sales, inclusive of volume of Clark Electric Distribution Corporation (CEDC), rose by 1% to 30,592 GWh in 2011, the highest volume ever, from 30,247 GWh in 2010.
- This was attained despite a weak market environment, with lower GDP growth of 3.7%, severe financial problems in Europe and North America, natural calamities in Japan and Thailand, rising commodity prices, and 1°C cooler temperature than 2010.
- Meralco consolidated energy sales were 75% of total Luzon Grid energy sales and 55% of total Philippine energy sales.
- By customer class, sales to commercial, residential and industrial customers accounted for 39%, 31% and 30% of total energy sales, respectively.
- The industrial market segment led the growth in total energy sales with a 4% rise to 9,080 GWh in 2011 from 8,734 GWh in 2010.
 - Key growth drivers were semiconductor companies, fabricated metals, food and beverage products.
- Sales to the commercial segment grew by 2% to 12,027 GWh in 2011 from 11,830 GWh in 2010.
 - Figuring prominently in the growth were real estate, communications, transport and storage, and trade.
- Sales to the residential segment declined by 2% to 9,344 GWh in 2011 from 9,540 GWh in 2010.
 - Lower temperature and early onset of the rainy season curtailed the use of cooling devices in households.

Sales Relationship



- Contributing to the growth in consolidated sales was the sustained increase in the number of customers, up by 4% to 5,026,543 from 4,847,238 in 2010.
 - Shift of self-generating and directly connected customers to Meralco service contributed 56% to the total incremental industrial volume.
 - Newly energized customers and pipeline projects accounted for the difference. New customers provided an average 56 GWh monthly.
 - Acquisition of volumes of the Cavite Export Zone, International Rice Research Institute, Inc. (IRRI), Toshiba Information Equipment (Philippines), Inc. and Chevron Philippines Inc., among others.
- Residential customers made up 91% of the total customer count, numbering 4,579,603 in 2011, from 4,411,847 in 2010.
- Number of commercial customers rose 3% to 432,732 in 2011, accounting for 9% of total customer count.
- Industrial customers were less than 1% of total customer count but contributed 30% to the total energy sales volume in 2011.





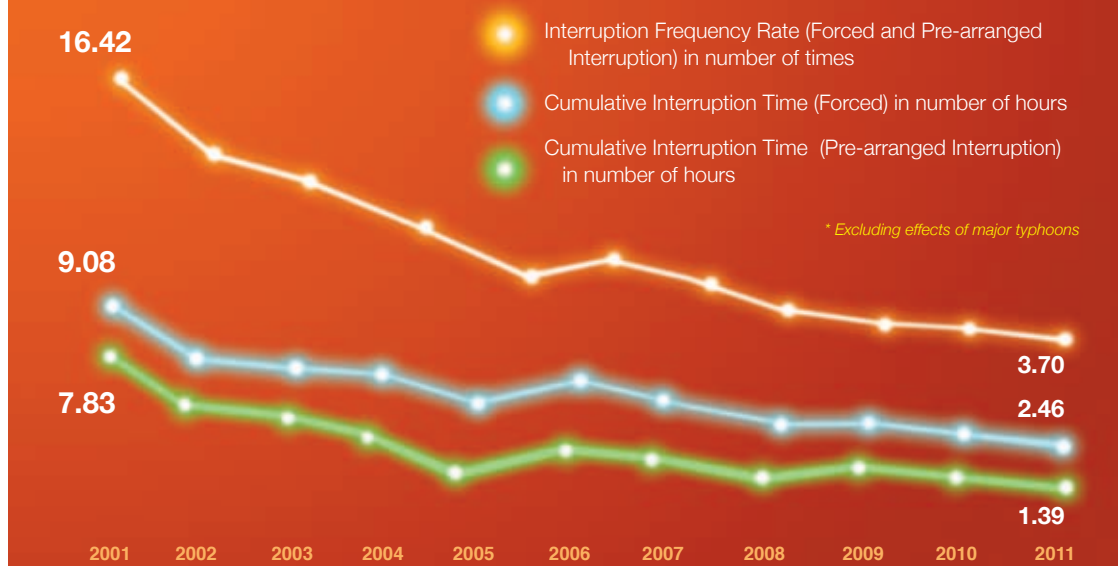
Net System Input: Closely Tracking Energy Sales / Efficiency Gains in System Loss

- Net System Input (NSI) rose by 0.5% to 33,081 GWh in 2011 from 32,925 GWh in 2010.
 - › Lower rate of increase in NSI relative to total energy sales indicated further gains in system loss reduction.
 - › Meralco peak demand dipped by 2% to 5,283 MW in 2011 from 5,374 MW in 2010.

Operational Performance: Besting Previous Bests

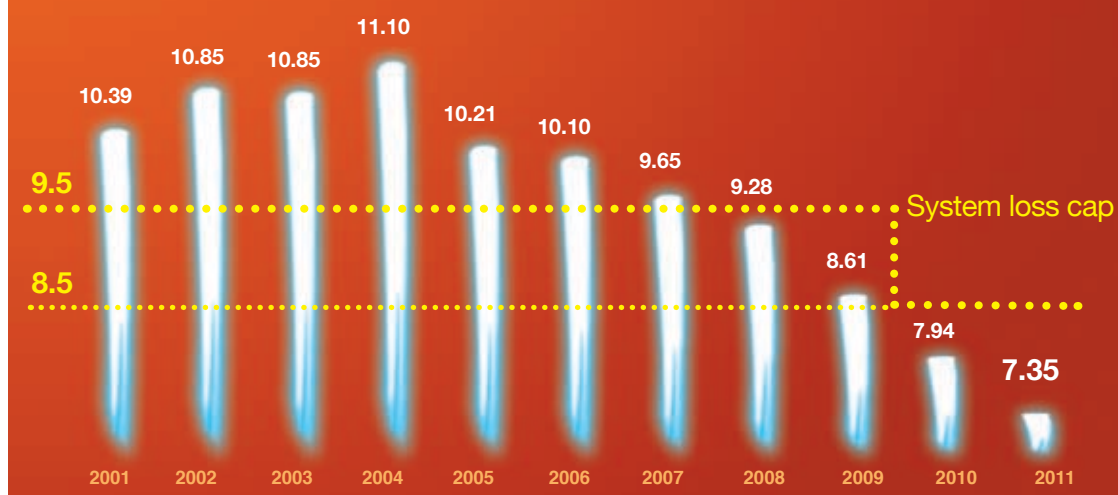
- Meralco's network and customer service performance surpassed previous records.
 - › Outperformed all eight S-Factor standards set by the Energy Regulatory Commission (ERC) as well as actual levels achieved since 2007.
 - › System loss, system reliability and availability, power quality, time-to-process applications and time-to-connect customers, and Call Center performance reached record levels.
 - › These system performance gains translate into rewards and savings, under the Performance Incentive Scheme (PIS) of the Performance-Based Regulation (PBR).

System Reliability and Availability Performance*



System Loss Performance

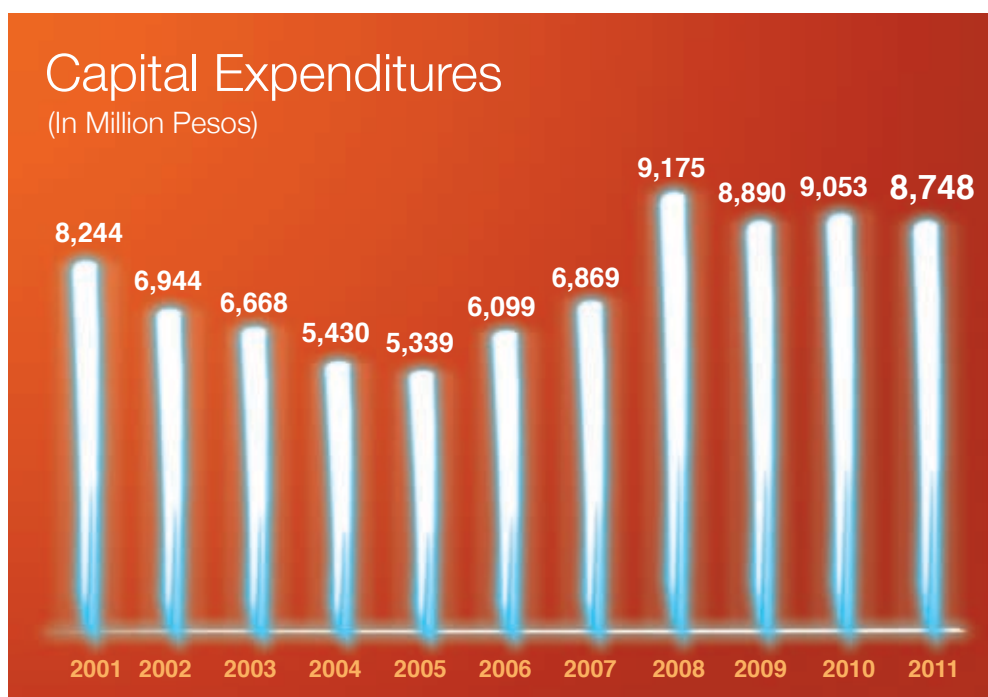
(In Percent)



- System loss level in 2011 at all-time low of 7.35% from 7.94% in 2010.
 - 1.15 percentage points below the 8.5% system loss cap resulting in lower rates to customers.
 - Php2.4 billion savings in 2011 or a cumulative Php5.3 billion savings over the last four years, equivalent to 4.61 centavos per kWh, realized by customers.
 - CEDC's system loss rate was at 3.96%.
- System reliability and availability recorded new lows in 2011.
- Time-to-process, time-to-connect, and Call Center performance also improved in 2011.

Capital Expenditures: Investing for Higher System Capacity and Resiliency

- Capital expenditures for 2011 is at Php8.7 billion.
 - Electric Capital Projects (ECP), which accounts for majority of the expenditures were intended to: (a) meet growth in power demand of existing and new customers; (b) sustain improvements in system loss performance; (c) enhance the robustness of the system against natural calamities and other contingencies.
 - Investments in customer service infrastructure.



ECPs completed in 2011		Count
Sub-Transmission		2
Construction of new sub-transmission line		2
Substation		10
Construction of new substation		1
Installation of additional capacity		3
Repair/replacement of substation facilities		6
Distribution		26
Construction of new distribution lines		3
Distribution system upgrading		23
Total		38

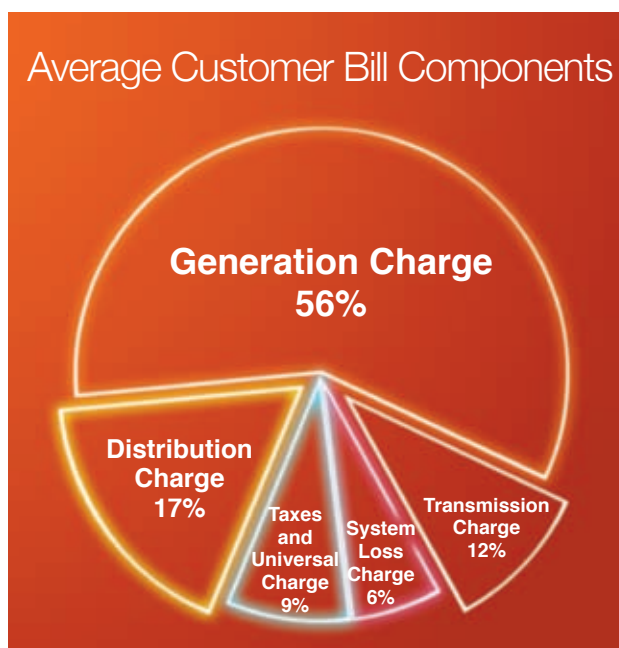
Electric Distribution System

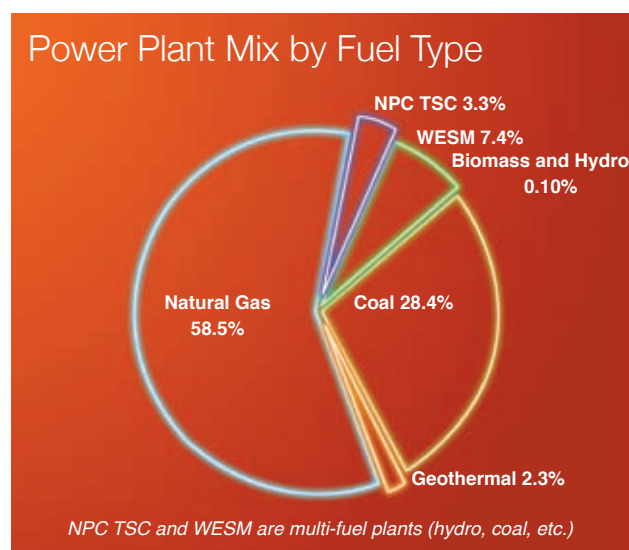
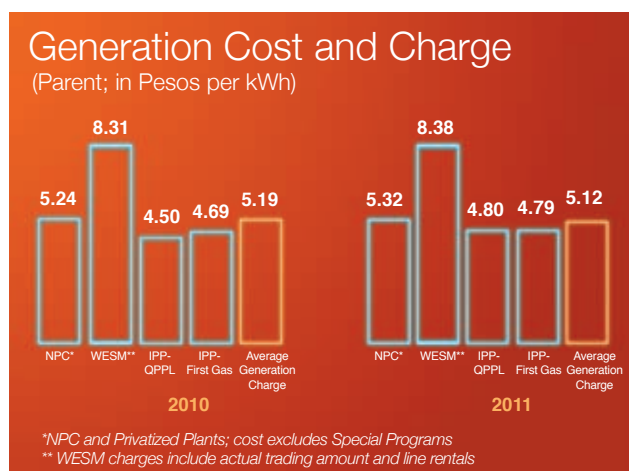
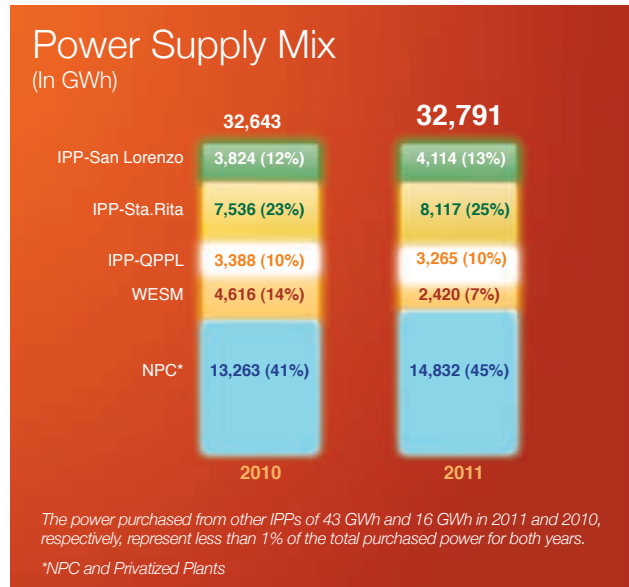
	2007	2008	2009	2010	2011
Count of Substations	117	114	115	114	113
Delivery Point (230 kV)	6	7	7	7	7
Major (115 kV and 69 kV)	70	71	73	77	78
Distribution (34.5 kV below)*	41	36	35	30	28
Substation Aggregate Capacity (MVA)	12,400	12,852	13,718	14,611	14,731
Franchise Area (km²)	9,337	9,337	9,337	9,337	9,337
Primary Circuit Length (km)	15,208	15,606	15,826	16,081	16,565
Distribution	14,557	14,866	15,052	15,271	15,744
Sub-transmission	651	740	774	810	821
Count of Circuits	756	793	805	832	839
Distribution	674	705	715	737	740
Sub-transmission	82	88	90	95	99
Distribution Transformers					
Count	134,749	143,947	145,979	148,862	152,046
Capacity (MVA)	11,286	11,668	11,892	12,200	12,499
Poles in Service	639,526	651,910	660,745	663,647	686,010
System Peak Demand (MW)	4,774	4,790	4,910	5,374	5,283

*Decrease in count is attributed to the retirement of odd-voltage substations.

The Customer Bill: Generation Charge, the Biggest Component

- Average customer bill across all customer classes at Php9.14 per kWh in 2011.
 - A 2% increase over the average bill of Php8.95 per kWh in 2010.
- Generation Charge, the biggest component of the average electricity bill, at Php5.12 per kWh in 2011, 56% of the total bill.
- Meralco's Distribution Charge accounted for only 17% of the average bill at Php1.59 per kWh.
 - Expected to remain generally stable up to June 2015, the end of current Regulatory Period.
 - Required to meet growth in electricity demand 24/7 throughout the entire franchise area.
- Transmission Charge at Php1.06 per kWh or 12% of customer bill.
- Taxes and Universal Charge comprised 9% at 85 centavos per kWh.
- System Loss Charge at 52 centavos per kWh or 6% of the average bill.





Generation Charge: Constructively Engaging with Generation Companies to Contain Rising Power Costs

- Meralco's Independent Power Producers (IPPs) remained the most cost-effective source in 2011.
 - › First Gas Corporation (FGC, 1,000 MW Sta. Rita Plant) and FGP Corp.'s (FGP, 500 MW San Lorenzo Plant), natural gas-fired plants, averaged Php4.79 per kWh in 2011, 2% up over Php4.69 per kWh in 2010.
 - › Quezon Power (Philippines) Limited Co. (QPPL) generation bill increased by 7% to Php4.80 per kWh in 2011 from Php4.50 per kWh in 2010, but was still lower than the cost from other sources.
- Wholesale Electricity Spot Market (WESM) cost was the highest at Php8.38 per kWh in 2011 from Php8.31 per kWh in 2010.
- National Power Corporation (NPC) Transition Supply Contracts (TSC) was at an average cost of Php5.32 per kWh in 2011, up 2% from Php5.24 per kWh in 2010.
- Meralco successfully concluded new long-term power supply agreements at the end of 2011, which is expected to benefit customers.
 - › Covering 2,380 MW of baseload and mid-merit generating capacity with four generation companies.
 - › At very competitive pricing
 - › Awaiting final regulatory approval by the ERC.
 - › In addition to existing long-term IPP contracts covering 1,960 MW

Power Sourcing: Securing New Long-Term Power Supply Agreements

- 48% of Meralco's power supply was sourced from contracted IPPs, 45% from NPC TSCs and the remaining 7%, from the WESM (45%, 41% and 14%, respectively, in 2010).
 - IPP's are FGC, FGP and QPPL (460 MW coal-fired power plant in Mauban, Quezon) under long-term Power Purchase Agreements.
 - NPC TSCs are with successor generating companies and IPPAs.
- By type of fuel, natural gas- and coal-fired power plants contributed 58.5% and 28.4% of total power supply, respectively.
 - The balance was supplied by geothermal, hydro, oil-fired and biomass power plants.

New Long-term Power Supply Agreements*

Contracted Capacity	Fuel	Generating Company	Power Plant Location
1,180 MW	Natural Gas/ Diesel	South Premiere Power Corporation	Ilijan, Batangas
210-420 MW	Coal	Sem-Calaca Power Corporation	Calaca, Batangas
330-430 MW	Coal	Masinloc Power Partners Co. Ltd.	Masinloc, Zambales
350 MW	Coal	Therma Luzon Inc.	Pagbilao, Quezon

*7 years, extendable upon mutual agreement

Customer Satisfaction Index: All-time high

- Record operational and customer service efficiencies led to all-time high customer satisfaction.
 - CSI at a record best 7.65% in 2011, 14 years after it was first measured
 - Quite an achievement considering customer concerns on power price
- High priority on customer-centricity and innovation led to more satisfied consumer.
 - More focused organization by customer segments – Corporate Business Group (CBG), Small & Medium Enterprise (SME) and Home & Micro Business (HMB).
 - Intensified customer engagement, communication and information on areas of high value and interest to customers, using multiple platforms, including social media.
 - Implementation of Customer Service Project with re-designed end-to-end business policies and processes, and more responsive systems.



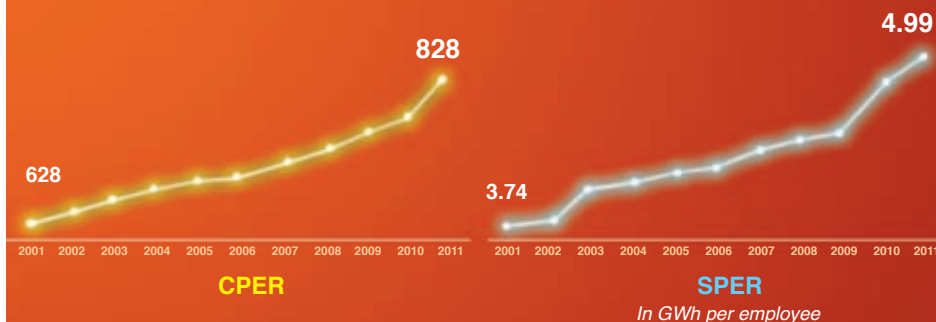
Human Resources: Driving a Culture of Delivering Performance and Productivity

- Sales, operating and financial results indicate success in building a high performance culture.
- Strategic HR-Business Partnerships, Cultural Alignment founded on our corporate values through a Performance-based Rewards and Management System and Talent Management/Leadership Development are key HR thrusts, which supported business strategies and have produced positive results across organizations.
- Latest 2011 Employee Engagement Survey, "The Pulse", revealed a highly positive overall employee engagement score of 87%.
 - › Well above local and global benchmarks.
 - › 90% response rate indicative of the high level of participation and involvement of our employees.
- The Company managed headcount even as operating performance and customer service reached new highs, ending the year with a lower regular employee headcount at 6,071, down 1% from 6,203 in 2010.
 - › Customer per Employee Ratio (CPER) was 828, the highest ever in the past 10 years.
 - › Sales per Employee Ratio (SPER) was approximately 5 GWh sales per employee, also the highest ever.

Regular Employee Count



HR Ratios





Corporate Social Responsibility

One Meralco Foundation: Meralco's re-energized approach in creating shared value

One Meralco Foundation, Inc. (OMF) was reorganized in July 2011 to align all the Company's corporate social responsibility (CSR) and sustainability initiatives. Through the OMF, Meralco renews its commitment to innovation and the sustainability of its social investments and become the country's partner in social development. OMF also gives Meralco employees the opportunity to contribute to nation-building through volunteerism.

The OMF carries the Company's firm belief that every household, especially the marginalized, should enjoy the benefits of electrification.

Providing access to reliable and affordable energy for communities without the means to secure electrical connection is Meralco's contribution to poverty reduction, sustainable development, and to improve the lives of Filipinos. Anchored on the corporate values of *Malasakit* and *Makabayan*, this social conscience is woven into the corporate culture, and is embedded in the business strategy that empowers and provides opportunities for growth and self-sufficiency.

Meralco's commitment to serve underprivileged Filipinos is embodied in its four CSR pillars: Community Electrification, Grassroots Partnerships, Sports and Youth Advocacy, and Emergency Preparedness and Disaster Response. In 2011 OMF implemented projects and activities under each pillar.



Community Electrification



Grassroots Partnerships



Sports and Youth Advocacy



Emergency Preparedness
and Disaster Response



COMMUNITY ELECTRIFICATION

More than 2,000 families in 16 communities who had long been unable to afford the cost of electrical connection and had been living without electricity service benefited from the program. The beneficiaries reside in informal settlements, resettlement areas and isolated communities within Meralco's franchise area.

OMF also provided streetlights to depressed areas to improve the safety of residents. A total of 895 households from the cities of Mandaluyong and San Juan enjoyed the benefits of streetlighting of dark alleys.

OMF started its school electrification program in six public elementary schools in Verde Island, Batangas City to help improve the learning experience of the students. OMF also continued to support electrical safety, assessment and audit, inspection of service wires and tree trimmings in more than 800 public elementary schools.

GRASSROOTS PARTNERSHIPS

OMF values its partnerships with local government units, government agencies and local barangays. As social enablers, OMF and its partners strive toward a common goal of uplifting the lives of Filipinos by addressing local community needs in health, sanitation, environmental protection, public safety, sports and education while enabling commercial and industrial businesses to operate in these communities in a sustainable manner. OMF strengthened its partnerships through the following programs:

- **Meralco Sibol Schools Project.** This program involves the construction of 60 m² pre-school buildings in Gawad Kalinga communities, setting up student feeding programs, providing teacher allowances, school rehabilitation and disease prevention programs. In 2011, four Meralco Sibol Schools, 144 students and 12 teachers benefited from this program.



- **Community livelihood programs.** A total of 50 Marikina residents were trained in various livelihood programs supporting income-generating activities, in particular the sale of home-made soaps.
- **Computer training project for local government units and the Philippine National Police.** A total of 344 individuals were trained in 2011.
- **Community outreach programs.** Organized by the Meralco Employees Fund for Charity, Inc. (MEFCI), the programs included medical missions, livelihood training, institutional donations, individual medical assistance and scholarship grants benefiting eight institutions and 2,882 individuals from depressed communities.
- **Bio-intensive Gardening.** Providing nutritional sustenance for marginalized families through training in backyard farming techniques, this project benefited 200 families from Antipolo City.

- **Maliwanag ang Pasko Activities.** These are fundraising activities and outreach programs to benefit chosen communities. In 2011, more than 5,000 individuals joined the fundraising projects benefiting the children of Verde Island, and 3,058 more individuals in underprivileged areas.

SPORTS AND YOUTH ADVOCACY

Sports not only develops the youth's health and well-being, but more importantly, it teaches discipline and teamwork that develop good character and leadership. In its first year, the OMF implemented the following programs:

- **Basketboys.** This program provides basketball clinics to marginalized youth (such as those in conflict with law) and help in their re-integration to society. Year 2011 saw the rise of 200 "Basketboys" from temporary shelters.
- **MVP Academic Assistance Award.** This is a scholastic grant given to children of Meralco employees who excel academically. Its 2011 pilot implementation assisted 100 students.



EMERGENCY PREPAREDNESS AND DISASTER RESPONSE

OMF stands at the forefront of emergency preparedness through safety awareness and environment-related programs while responding to the needs of families and institutions who are victims of disasters and calamities:

- **Youth First Aid Challenge.** A competition-based program in partnership with the Philippine National Red Cross (PNRC) to provide a venue for grade school and high school students to learn and practice first aid. 150 youths from the PNRC - Rizal Chapter participated in the program in 2011.
- **Disaster Relief Operations.** In 2011, Meralco employees donated food and clothing to victims of calamities, assisting 7,200 families even outside Meralco's franchise area such as the provinces of Albay and Misamis Oriental.

- **Tree Planting Activities.** In partnership with the Department of Environment and Natural Resources (DENR), 2,500 fruit-bearing and indigenous-species trees were planted in various DENR-protected areas in Rizal.

The success of OMF projects in 2011 was not only due to proper needs identification of recipients but more importantly, to the support of the 2,246 employees who volunteered their time, talent and treasure to OMF's programs and sustainability initiatives. The 10,898 volunteered manhours rendered in the past year indicate that Meralco employees have imbibed the corporate values of *Malasakit* and *Makabayan*.

Through the OMF, Meralco employee-volunteers not only provide power to a quarter of the country's population residing in its franchise area; they also empower communities in more ways than one.



Corporate Governance Report

This report highlights Corporate Governance (CG) achievements in 2011, manifesting Meralco's commitment to fulfill governance aspirations and compliance with the Securities and Exchange Commission's (SEC) Revised Code of Corporate Governance for publicly-listed companies in the Philippines.

Policies and initiatives are implemented to guide Board of Directors (Board), officers and employees in the practice of fairness, accountability, integrity and transparency.

I. PERFORMANCE IN GOVERNANCE

Meralco's efforts to pursue good governance initiatives and to comply with relevant regulations were recognized both locally and internationally.

A. Compliance to Regulations

Pursuant to the governance principle of transparency, Meralco fully complied with the SEC and Philippine Stock Exchange's (PSE) reportorial requirements on corporate governance, including:

1. The 2011 Certification by the Compliance Officer of Meralco's compliance with the Revised Manual of Corporate Governance.

2. Certification of Board attendance, reports involving financial statements, disclosure of material information and events, clarifications on specific news articles concerning Meralco, and trainings attended by Board members and key officers on corporate governance.
3. Disclosure requirements on direct and indirect ownership of securities under the Securities Regulation Code (SRC) and the reporting of trading transactions of directors and concerned officers of Meralco by the Compliance Officer not later than the following day after the required event or transaction. There has been no case of insider trading involving directors and management of Meralco.

Meralco participated in the following annual CG Performance Assessments:

1. The CG Scorecard Assessment conducted by the Institute of Corporate Directors (ICD) in cooperation with SEC and PSE. It evaluates the level of CG practices of Publicly Listed Companies (PLCs) relative to local and international standards and best practices. Meralco's corporate governance scorecard shows its performance as higher than the average performance of all other participating PLCs.
2. The PSE's CG Disclosure Guide, which helps publicly listed companies in their operations and informs shareholders of the good governance practices of the companies they invested in.

B. Building Competencies

Corporate governance education in Meralco continues with orientations and trainings for the Board, management and employees. All directors attended seminars on corporate governance as required by the Company's Manual of Corporate Governance and the Energy Regulatory Commission (ERC) Resolution No. 1, entitled "Program to Promote Good Corporate Governance in Distribution Utility." The Board of Meralco also attended a Governance Enhancement course on Regulatory Process and Related Issues on November 28, 2011 to constantly update itself of changes in the power distribution industry.

Senior executives attended the Corporate Governance Forum on December 7, 2011 entitled "Tips and Traps: A Discussion on the Experiences of US and Global Companies in Ethics, Compliance and Corporate Governance". It was facilitated by Mr. Steve Priest of Global Compliance and the Ethical Leadership Group.

Senior Executives – namely Ms. Ivanna G. de la Peña, Ms. Betty C. Siy-Yap and Mr. Ramon B. Segismundo, joined representatives of companies in an orientation course on corporate governance principles, road maps and best practices conducted by the ICD at the Manila Peninsula on December 1, 2011.

In 2011, three officers of Meralco – Mr. Jesus P. Francisco, Atty. Simeon Ken R. Ferrer and Mr. Gerardo F. dela Paz, were conferred the title of "Fellow" by the ICD after going through the Professional Directors Program, which included a Corporate Governance Orientation. They joined other ICD Fellows in Meralco – Mr. Oscar S. Reyes, Ms. Helen T. de Guzman and Mr. Manuel Lorenzo L. Tuason.

C. Governance Advocacies

Corporate Governance Deputy Head, Mr. Gerardo F. dela Paz, spoke before the 2011 National Electrification Administration – Electric Cooperatives (NEA-EC) Conference and Recognition held on April 28, 2011 at the Radisson Blu Hotel, Cebu City. The topic of his discussion was "Corporate Governance and Best Practices in Managing an Electric Utility Business".

Meralco also joined Philippine Long Distance Telephone Company and Smart Communications, Inc. as associate member in the Ethics and Compliance Officer Association (ECO) an association for individuals responsible for their organization's ethics, compliance, and business conduct programs, which has the largest group of ethics and compliance practitioners in the world as its members. ECOA is based in Massachusetts, U.S.A.

Meralco sent its representative to the ICD Annual Working Session held at the Sheridan Beach Resort and Spa in Palawan on November 17, 2011. The annual event enabled regulators, advocates and publicly listed companies to tackle relevant corporate governance issues and strengthen best practices in the country.

Meralco encourages active participation in the activities of the Good Governance Advocates and Practitioners of the Philippines (GGAPP) to discuss best governance practices, regulatory issues and other relevant developments. GGAPP is an association of corporate governance advocates and practitioners from various publicly-listed companies, the public sector and other organizations.

D. Continuing Policy Formulation

With the creation of a Corporate Governance Office in Meralco in 2010, several corporate policies and programs were implemented such as the Revised Manual of Corporate Governance, Revised Code of Ethics, Policy on Blackout Period/Restriction on Trading of Shares, Policy on Solicitation and Acceptance of Gifts, “Be Right” Open Communication (integrated whistle-blowing) Policy, among others.

In 2011, Meralco continued to move forward with its corporate governance practices through the following initiatives:



1. “E-Report Mo” – A program that supports the “Be Right” Open Communication Policy of Meralco, a whistle-blowing channel that receives reports and initiates actions that will address:
 - Violation of the Corporate Governance Rules;
 - Violation of the Code of Ethics and Code on Employee Discipline or other related codes; and
 - Financial malfeasance including those related to financial fraud, questionable accounting and auditing matters.



2. “E-Suggest Mo” – The positive reporting program of the “Be Right” Open Communication Policy that harnesses the value of employees’ bright ideas and nurtures their contributions in improving Meralco’s operations through ingenious suggestions.

3. Corporate-wide launching of the New Meralco Corporate Values of Customer Service, Performance, Accountability/ Empowerment, Integrity/ Transparency, Teamwork/ Collegiality, *Malasakit* and *Makabayan*. The goal is to acquire the commitment of the participants in living out these values.

II. SHAREHOLDER RELATIONS

Meralco recognizes its responsibility to protect its shareholders’ rights by creating value and ensuring sustainable growth in business. Meralco upholds their rights to obtain relevant information about Meralco in a timely and regular basis.

Meralco’s financial performance and prospects are regularly reported to the SEC and PSE. These reports are immediately made public through press releases and postings in the Meralco’s website.

Investors’ briefings are held quarterly, where equity and credit analysts of both local and foreign-based institutions are invited. Analysts who are unable to attend in person participate through a teleconferencing facility with playback feature available up to three days after the event. Members of Senior Management make themselves available for meetings with institutional investors through Company visits, teleconferences, briefings and attendance in local and international investor conferences.

Press and media briefings are likewise held regularly to report on Meralco’s operating and financial results to the various representatives of media, particularly from the television, print and wire agencies. Such briefings are venues for Management to answer questions and clarify issues prior to the release of information to the public.



Shareholders and investors are provided with adequate facilities to communicate with Meralco through telephone, mail, electronic mail, and website, www.meralco.com.ph. The Investor Relations Office supervises the investors' briefings and attends to institutional investors' needs. Stockholder Affairs Office attends to the inquiries and other concerns of shareholders, including the distribution of Notice and Agenda of the Annual General Meeting (AGM) at least 30 days before the said meeting. Notices were sent on April 27, 2011, 34 days before the 2011 AGM on May 31, 2011.

Meralco also adheres to its commitment to maintain a fair and competitive return to its investors. Meralco has a dividend policy approved by the Board, which was ratified by the shareholders in 2010. The policy provides for payment of regular dividends equivalent to 50% of core earnings, which may be supplemented by a special dividend

determined on a "look-back" basis. Any declaration and payment of special dividend shall be dependent on the availability of unrestricted retained earnings and availability of free cash. The details of the cash dividend pay-outs are included in Note 18 to the the Consolidated Financial Statements.

Annual General Meeting

The AGM serves as a venue to report to and engage the shareholders, as well as to clarify issues in the presence of the Board, Management and external auditors. Shareholders are encouraged to personally attend the AGM and if unable to do so, are advised of their right to appoint a proxy on their behalf. Notarization of a proxy is not required but has to comply with the requirements of law, in particular, the Corporation Code and SRC, pertinent rules and regulations, By-Laws, and rules and policies adopted by the Board.

The AGM held on May 31, 2011 was attended, in person or proxy, by stockholders who owned or held a total of over 949 million shares or approximately 84% of the 1,127 million total issued and outstanding common shares of Meralco entitled to vote.

The Chairman of the Board, Ambassador Manuel M. Lopez, presided over the meeting. All of the members of the Board elected at the AGM, except for Mr. Ray C. Espinosa and Mr. Napoleon L. Nazareno, were present.

III. BOARD OF DIRECTORS

The Board is primarily responsible for the governance of Meralco. Corollary to setting the policies for the accomplishment of the corporate objectives, the Board also provides an independent oversight on Management. The Board establishes Meralco's vision, mission, strategic objectives, policies and procedures that guide its activities, including the mechanisms for effective monitoring of Management's performance. The Board also ensures that internal control mechanisms for good governance are adequate.

A. Board Composition

The Board consists of 11 directors which are elected by the stockholders during the AGM. The Board represents a mix of disciplines in the area of business, finance, operations and legal competencies, with each director capable of adding value and exercising independent judgment. Of these directors, two are independent directors, seven are non-executive directors, and two are executive directors. The composition of the Board clearly delineates their responsibilities with those of Management.

B. Board Independence

Meralco complies with Rule 38 of the Implementing Rules of the SRC on the qualifications, nomination and election of independent directors. Each elected independent director has no business or other relationship with Meralco that could, or could reasonably be perceived to, materially interfere with the exercise of his independent judgment in carrying out his responsibilities as a director.

C. The Chairman of the Board and the President and CEO

To further strengthen the Board's independence, the position of the Chairman of the Board is separated from the President and CEO. Each position has distinct and separate duties and responsibilities in accordance with Meralco's amended By-Laws and Revised Manual of Corporate Governance. The Chairman of the Board is Ambassador Manuel M. Lopez, while the President and CEO is Mr. Manuel V. Pangilinan.

D. Election of Directors

In accordance with the provisions of the Company's By-Laws and Manual of Corporate Governance, the Corporation Code of the Philippines and the SRC, nominees for board directorship go through a nomination and screening process. The final list of nominees is determined after pre-screening and evaluation. The directors are elected by stockholders who are entitled to vote during the AGM. They serve for a period of one year and until their successors are qualified and elected.

E. Board Remuneration

Meralco's directors do not receive any compensation other than the Board-approved per diem for their attendance in Board and Committee Meetings. In 2011, each director was entitled to a director's fee of Php120,000 for each Board meeting attended. Each member or advisor of the Audit and Risk Management, Remuneration and Leadership Development (formerly Compensation and Benefits), Finance, Nomination and Governance Committees was entitled to a fee of Php20,000 for every committee meeting attended.

F. Board Performance

The Board holds monthly meetings and special Board meetings, if so required, with agenda that include updates by the Chairman of the Board and the

Board committees, reports on financial performance by the Chief Finance Officer (CFO) and operational performance by the President and CEO, the Senior Executive Vice President and Chief Operating Officer (COO) among other major issues of Meralco.

The Board has separate and independent access to the Corporate Secretary, who oversees the adequate flow of information to the Board prior to meetings and advises directors about their duties. During Board meetings, discussions are open and independent views are given due consideration. Average attendance in the Board's 12 meetings last year was more than 89%.

The following table shows the participation of the Board in the AGM, Organizational Meeting and its regular meetings:

Member	Designation	AGM and Organizational Meeting May 31, 2011	Board Meetings
Ambassador Manuel M. Lopez	Chairman	Present	6/12
Ramon S. Ang	Vice-Chairman and Director	Present	8/12
Manuel V. Pangilinan	Director	Present	10/12
Ray C. Espinosa	Director	Not Present	12/12
Estelito P. Mendoza	Director	Present	12/12
Napoleon L. Nazareno	Director	Not Present	12/12
(Ret.) Chief Justice Artemio V. Panganiban	Independent Director	Present	12/12
Vicente L. Panlilio	Director	Present	11/12
Eric O. Recto	Director	Present	12/12
Oscar S. Reyes	Director	Present	12/12
Pedro E. Roxas	Independent Director	Present	11/12

The Board recognizes the importance of a regular performance assessment, individually and collectively, as part of their accountability. Assessments were done to evaluate their specific and overall performance for the past calendar year. The assessment of their 2011 performance was conducted on February 3, 2012.

On May 20, 2011 the Board also assessed the performance of the different committees. The Board evaluated their individual and collective performances regarding the Board and its committees' structures, processes and responsibilities. The assessment likewise identified the training and skills development program needed by the Board. As a result, an orientation on the regulatory process and related issues was held on November 28, 2011.

The Board reviewed the 2011 performance of the President and CEO during the January 30, 2012 Board meeting. It was based on the attainment of target corporate goals for 2011.

IV. BOARD COMMITTEES

The Board formed five committees to ensure compliance with the principles of good corporate governance. The members of the committees were appointed by the Board during the organizational meeting held immediately after the AGM.

All committees have approved charters defining and specifying the scope of their responsibilities.

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

A. Executive Committee (ExCom) –

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

B. Nomination and Governance Committee (Nom & GovCom) –

composed of four directors with an independent director as chairman. It is responsible for screening qualified nominees for election as directors; assessing the independence of directors; introducing improvements on Board organization and procedures; setting-up of mechanisms for performance evaluation of the Board and Management; and providing programs for continuing education of the Board.

In 2011, the Nom & GovCom

- a) screened and selected the nominees for election as members of the Board;
- b) reviewed the rules on nomination of candidates, validation of proxies, and appreciation of ballots;
- c) reviewed revisions in the Manual of Corporate Governance;
- d) reviewed the committee charter;
- e) conducted the Board and Board Committee self-assessment and evaluated its results; and
- f) facilitated the Board orientation on regulatory processes.

C. Audit and Risk Management Committee (AuditCom) –

composed of five directors with accounting and finance backgrounds and two of whom are independent. The AuditCom provides assistance to the Board in its oversight responsibility in the financial reporting process, system of risk management and internal control, audit process, and monitoring compliance with applicable laws, rules and regulations.

In 2011, the AuditCom was able to accomplish the following: a) review of Meralco's 2010 audited financial statements and 2011 quarterly financial statements; b) review and approval of the 2010 Audit and Risk Management Committee Report to the Board; c) evaluation of the external auditor's performance and endorsement of the nomination of the external auditor and its fees for 2011; d) review of 2010 internal audit performance and status report; e) approval of external quality assessment review for the internal audit activity; f) review and approval of external auditor's 2011 audit plan; g) evaluate Board Committee self-assessment results; h) review the AuditCom charter; and i) evaluate Meralco's risk profile and management structure, systems and processes.

D. Remuneration and Leadership Development Committee (Remuneration & LDCom, formerly Compensation and Benefits Committee) – composed of four directors, one of whom is an independent director. The Remuneration & LDCom assists the Board in the development of Meralco's overall performance management, compensation, retirement and leadership development policies and programs based on the Meralco-approved philosophy and budget.

In 2011, the Remuneration & LDCom a) reviewed and endorsed to the Board new remuneration policy, philosophy, design, and programs of Meralco; b) recommended the implementation of the Long-term Incentive Plan; c) evaluated the 2010 employee performance results and proposals for the 2011 and 2012 performance management system and incentive plans; d) conducted the 2010 performance

evaluation of the President and CEO; e) reviewed and recommended improvements to the Remuneration & LDCom charter, including renaming the committee to Remuneration and Leadership Development Committee to align with its expanded responsibilities; and f) nominated the Board of Trustees of the Meralco Pension Fund.

E. Finance Committee (FinCom) – composed of four directors, one of whom is an independent director, with the CFO as ex-officio member. It reviews the financial operations of Meralco and matters regarding major purchase contracts, and acquisition and/or divestment of investments, businesses or ventures.

In 2011, the FinCom a) reviewed and recommended the approval of the 2012 consolidated corporate budget; b) reviewed and recommended the approval of the medium-term financial plans; c) recommended the approval of cash dividend declarations for common and preferred shares; d) reviewed the quarterly cash projections and finance operations reports; e) recommended the redemption on the callable preferred shares; f) reviewed the proposals for new debts and refinancing of existing obligations; g) reviewed investment plans; h) reviewed and recommended the funding of the Meralco Pension Fund; i) recommended the approval of the divestment from the real estate business; j) reviewed and recommended major purchase contracts; k) approved the disposal of asset no longer needed in the operations; and l) recommended approval of bank accreditation and signing authorities.

F. Board Committee Meeting and Attendance

Member	2011 Board Committee Meeting Attendance			
	Nom & GovCom	AuditCom	Remuneration & LDCOM	FinCom
Ambassador Manuel M. Lopez	N/A	N/A	N/A	6/12
Ramon S. Ang	N/A	N/A	N/A	N/A
Manuel V. Pangilinan	N/A	N/A	5/5	N/A
Ray C. Espinosa	5/5	N/A	N/A	11/12
Estelito P. Mendoza	4/5	N/A	N/A	N/A
Napoleon L. Nazareno	5/5	6/7	5/5	N/A
(Ret.) Chief Justice Artemio V. Panganiban ¹	N/A	7/7	N/A	N/A
Vicente L. Panlilio	N/A	7/7	N/A	N/A
Eric O. Recto	N/A	6/7	5/5	11/12
Oscar S. Reyes	N/A	N/A	N/A	N/A
Pedro E. Roxas ¹	5/5	7/7	5/5	11/12
Ferdinand K. Constantino ²	N/A	N/A	N/A	7/12
Anabelle L. Chua ²	N/A	6/7	N/A	11/12

¹ Independent Director; ² Non-Voting Member

V. MANAGEMENT

The Management is represented by a Management Committee (ManCom) composed of corporate officers and executives headed by the President and CEO, or in his absence, the Senior Executive Vice President and COO. All principal policies and directions governing the organization, management and operation of Meralco, as well as its subsidiaries are formulated and implemented by the ManCom, subject to Board approval. Weekly meetings are conducted by the ManCom to ensure implementation of major policies and directions governing Meralco and its subsidiaries. It reports to the Board during regular Board meetings or special meetings through the President and CEO and/or the Senior Executive Vice President and COO.

The annual performance of Management is assessed through the achievement of the established target goals of Meralco.

VI. ENTERPRISE RISK MANAGEMENT

Meralco crafts annual strategies and conducts self-assessments to evaluate risks and their likely impact on its business performance.

Meralco has an existing Risk Management Policy Manual, approved in September 2009, which aims to enhance shareholder value through a risk management framework. This framework includes procedures for identifying and reviewing risks and in ensuring that mitigation and management activities are undertaken. It defines the infrastructure that guides employees, Senior Management and the Board in making appropriate decisions for managing Meralco's risk portfolio to meet its goals and strategies.

In 2011, Meralco intensified its risk management awareness campaign by expanding its Risk Management Office's function and scope to include external

risks involving subsidiaries and associates. Meralco's annual Risk Self-Assessment activity included the identification and verification of critical business risks of both Meralco and its subsidiaries. The top business risks that were identified in the process served as valuable inputs in Meralco's planning and budgeting activities.

VII. ACCOUNTABILITY AND AUDIT

A. External Auditors

SyCip, Gorres, Velayo & Co. (SGV) has been reappointed as external auditors of Meralco in the AGM on May 31, 2011. The engagement partner assigned to Meralco since 2008 is Mr. Gemilo J. San Pedro, who has extensive accounting and auditing experience. The appointment is in accordance with the SEC regulation on the qualification of external auditors.

The AuditCom ensures that the independence of the external auditors is maintained. In line with this, the AuditCom does not allow engagement of SGV in any non-audit work that (i) will conflict with their duties as external auditors or (ii) may impair or pose a threat to their independence. Any non-audit work, if allowed, is disclosed in the Meralco annual report.

During the year, the external auditors provided the following audit and permissible non-audit services to Meralco and its subsidiaries.

Consolidated Audit Fees (in million Php)		
	2011	2010
Financial statements audit	9.2	9.4
Tax services and others	1.0	1.5
TOTAL	10.2	10.9

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

B. Internal Auditors

The internal audit activities conform with the concepts and principles enunciated in the definition of internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Internal audit services are performed in accordance with the International Standards for the Professional Practice of Internal Auditing.

The internal audit group is led by a chief audit executive and includes 23 other staff with professional qualifications, which include Certified Internal Auditors, Certified Information Systems Auditors and Certified Public Accountants. The tasks of the internal audit group are set out in the Corporate Audit Charter and the Code of Corporate Governance of Meralco. To provide for independence of the internal audit group, the chief audit executive reports functionally to the AuditCom and administratively to the President and CEO in a manner outlined in the Corporate Audit Charter.

Annually, a risk-based internal audit plan is prepared and approved by the AuditCom.

In 2011, the internal audit group issued reports to Senior Management and the Audit and Risk Management Committee to communicate the results of reviews and audits covering various operational units of the Company and its subsidiaries including specific areas of concern identified by Management. Significant concerns, which have been reported by the internal audit group, and the implementation of responsive remedial measures, are monitored by Management and by the AuditCom.

C. Internal Control

The control environment of Meralco consists of:

- The Board, which ensures that Meralco is properly managed and effectively supervised;
- A Management that handles day-to-day operations and ensures that sound and prudent decisions and actions are made;
- The organizational and procedural controls supported by effective management information and risk management reporting systems; and
- An independent audit mechanism to monitor the adequacy and effectiveness of Meralco's financial reporting, governance, operations, and information systems, including the reliability and integrity of financial and operational information, the effectiveness and efficiency of operations, the safeguarding of assets, confidential information, and compliance with laws, rules and regulations and contracts.

VIII. FINANCIAL REPORTING

The consolidated financial statements were prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS includes statements named PFRS and Philippine Accounting Standards, including interpretations issued by the Philippine Financial Reporting Standards Council. The consolidated financial statements are reviewed by the AuditCom to ensure that they present fairly, in all material aspects, the financial position of Meralco and subsidiaries and are recommended for approval by the Board. In 2011, the audit of the consolidated financial statements was conducted by the external auditors, the results of which were discussed with the AuditCom. The consolidated financial statements were presented to the Board for approval before these were filed with the SEC and released to the public.

IX. DISCLOSURES ON OWNERSHIP STRUCTURE

Meralco ensures that it consistently complies with the required disclosures on shareholdings of its securities. In compliance with the PSE requirements, a quarterly report of Meralco's top 100 shareholders is disclosed to the PSE and posted in the Meralco website.

Based on Meralco's stock and transfer book, the security ownership as at December 31, 2011 of beneficial owners of more than 5% of any class of its voting securities is as follows:

Name	No. of Shares	Percentage
Beacon Electric Asset Holdings, Inc.	480,033,776	42.6%
San Miguel Corporation	241,872,280	21.5%
PCD Nominee Corporation (Filipino)	64,135,540	5.7%
Social Security System	62,990,689	5.6%
San Miguel Purefoods Company, Inc.	59,090,909	5.2%
Complete list is found in the "List of Top 100 Stockholders as at December 31, 2011" as filed with the PSE on January 12, 2012.		

Meralco's public ownership level as at December 31, 2011 as submitted to the PSE on January 24, 2012 is at 19.08%.

X. RELATED PARTY TRANSACTIONS

Meralco transacts with related parties to whom it supplies and delivers electricity and/or those who provide services to support its operations. Any dealing with a related party is set on an arm's-length basis in a manner similar to the transactions with third parties. Meralco fully discloses its related party transactions in accordance with revised PFRS. The nature, extent and other material information of these transactions are disclosed to the SEC and PSE through the consolidated financial statements and annual report within prescribed schedules. These disclosures are likewise posted on the Meralco website for easy access by all its stakeholders and the public. No disputes in connection with such related party transactions were reported in the past.

XI. EMPLOYEE RELATIONS

Meralco is committed to the development and welfare of its employees. As the Company sustain its efforts in building a high performance culture to fully respond to the requirements of the new business environment, employees are continuously trained and developed to enable them to achieve excellent performance founded on our corporate values. Career development programs are implemented to ensure professional growth through skills and job enrichment opportunities, learning and development programs, performance management and promotions systems. Employees are compensated based on performance and over-all qualifications and market competitiveness. Adequate provisions for medical, health and other essential benefits; and workplace safety are provided to promote employee welfare and well-being. Uprightness and impartiality are observed in conflict resolution. HR Programs for our employees are continuously reviewed and enhanced to ensure their overall effectiveness and responsiveness.

The Company is further committed in sustaining and/or further enhancing the high level of engagement of employees. Guided by the results of an employee engagement survey conducted, focused and deliberate initiatives are undertaken to help ensure employees job satisfaction and motivation. Employee communication is strengthened to keep employees well-informed on significant developments. Employees are likewise encouraged to give feedback and suggestions to Management to further improve corporate and operational performance, thereby, promoting employee accountability and empowerment.

XII. OBLIGATIONS TO OTHER STAKEHOLDERS

Meralco fully considers the impact of business decisions on the interests of its shareholders and other stakeholders. The Declaration of Corporate Principle of the Revised Manual of Corporate Governance specifically mentions: "The Company... uphold(s) an ethical culture that will

protect and promote the best interest of the Company for the common benefit of the Company's stockholders and other stakeholders."

Meralco also protects and maintains professional relationships with its suppliers and creditors based on mutual respect and benefit. Meralco commits to foster long-term stability, direct and open relation, and continuous development with suppliers to attain quality, competitiveness, process efficiency and performance reliability; foster governance principles in all of its business dealings; and seek, encourage and prefer suppliers whose business practices adhere to the principles of good corporate governance and social responsibility.

XIII. GOVERNANCE OF SUBSIDIARIES

As one of Meralco's five strategic business pillars, the subsidiaries contribute significantly in boosting shareholder value.

The Subsidiary Management Policy continues to serve as the guidebook in creating and managing subsidiaries based on the criteria and principles embodied in the Revised Manual of Corporate Governance, Code of Ethics, and existing laws, rules and regulations.

In 2011, Meralco continued to strengthen the good governance practice of its subsidiaries by strongly advocating the need for each subsidiary to adopt its own Manual of Corporate Governance. Specifically, the subsidiaries were provided with a template based on the requirements stipulated in the SEC Revised Code of Corporate Governance and the Revised Manual of Corporate Governance to assist each subsidiary in developing and adopting its own manual.

(Meralco provides a detailed report on all the foregoing facts, programs and initiatives in the corporate governance section in its website, www.meralco.com.ph. The same section also features Meralco's corporate governance structures and key players, principles, responsibilities, policies, processes and practices.)

Board of Directors



MANUEL M. LOPEZ, 69

Director (since April 14, 1986)

Chairman and CEO (from July 1, 2001 to June 30, 2010)

Chairman (since July 1, 2010)

Mr. Lopez is the Philippine Ambassador to Japan. He is concurrently the Chairman and CEO of Lopez Holdings Corporation and is the Chairman of Bayan Telecommunications, Inc., Indra Philippines, Inc., Rockwell Land Corporation and Rockwell Leisure Club. He is the Vice Chairman of First Philippine Holdings Corporation and a member of the Board of Directors of ABS-CBN Corporation, Adtel, Inc., First Philippine Realty Corporation and Griffin Sierra Travel, Inc. He is also the President of Eugenio Lopez Foundation Inc.

MANUEL V. PANGILINAN, 65

Director (since May 26, 2009)

President and CEO (since July 1, 2010)

Mr. Pangilinan is the Chairman of Philippine Long Distance Telephone Company, Smart Communications, Inc. and Digitel, Inc., the country's dominant telecommunications group. He is the Chief Executive Officer and Managing Director of First Pacific Company Limited, a publicly-listed company in Hong Kong. He is currently the Chairman of the Board of Trustees of San Beda College, and was the Chairman of the Board of Trustees of the Ateneo de Manila University.

OSCAR S. REYES, 65

Director, Senior Executive Vice President and Chief Operating Officer (since July 1, 2010)

Mr. Reyes is a member of the Advisory Board of Philippine Long Distance Telephone Company and of the Board of Directors of Bank of the Philippine Islands, Manila Water Company, Inc., Ayala Land, Inc., Smart Communications, Inc., Pepsi Cola Products Philippines, Inc. and Sun Life Financial Phils., Inc., among other firms. He is also the President of Meralco PowerGen Corporation and Chairman of Meralco Industrial Engineering Services Corporation, CIS Bayad Center, Inc., Meralco Energy, Inc., MRL Gold Phils., Inc. and Link Edge, Inc. He is a member of the Board of Trustees of One Meralco Foundation, Inc., Pilipinas Shell Foundation, Inc., SGV Foundation, Inc. and El Nido Foundation, Inc. He served as Country Chairman of the Shell Companies in the Philippines and concurrently President of Pilipinas Shell Petroleum Corporation and Managing Director of Shell Philippines Exploration B.V.



RAMON S. ANG, 57

Director and Vice Chairman (since February 1, 2009)

Mr. Ang is the Vice Chairman, President and Chief Operating Officer of San Miguel Corporation. He is the Chairman, CEO and Executive Director of Petron Corporation and Chairman and CEO of SMC Global Power Holdings Corporation. He is the Chairman of San Miguel Brewery, Inc., San Miguel Foods, Inc., The Purefoods-Hormel Company, Inc., San Miguel Yamamura Packaging Corporation, South Luzon Tollway Corporation, Eastern Telecommunications Philippines, Inc., Liberty Telecoms Holdings, Inc., Sea Refinery Corporation and Philippine Diamond Hotel & Resort Inc. He is the Vice Chairman of Ginebra San Miguel, Inc. and San Miguel Pure Foods Company, Inc. He is also the Chairman and President of San Miguel Properties, Inc., Bell Telecommunication Philippines, Inc., Atea Tierra Corporation, Cyber Bay Corporation and Philippine Oriental Realty Development Inc.. He is a Director of other subsidiaries and affiliates of the San Miguel Group of Companies in the Philippines and Southeast Asia and an Independent Director of Philweb Corporation.

RAY C. ESPINOSA, 55

*Director (since May 26, 2009)
General Counsel*

Atty. Espinosa is the President and Chief Executive Officer of Mediaquest Holdings, Inc., ABC Development Corporation (TV5), Mediascape, Inc. (Signal TV), Nation Broadcasting Corporation, and other subsidiaries of Mediaquest Holdings Inc. He is a member of the Board of Trustees of the PLDT Beneficial Trust Fund, a member of the Board of Directors of Philippine Long Distance Telephone Company, Meralco PowerGen Corporation and Metro Pacific Investments Corporation and Lepanto Consolidated Mining Corporation; and Vice Chairman of Philweb Corporation. He also serves as Head of Regulatory Affairs and Policy of Philippine Long Distance Telephone Company.

ESTELITO P. MENDOZA, 81

Director (since February 1, 2009)

Atty. Mendoza is the Managing Partner of Estelito P. Mendoza and Associates. He is a member of the Board of Directors of San Miguel Corporation, Petron Corporation, Philippine National Bank and Philippine Airlines, Inc. He has also been a Professorial Lecturer of law at the University of the Philippines and served as Solicitor General, Minister of Justice, Member of the Batasang Pambansa and Provincial Governor of Pampanga. He was also the Chairman of the Sixth (Legal) Committee, 31st Session of the UN General Assembly and the Special Committee on the Charter of the United Nations and the Strengthening of the Role of the Organization.



NAPOLEON L. NAZARENO, 62

Director (since May 26, 2009)

Mr. Nazareno is the President and Chief Executive Officer of Philippine Long Distance Telephone Company, Smart Communications, Inc. and Connectivity Unlimited Resources Enterprise, Inc. He also serves as Chairman of PLDT Communications and Energy Ventures, Inc.; member of the Board of Directors of Smart Broadband, Inc., Wolfpac Mobile, Inc., and i-Contacts Corporation. He is a member of the Board of Directors of PLDT Global Corporation, ePLDT, Inc. and GSM Association Worldwide and Wireless Applications Community (WAC), an international alliance of telecommunications companies; and a non-executive Director of First Pacific Company Limited. He is also the Chairman of the Board of Trustees and Governors of the Asian Institute of Management, Governor of the Management Association of the Philippines and member of the Council of Advisors of the De La Salle University Graduate School of Business and Philippine-Thailand Business Council.

ARTEMIO V. PANGANIBAN, 75

Independent Director (since May 27, 2009)

Justice Panganiban was a former Chief Justice of the Supreme Court of the Philippines. He was a Chairperson of the Presidential Electoral Tribunal, Judicial and Bar Council and Philippine Judicial Academy. He is an Independent Director of Petron Corporation, Bank of the Philippine Islands, First Philippine Holdings Corporation, Metro Pacific Investments Corporation, Metro Pacific Tollways Corporation, Robinsons Land Corporation, GMA Network, Inc., GMA Holdings, Inc. and Asian Terminals, Inc. He is a Senior Adviser of Metropolitan Bank and Trust Company, Chairman of the Board of Advisers of Metrobank Foundation and a columnist for the Philippine Daily Inquirer.

VICENTE L. PANLILIO, 65

Independent Director (from May 27, 2008 to May 25, 2010)

Director (since June 28, 2010)

Mr. Panlilio is a member of the Board of Directors of San Fernando Electric Light and Power Company, Bank of Commerce, and a member of the Board of Trustees and Treasurer of Tulay sa Pag-unlad Foundation, Inc. He was a Director of the Philippine Stock Exchange, the Philippine Dealing Exchange Corporation, Equitable PCIBank and the Philippine National Bank. He was also Chief Operating Officer and member of the Advisory Board of Far East Bank and Trust Company.



PEDRO E. ROXAS, 55

Independent Director (since May 25, 2010)

Mr. Roxas is the Chairman and a member of the Board of Directors of Roxas Holdings, Inc., Roxas and Co., Inc. and Roxaco Land Corporation. He is the Chairman of Roxol Bionergy Corporation, Club Punta Fuego, Inc. and Fuego Land Corporation. He is a member of the Board of Directors of Philippine Long Distance Telephone Company, BDO Private Bank and Brightnote Assets Corporation.

ERIC O. RECTO, 48

Director (since June 28, 2010)

Mr. Recto is the Vice Chairman of Philippine Bank of Communications and is the President of Petron Corporation, Top Frontier Investment Holdings, Inc., Q-Tech Alliance Holdings, Inc. and ISM Communications Corporation. He is also a member of the Board of Directors of San Miguel Corporation, and Vice Chairman of Atok-Big Wedge Co., Inc., Alphaland Corporation and Philweb Corporation. He was a Director of Philex Petroleum Corporation, Maynilad Water Services, Inc., Bulawan Mining Corporation and Philippine National Bank.

Corporate Officers



RAFAEL L. ANDRADA, 52

*First Vice President and Treasurer
Head, Investment Management and Treasury*

Mr. Andrada is a member of the Board of Directors of CIS Bayad Center, Inc., Clark Electric Distribution Corporation, General Electric Philippines Meter & Instrument Co., Inc., Republic Surety and Insurance Company, Inc., Meralco Industrial Engineering Services Corporation, Rockwell Leisure Club, Inc., Rockwell Land Corporation, Bauang Private Power Corporation and Lighthouse Overseas Insurance Ltd., Inc. He is the Treasurer of Clark Electric Distribution Corporation, Lighthouse Overseas Insurance Ltd., Inc., Meralco PowerGen Corporation, Calamba Aero Power Corporation, Redondo Peninsula Energy, Inc. and Atimonan Land Ventures Development Corporation. He holds a Bachelor of Science degree in Management from De La Salle University.

RUBEN B. BENOSA, 55

*First Vice President and Head,
Corporate Logistics Office*

Mr. Benosa is a member of the Board of Directors of Miescorrail, Inc., Meralco Energy, Inc. and e-Meralco Ventures, Inc. and Trustee of the Meralco Management and Leadership Development Center Foundation, Inc. Mr. Benosa holds a Bachelor of Science degree in Electrical Engineering from the Mapua Institute of Technology and completed his Masters in Management at the Asian Institute of Management.

RICARDO V. BUENCAMINO, 67

*Executive Vice President and Head,
Networks*

Mr. Buencamino is a member of the Board of Directors of Clark Electric Distribution Corporation, General Electric Philippines Meter & Instrument Company, Inc., Meralco Energy, Inc., Calamba Aero Power Corporation, Atimonan Land Ventures Development Corporation, Conference of the Electric Power Supply Industry Philippines, Inc. and Association of Electricity Supply Industry of East Asia and the Pacific. Mr. Buencamino holds a Bachelor of Science degree in Electrical Engineering from the Mapua Institute of Technology. He completed his Masters in Management at the Asian Institute of Management and attended the General Management of Electric Utilities training program at the International Management Development Center in Texas, U.S.A.



MARTHYN S. CUAN, 32

*Vice President
Chief Information Officer*

Mr. Cuan is a member of the Board of Directors of e-Meralco Ventures, Inc. He was the Operations Head, Information Enterprise Services of Deutsche Bank Group – Manila Shared Service Centre. Mr. Cuan holds a Bachelor of Science degree in Management Information Systems from the Ateneo de Manila University.

IVANNA G. DE LA PEÑA, 57

*First Vice President and Head,
Regulatory Management Office*

Ms. De la Peña is a member of the Board of Directors of Clark Electric Distribution Corporation, e-Meralco Ventures, Inc., Share An Opportunity Philippines Inc. and Medical Ambassadors Phils., Inc. Ms. de la Peña holds a Bachelor of Science degree in Statistics and a Masters in Business Administration from the University of the Philippines. She attended the Public Utility Research Center-World Bank Training Course on Utility Regulation and Strategy at the University of Florida and the General Management of Electric Utilities training program at the International Management Development Center in Texas, U.S.A.

SIMEON KEN R. FERRER, 55

*Corporate Secretary and Compliance Officer
(since May 26, 2009)*

Atty. Ferrer is a member of the Board of Directors and Corporate Secretary of Habibi Cove Realty Corporation, Marbelene Realty Corporation and Park Lane Assets, Inc., among others. Atty. Ferrer is a Senior Partner of SyCip Salazar Hernandez & Gatmaitan. He is a member of the Integrated Bar of the Philippines and the Philippine Bar Association and a Fellow of the Institute of Corporate Directors. He is also the International Alumni Contact for the Philippines of the University of Michigan Alumni Association.



ALFREDO S. PANLILIO, 48

*Senior Vice President and Head,
Customer Retail Services and
Corporate Communications*

Mr. Panlilio is a member of the Board of Directors of PLDT Global Corporation, ATH Holdings, Inc. (Malaysia), Mabuhay Satellite Corporation, CIS Bayad Center, Inc., Corporate Information Solutions, Inc., Meralco Energy, Inc. and Customer Frontline Solutions, Inc.; Vice Chairman and Trustee, Meralco Management and Leadership Development Center Foundation, Inc.; and Trustee of One Meralco Foundation, Inc. (formerly Meralco Millennium Foundation, Inc.) and Loyola Meralco Sparks Football Club; President of the MVP Sports Foundation. Mr. Panlilio holds a Bachelor of Science degree in Business Administration (Computer Information Systems) from the California State University – San Francisco State University and obtained his Masters in Business Administration at J. L. Kellogg School of Management of Northwestern University and The Hong Kong University of Science and Technology. He has 25 years of experience with telecommunications and information systems. Prior to joining Meralco, he was the President and CEO of PLDT Global based in Hong Kong.

RAYMOND B. RAVELO, 34

*Vice President and Head,
Strategy and Corporate Development*

Mr. Ravelo is concurrently President and Chief Executive Officer and a member of the Board of Directors of e-Meralco Ventures, Inc. Prior to joining Meralco, he was part of McKinsey and Company's Washington DC office where he led strategy development efforts and operations performance transformations for clients in North America, Latin America, Europe, Southeast Asia, and across a wide range of industries. Mr. Ravelo holds a Bachelor of Science degree, magna cum laude, in Management Engineering from the Ateneo de Manila University. He completed his Masters in Business Administration at the Wharton School of the University of Pennsylvania where he was a Joseph Wharton Fellow and an Omnicom Communication Fellow. He is also presently a member of the Board of Trustees of the Wharton Penn Alumni Association, Inc.

ANTHONY V. ROSETE, 55

*Vice President and Head,
Legal*

Atty. Rosete is the Assistant Corporate Secretary of Meralco. He was Head of Legal until December 31, 2011. He is the Corporate Secretary of Meralco PowerGen Corporation, Calamba Aero Power Corporation, Atimonan Land Ventures Development Corporation and Redondo Peninsula Energy, Inc.; Assistant Corporate Secretary of Clark Electric Distribution Corporation; a member of the Board of Directors of Miescorrail, Inc. and was Corporate Secretary of e-Meralco Ventures, Inc. Atty. Rosete holds a Bachelor of Arts degree in Political Science and Bachelor of Laws degree from the Ateneo de Manila University.



RAMON B. SEGISMUNDO, 54

*Senior Vice President and Head,
Human Resources and Corporate Services*

Mr. Segismundo is a member of the Board of Directors of Meralco Industrial Engineering Services Corporation, Miescorrail, Inc., CIS Bayad Center, Inc. and General Electric Philippines Meter & Instrument Company, Inc.; Chairman of Customer Frontline Solutions, Inc.; Trustee of the One Meralco Foundation, Inc., Meralco Management and Leadership Development Center Foundation, Inc., Meralco Pension Fund and the Loyola Meralco Sparks Football Club. He is a Governor and Board Treasurer of the Philippine Basketball Association. In the course of his career, he has worked in various Asia Pacific and International Human Resource Leadership roles in global multinational companies based in Singapore, United Kingdom and the United States. Mr. Segismundo holds a Bachelor of Science degree in Industrial Engineering and completed his Masters in Business Administration, both from the University of the Philippines.

BETTY C. SIY-YAP, 50

*Senior Vice President
Chief Finance Officer*

Ms. Siy-Yap is a member of the Board of Directors of Republic Surety and Insurance Company, Inc., Meralco Industrial Engineering Services Corporation, Clark Electric Distribution Corporation, General Electric Philippines Meter & Instrument Co. Inc., CIS Bayad Center Inc., Miescorrail Inc., Rockwell Land Corporation, e-Meralco Ventures, Inc., Indra Philippines, Inc., Meralco PowerGen Corporation, Lighthouse Overseas Insurance Limited, Redondo Peninsula Energy, Inc. and other subsidiaries. She is a Trustee of the Meralco Pension Fund, One Meralco Foundation, Inc. and Loyola Meralco Sparks Football Club. She is the Treasurer of the MVP Sports Foundation, Inc. and alternate Governor of the Philippine Basketball Association. She was a Partner at SyCip Gorres Velayo & Co. before joining Meralco. Ms. Siy-Yap holds a Bachelor of Science in Business Administration and Accountancy degrees from the University of the Philippines and a Masters in Business Administration at J.L. Kellogg School of Management at Northwestern University and The Hong Kong University of Science and Technology. She also attended the Special Executive Program in Corporate Restructuring and Finance at the Arthur D. Little Management Institute in Cambridge, Massachusetts, U.S.A.

WILLIAM S. PAMINTUAN

*First Vice President, Deputy General
Counsel and Head,
Legal*

Mr. Pamintuan is head of Legal Services, effective January 1, 2012. He is the Corporate Secretary of Meralco PowerGen Corporation, Digital Telecommunications Phils., Inc., Digitel Mobile Phils., Inc.; Assistant Corporate Secretary of Cebu Pacific, Inc.; and a member of the Board of Directors of Miescorrail, Inc. Mr. Pamintuan graduated with a Bachelor of Arts degree in Political Science and Bachelor of Laws degree from the University of the Philippines.

Our Subsidiaries

MERALCO POWERGEN CORPORATION (MGen)

MGen is a wholly-owned subsidiary of Meralco. MGen's mission is to develop highly cost-competitive and reliable power plants, and ensure the provision of adequate, reliable and affordable power to residential, commercial and industrial customers in the Meralco franchise area and in other areas which may benefit from its supply of power.

On July 22, 2011, MGen signed a Shareholders' Agreement with Therma Power Inc. (TPI) and Taiwan Cogeneration International Corporation - Philippine Branch (TCIC) to formalize MGen's participation in Redondo Peninsula Energy, Inc. (RP Energy) for the construction and operation of a 600 MW independent coal-fired Circulating Fluidized Bed (CFB) power plant in the Subic Bay Freeport Zone. MGen has the largest shareholding in RP Energy with the Meralco Employee's Retirement Fund holding a relatively small interest, and TPI and TCIC owning the remaining stake equally.

MGen is also in the process of developing other power generation projects for the planned portfolio of potentially up to 2,500 MW total power generation capacity.

MANUEL V. PANGILINAN, Chairman
OSCAR S. REYES, President and Director
AARON A. DOMINGO, Executive Vice President,
General Manager and Director

CLARK ELECTRIC DISTRIBUTION CORPORATION (CEDC)

CEDC is 65%-owned by Meralco and 35%-owned by Angeles Electric Corporation. It is the exclusive franchised distribution company in the Clark Economic Zone (CEZ) through its three substations with a total capacity of 98 MVA. Its present distribution network consists of 1,281 distribution transformers, 128-km linear length of primary lines and 48.82-km of secondary lines. Its system loss has continuously improved from 7.01% in 2002 to 3.96% in 2011. Its supply rates are one of the lowest in Luzon. CEDC aspires to be a world-class electric distribution utility and CEZ's partner towards the nation's progress. CEDC has filed its application for the approval of the translation into distribution rates of different customer classes for the first Regulatory Year of the ERC - approved Annual Revenue Requirement, under Performance-Based Regulation for the Regulatory Period October 1, 2011 to September 30, 2015.

PETER G. NEPOMUCENO, Chairman
JESUS P. FRANCISCO, President and Director

CORPORATE INFORMATION SOLUTIONS, INC. (CIS)

CIS is wholly-owned by Meralco. It was incorporated in 1974 to provide information technology services and integrated business solutions to enterprise clients.

In 1997, CIS engaged in the business of bills payment collection, which was spun off as CIS Bayad Center, Inc., (formally incorporated in 2006). CIS Bayad Center, Inc. offers the largest network of bills payment collection service in the Philippines operating nationwide with brand name "Bayad Center." Bayad Center is the country's trailblazer and brand leader in outsourced over-the-counter payment collection. Trusted by top multinational and local organizations with their payment collection requirements, it accepts payments for over 160 industry-leading partners through its more than 1,700-strong, strategically-located branches in the country, and US-based online payment facility. To complement its bills payment business, Bayad Center now offers electronic wallet services for vehicle insurance, prepaid loading, and service applications acceptance. In 2011, Bayad Center was awarded "Best in Franchising Support" by Entrepreneur Magazine for its nationwide network of sites. It is set on becoming the leading Service Fulfillment Center of the country.

OSCAR S. REYES, Chairman
MANUEL LORENZO L. TUASON, President
and CEO and Director

LIGHTHOUSE OVERSEAS INSURANCE LIMITED (LOIL)

LOIL, Meralco's wholly-owned subsidiary and captive reinsurer, is registered as a Class 1 insurer under The Bermuda Insurance Act 1978 and Related Regulations. LOIL was incorporated in Bermuda in 2007 and received its license to operate in the territory in 2008. Together with Republic Surety and Insurance Company, Inc., LOIL plays a major role in Meralco's business risk management model. LOIL serves as the vehicle to reinsure Meralco's major catastrophic risk exposure.

OSCAR S. REYES, Chairman
BETTY C. SIY-YAP, President and Director

MERALCO ENERGY, INC. (MEI)

MEI was established as a wholly-owned subsidiary of Meralco in June 2000 to provide demand-side energy services to Meralco's key accounts. It aims to establish itself as a "Super" Energy Service Company (ESCO), which offers integrated energy efficiency solutions including marketing, investment grade energy auditing, engineering design capability, turnkey installation management, project financing development, monitoring and performance assurance of energy management projects.

OSCAR S. REYES, Chairman
JESUS P. FRANCISCO, Vice Chairman
and President

MERALCO FINANCIAL SERVICES CORPORATION (Finserve)

A wholly-owned subsidiary of Meralco, Finserve was established in 2002 to enhance Meralco's shareholder value creation and expand customer service through innovative consumer and customer-based products and services that support Meralco's core business. Its range of services is envisioned to improve customer convenience and develop customer loyalty. Finserve has embarked on investing and managing commercial center operations with The Strip along Ortigas Avenue as its flagship project. To give more value to consumers through partnerships with major corporations, Finserve also has in its portfolio the Integrated Direct Marketing (IDM) business, which offers targeted advertising and marketing services utilizing non-traditional channels. Finserve has added tele-collection, which offers a committed service on efficient and speedy collection of a company's receivables.

MONICO V. JACOB, Chairman and President
MARY JOCELYN Z. FRANQUELLI,
General Manager

MERALCO INDUSTRIAL ENGINEERING SERVICES CORPORATION (Miescor)

Miescor is 99%-owned by Meralco with the remaining 1% by the Miescor Provident Fund. Miescor, a holder of the highest contractor license Category AAA since 1982, is a contractor-specialist engaged in engineering, construction and maintenance activities related to power generation, transmission and distribution, as well as industrial plants, water resources and telecommunications. Miescor is Meralco's most reliable service provider in electro-mechanical

works, engineering, distribution and technical services. It also handles telecommunication projects for its affiliates and third parties for Meralco.

To support Miescor in achieving its aspirations of becoming the top-of-mind electro-mechanical service provider and a preferred Engineering, Procurement and Construction (EPC) contractor in power generation, transmission and distribution are its subsidiaries Miescor Builders, Inc., Landbees Corporation and Miescorrail, Inc.

OSCAR S. REYES, Chairman
JESUS P. FRANCISCO, President and Director

e-MERALCO VENTURES, INC. (eMVI)

eMVI is a wholly-owned subsidiary of Meralco, operating a telecommunications infrastructure anchored on a 2,000-km fiber optic network within the Meralco franchise area. It offers data connectivity solutions to local and international carriers, internet service providers, data centers and other businesses. It is a premium data transport provider to the biggest names in the market. Its services include leased line connections, Metro Ethernet connections, disaster recovery transport services, and dedicated internet access. Over the years, it has consistently maintained service levels significantly above industry standards and has always been true to its commitment to operate a future-proof network.

eMVI together with its subsidiary, Radius Telecoms, Inc. aim to be the fiber optic solutions provider of choice in the country.

FELIPE B. ALFONSO, Chairman
RAYMOND B. RAVELO, President and CEO
and Director

REPUBLIC SURETY AND INSURANCE COMPANY, INC. (RSIC)

RSIC is a professional non-life insurance company and a wholly-owned subsidiary of Meralco. It was acquired in 2007 to align with Meralco's recognition of the imperative for a disciplined approach in managing its risk exposures. RSIC continues to renew an insurance program that provides coverage to Meralco's transmission and distribution assets. It aims to be the most dynamic, pro-active risk management and underwriting company – not just for Meralco, its subsidiaries and affiliated companies in terms of synergistic opportunities, but for the insurance industry as a whole, with a commitment to implement risk management methods with emphasis on risk analysis and mitigation, loss control management and general insurance management.

MONICO V. JACOB, Chairman
PEDRO P. BENEDICTO, JR., President
and Director

ROCKWELL LAND CORPORATION (Rockwell Land)

Rockwell Land is 51%-owned by Meralco and 49%-owned by First Philippine Holdings Corporation. Formed in 1995, Rockwell Land is one of the premier real estate developers in the Philippines and its ground-breaking master plan transformed Meralco's former thermal plant site into a high-end residential living and commercial environment now known as the Rockwell Center.

Rockwell Center, Rockwell Land's flagship project, sits on a 15.5-hectare site in Makati City and is strategically located between the three major commercial business districts of Makati City, Bonifacio Global City and Ortigas.

In recent years, Rockwell Land has built a strong brand and track record in property development with its most recent projects outside Rockwell Center such as The Grove, a 5.4-prime hectare property along E. Rodriguez Avenue (commonly known as C-5 Road) and the Rockwell Business Center inside the Meralco Ortigas compound. Its retail and cinema operations are performing well, contributing continuous revenue growth year-on-year. On December 12, 2011, Meralco disclosed its plan to divest its investment in Rockwell Land through the declaration of all of Meralco's common shares in Rockwell Land as property dividends to Meralco shareholders.

MANUEL M. LOPEZ, Chairman
NESTOR J. PADILLA, President and CEO

Management's Discussion and Analysis

The following discussion and analysis of financial position and results of operations of Manila Electric Company or *MERALCO* and its subsidiaries, collectively referred to as the “*MERALCO Group*” should be read in conjunction with the audited consolidated financial statements as at and for the year ended December 31, 2011. The consolidated financial statements have been prepared in compliance with the Philippine Financial Reporting Standards or *PFRS*. *PFRS* includes statements named *PFRS* and Philippine Accounting Standards, including Interpretations issued by the Philippine Financial Reporting Standards Council.

The consolidated financial statements are presented in Philippine peso, *MERALCO Group's* functional and presentation currency as defined under *PFRS*. All values are rounded to the nearest million peso, except when otherwise indicated. The exchange rate used to translate U.S. dollars to Philippine peso in this report and in the accompanying consolidated financial statements is US\$1.00 to P43.84, the closing rate as at December 29, 2011 (the last trading day in 2011) quoted through the Philippine Dealing System.

Financial Highlights and Key Performance Indicators

(Amounts in millions, except financial ratios, earnings per share, and operational data)

	As at December 31			% Change	
	2011 (A)	2010	2009	2011 vs. 2010	2010 vs. 2009
Condensed Statements of Financial Position					
Total assets	P210,388	P178,968	P172,129	17.6	4.0
Current assets					
Continuing operations	77,424	60,003	48,336	29.0	24.1
Discontinued operations	18,349	—	—	—	—
Cash and cash equivalents	44,141	24,370	17,068	81.1	42.8
Equity attributable to equity holders of the parent	63,788	58,969	57,369	8.2	2.8
Total debt	24,443	21,221	21,816	15.2	(2.7)
Current liabilities					
Continuing operations	53,042	45,146	42,123	17.5	7.2
Discontinued operations	9,113	—	—	—	—
Financial Ratios					
Debt to equity	0.38	0.36	0.38	—	—
Current ratio - continuing operations	1.46	1.33	1.15	—	—
Operational Data					
Number of customers (in thousands)					
Residential	4,580	4,412	4,277	3.8	3.2
Commercial	433	421	410	2.9	2.7
Industrial	10	10	10	—	—
Streetlights	4	4	4	—	—

Note A:

On December 12, 2011, the *Board of Directors* of *MERALCO* approved the plan to divest all of its investment in common shares of *Rockwell Land* through the declaration of property dividends. Consequently, in 2011, *MERALCO* reclassified the related assets, liabilities and accumulated other comprehensive income of *Rockwell Land* as "Assets of discontinued operations", "Liabilities of discontinued operations" and "Unrealized fair value gains on AFS investments of discontinued operations", respectively, in the consolidated statement of financial position. The consolidated statements of financial position as of December 31, 2010 and 2009 were not restated and therefore not comparable.

	For the years ended December 31			% Change	
	2011	2010 (B)	2009 (B)	2011 vs. 2010	2010 vs. 2009
Condensed Statements of Income					
Revenues	P256,808	P240,933	P180,758	6.6	33.3
Costs and expenses	239,014	228,640	173,125	4.5	32.1
Other expenses (income)	(907)	(1,025)	(422)	(11.5)	142.9
Income before income tax	18,701	13,318	8,055	40.4	65.3
Income from discontinued operations, net of income tax	966	822	632	17.5	30.1
Net income	13,726	10,117	6,356	35.7	59.2
Net income attributable to equity holders of the parent	13,227	9,685	6,005	36.6	61.3
Earnings per share					
Basic and diluted - attributable to equity holders of the parent	11.73	8.59	5.42	36.6	58.5
Basic and diluted - attributable to equity holders of parent for continuing operations	11.28	8.21	5.13	37.4	60.0

Note B:

The consolidated statements of income for the years ended December 31, 2010 and 2009 have been restated to present the results of operations of *Rockwell Land* as "Net income from discontinued operations".

	For the years ended December 31			% Change	
	2011	2010 (B)	2009 (B)	2011 vs. 2010	2010 vs. 2009
Financial Ratios					
Profit margin	5%	4%	4%		
Return on equity	21%	16%	10%		
Asset turnover	1.22	1.35	1.05		
Condensed Statements of Cash Flows					
Cash generated from operating activities	P32,116	P20,358	P29,270	57.8	(30.4)
Cash used in investing activities	(6,996)	(6,292)	(8,770)	11.2	(27.4)
Capital expenditures	8,997	9,053	8,890	(0.6)	1.8
Cash used in financing activities	(4,580)	(6,764)	(8,834)	(32.3)	(24.2)
Operational Data					
Electricity sales volume (in GWh)	30,592	30,247	27,516	1.1	9.9
System loss (in percentage) ¹					
MERALCO	7.35%	7.94%	8.61%	(7.4)	(7.8)
CEDC	3.96%	3.81%	3.86%	3.9	(1.3)

Note B:

The consolidated statements of income for the years ended December 31, 2010 and 2009 have been restated to present the results of operations of *Rockwell Land* as "Net income from discontinued operations".

¹ Based on 12-month moving average

OVERVIEW

MERALCO is the Philippines' largest electric power distribution company, with franchise service area covering 9,337 square kilometers. It provides power to over 5 million customers in 31 cities and 80 municipalities, which include Metro Manila, the provinces of Rizal, Cavite and Bulacan, and parts of the provinces of Pampanga, Batangas, Laguna and Quezon. Turnover of business establishments in the franchise area accounts for almost 50% of the country's Gross Domestic Product or *GDP*.

Through Clark Electric Distribution Corporation or *CEDC*, a 65%-subsidiary, it holds the power distribution franchise for the Clark Special Economic Zone or *CSEZ* in Clark, Pampanga. *CEDC* franchise area covers 44 square kilometers and 1,724 customers.

In 2010, Meralco PowerGen Corporation or *MGen*, a wholly owned subsidiary, was reorganized as *MERALCO*'s vehicle for its re-entry into power generation. On July 22, 2011, *MGen*, together with the Meralco Pension Fund, acquired a majority interest in Redondo Peninsula Energy, Inc. or *RP Energy*. *RP Energy*, which is a partnership among *MERALCO*, Therma Power, Inc. (a wholly-owned subsidiary of Aboitiz Power Corporation) and Taiwan Cogeneration International Corporation, shall build a 2 x 300MW Circulating Fluidized Bed coal-fired power plant to be located in the Subic Bay Freeport Zone. *RP Energy* has undertaken substantive site preparation work and is awaiting the submission by selected bidders of their engineering, procurement and construction bids.

MERALCO Group's business is divided into two segments, namely, power and, services and others. The power segment, primarily power distribution, consists of operations of *MERALCO* and its subsidiary, *CEDC*. *CEDC* is registered with Clark Development Corporation or *CDC* under *RA* No. 9400, *Bases Conversion Development Act of 1992*, as a *CSEZ*-enterprise primarily engaged in owning, operating, and maintaining a power distribution system within the zone.

Separately, *MERALCO* organized a segment for its re-entry into power generation through its wholly-owned subsidiary, *MGen* and another segment for its entry into retail electricity supply through a Meralco Retail Electricity or *MPower* business unit within *MERALCO*. Through several other subsidiaries, its services and other business segments develop and sell real estate properties and provide engineering, construction and consulting services, bill payments collection services, energy management services and information systems and technology services. *MERALCO*'s investment in common equity shares in Rockwell Land Corporation or *Rockwell Land*, has been declared on February 27, 2012 as property dividends to stockholders of record as at March 23, 2012 except for foreign common shareholders who will be paid the cash equivalent of the property dividend, payable within five trading days after the approval of the property dividend by the Securities and Exchange Commission and registration of the *Rockwell Land* shares under the Securities Regulation Code and the listing thereof with the Philippine Stock Exchange.

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

BUSINESS SEGMENTS	
Power	Services and Others
Distribution <ul style="list-style-type: none"> • <i>MERALCO</i> • <i>CEDC</i> Generation <ul style="list-style-type: none"> • <i>MGen</i> and subsidiaries Retail electricity supply <ul style="list-style-type: none"> • <i>MERALCO</i> through <i>MPower</i> business unit 	<ul style="list-style-type: none"> • Meralco Industrial Engineering Services Corporation or <i>MIESCOR</i>, and subsidiaries • Meralco Financial Services Corporation or <i>Finserve</i> • Lighthouse Overseas Insurance Limited or <i>LOIL</i> • Republic Surety and Insurance Company, Inc. or <i>RSIC</i> • Corporate Information Solutions, Inc. or <i>CIS</i> and subsidiaries • e-Meralco Ventures, Inc. or <i>e-MVI</i> and subsidiary • Meralco Energy, Inc. or <i>MEI</i>

RESULTS OF OPERATIONS

The table summarizes the consolidated results of operations and the contribution of each business segment to *MERALCO Group's* revenues, costs and expenses, and net income for each of the three years in the period ended December 31, 2011.

<i>(Amounts in millions)</i>	Power²	Services and Others	Inter-segment transactions (Note A)	Consolidated
For the year ended December 31, 2011				
Revenues	P253,989	P3,923	(P1,104)	P256,808
Costs and expenses	237,349	2,769	(1,104)	239,014
Other expenses (income)	(1,689)	(99)	881	(907)
Net income attributable to equity holders of the parent	12,708	888	(369)	13,227
For the year ended December 31, 2010				
Revenues	239,077	3,444	(1,588)	240,933
Costs and expenses	227,716	2,512	(1,588)	228,640
Other expenses (income)	(1,811)	21	765	(1,025)
Net income attributable to equity holders of the parent	9,398	623	(336)	9,685
For the year ended December 31, 2009				
Revenues	178,686	2,788	(716)	180,758
Costs and expenses	171,765	2,076	(716)	173,125
Other expenses (income)	(1,072)	(72)	722	(422)
Net income attributable to equity holders of the parent	5,851	565	(411)	6,005

Note A –Inter-segment transactions of “Net income attributable to equity holders of the parent” include discontinued operations

²Principally power distribution

2011 compared with 2010**On a Consolidated Basis****Revenues**

For the year ended December 31, 2011, *MERALCO Group* generated consolidated revenues of P256,808 million, 7% higher compared with P240,933 million in 2010 due to improvement in the revenues of both business segments led by the power segment. Revenues from the power segment, of which sales of electricity comprised 99% of the total consolidated revenues, increased by P14,912 million from P239,077 million in 2010 to P253,989 million in 2011 brought about by the increase in volume of energy sold of 1% in 2011 as well as the increase in the number of billed customers to 5 million and slightly higher distribution rate.

The following table shows the composition of *MERALCO Group's* consolidated revenues for the years ended December 31, 2011 and 2010 by business segment:

(Amounts in millions)	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Power ³	P253,989	99	P239,077	99	P14,912	6
Services and others	3,923	1	3,444	1	479	14
Inter-segment transactions	(1,104)	–	(1,588)	–	(484)	(30)
Total	P256,808	100	P240,933	100	P15,875	7

Costs and Expenses

Consolidated costs and expenses for the year ended December 31, 2011 amounted to P239,014 million, 5% higher compared with P228,640 million in 2010. The higher costs and expenses are attributable to increases in purchased power, salaries and employee benefits, provisions for probable charges and expenses from claims, contracted services and provision for doubtful accounts, all mainly attributed to the power segment.

The following table shows the breakdown of *MERALCO Group's* consolidated costs and expenses for the years ended December 31, 2011 and 2010 by business segment:

(Amounts in millions)	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Power ⁴	P237,349	99	P227,716	99	P9,633	4
Services and others	2,769	1	2,512	1	257	10
Inter-segment transactions	(1,104)	–	(1,588)	–	(484)	30
Total	P239,014	100	P228,640	100	P10,374	5

Other Expenses (Income)

Consolidated other expenses net of income for the year ended December 31, 2011 amounted to P907 million, 12% lower compared with P1,025 million in 2010 due to increase in borrowing costs brought about by additional long-term loans drawn in 2011, absence of approvals of under-recoveries with carrying charge, and reversal of interest from bill deposits as a result of reduction of interest rate in 2010. .

The following table shows the breakdown of *MERALCO Group's* consolidated other expenses (income) for the years ended December 31, 2011 and 2010 by business segment:

(Amounts in millions)	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Power ⁵	(P1,689)	(186)	(P1,811)	(177)	(P122)	(6)
Services and others	(99)	(11)	21	2	(120)	(571)
Inter-segment transactions	881	97	765	75	116	15
Total	(P907)	100	(P1,025)	100	P118	12

³*Ibid.*⁴*Ibid.*⁵*Ibid.*

Net Income Attributable to Equity Holders of the Parent

Consolidated net income attributable to equity holders of the parent increased by 36% to P13,227 million for the year ended December 31, 2011 from P9,685 million last year largely due to the higher sales volume, slightly higher distribution rate up to October 2011, and improvement in the subsidiaries' contribution brought about by increased third party business volume.

The following table shows the breakdown of *MERALCO's* consolidated net income attributable to the equity holders of *MERALCO* for the years ended December 31, 2011 and 2010 by business segment:

(Amounts in millions)	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Power ⁶	P12,708	96	P9,398	97	P3,310	35
Services and others	888	7	623	6	265	43
Inter-segment transactions	(369)	(3)	(336)	(3)	33	10
Total	P13,227	100	P9,685	100	P3,542	37

On a Business Segment Basis**Power****Revenues**

Revenue from the power segment, which is substantially generated from electric distribution, amounted to P253,989 million for the year ended December 31, 2011, 6% higher compared with P239,077 million in 2010. The composition of revenues from power distribution for the years ended December 31, 2011 and 2010 is summarized as follows:

(Amounts in millions)	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Electric revenues						
Pass-through charges:						
Generation charge	P157,850	62	P158,850	66	(P1,000)	(1)
Transmission charge	32,340	13	25,456	11	6,884	27
System loss charge	15,500	6	11,567	5	3,933	34
Power act reduction	(106)	—	(219)	—	(113)	(52)
Inter-class, lifeline subsidies and others	(201)	—	(233)	—	(32)	(14)
	205,383	81	195,421	82	9,962	5
Distribution service charges	48,606	19	43,656	18	4,950	11
Total	P253,989	100	P239,077	100	P14,912	6

Pass-Through Charges

Of the total consolidated revenues from electric distribution, 81% or P205,383 million of such amount pertained to pass-through charges, 5% higher compared with P195,421 million in 2010. Generation, transmission and system loss charges represented 77%, 16% and at 8% of the total pass-through charges. The higher pass-through charges are attributable to (a) 1% increase in electric sales volume from 30,247 GWh in 2010 to 30,592 GWh in 2011, (b) higher average transmission charge per kWh from P0.84 in 2010 to P1.06 in 2011 brought about by the approval of the Maximum Allowable Revenue or *MAR* of the National Grid Corporation of the Philippines or *NGCP* for 2011, offset by the decrease in average generation charge per kWh from P5.24 in 2010 to P5.16 in 2011 due to lower volume purchased from Wholesale Electricity Spot Market or *WESM*.

MERALCO's system loss rate for the year ended December 31, 2011 was 7.35%, 59 basis points lower compared with 7.94% in 2010 and 1.15 percentage points lower compared with the *ERC*-mandated 8.5%-cap.

⁶*Ibid.*

Distribution Service Charges

Total distribution service charges amounted to P48,606 million for the year ended December 31, 2011, 11% higher compared with P43,656 million in 2010. The rate for 4th Regulatory Year or *RY*, of the 2nd Regulatory Period or *RP*, was implemented only in January 2011 through October 2011. For the year ended December 31, 2011, the average distribution rate was P1.58 per kWh, 10% higher compared with P1.43 per kWh in 2010. As at December 31, 2011, the number of billed customers exceeded 5.0 million, 3.7% higher than the 4.8 million at the end of 2010. Energy sales to the industrial sector was up by 4% to 9,080 GWh from 8,734 GWh in 2010 due to businesses gained from Cavite Export Zone, International Rice Research Institute, Toshiba Information Equipment (Philippines), Inc. and Chevron Philippines Inc., among others, and higher sales to the semiconductor and cement industries. Sales to commercial sector increased to 12,027 GWh in 2011 from 11,830 GWh in 2010 due to higher sales to the transportation, storage and communication and real estate sectors.

The following table summarizes the customer count as at December 31, 2011 and 2010 and the corresponding electric consumption per customer class for the years ended December 31, 2011 and 2010:

Customer Class	No. of Customers		Electricity Sales		% Change	
	<i>(in thousands)</i>		<i>(in GWh)</i>		No. of Customers	Electricity Sales
	2011	2010	2011	2010		
Residential	4,580	4,412	9,344	9,540	3.8	(2.1)
Commercial	433	421	12,027	11,830	2.9	1.7
Industrial	10	10	9,080	8,734	–	4.0
Streetlights	4	4	141	143	–	(1.4)
Total	5,027	4,847	30,592	30,247	3.7	1.1

Costs and Expenses

Costs and expenses of the power segment for the year ended December 31, 2011 amounted to P237,349 million, 4% higher compared with P227,716 million in 2010 due to increases in purchased power, salaries, wages and employee benefits, contracted services and provision for doubtful accounts.

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

<i>(Amounts in millions)</i>	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Purchased power	P205,674	87	P200,916	88	P4,758	2
Salaries, wages and employee benefits	10,258	4	8,180	4	2,078	25
Provision for probable charges and expenses from claims	7,644	3	4,120	2	3,524	86
Depreciation and amortization	5,360	2	5,795	3	(435)	(8)
Contracted services	3,835	2	3,678	2	157	4
Provision for doubtful accounts	2,239	1	952	–	1,287	135
Taxes, fees and permits	375	–	817	–	(442)	(54)
Other expenses	1,964	1	3,258	1	(1,294)	(40)
Total	P237,349	100	P227,716	100	P9,633	4

For the year ended December 31, 2011, purchased power cost increased by P4,758 million or 2% to P205,674 million from P200,916 million in 2010. The increase in purchased power cost is due to higher electricity volume purchased in 2011 at 33,081 GWh from 32,925 GWh in 2010, offset by the lower average purchased power cost of P6.22 per kWh or 2% lower than in 2010. The volume of energy purchased under long-term power supply contracts with Independent Power Producers or *IPPs*, First Gas and Quezon Power (Philippines) Limited Co. or *QPPL*, represent 47% of *MERALCO*'s Net Systems Input. The volume purchased from the National Power Corporation's successor generating companies or *NPC-SGC*, and *IPP* Administrators account for 46%. The balance was sourced from the Wholesale Electricity Spot Market or *WESM*, and other *IPPs*. The average *WESM* charge in 2011 was at P9.70, 2% higher compared with 2010.

Salaries, wages and employee benefits amounted to P10,258 million for the year ended December 31, 2011, 25% higher compared with P8,180 million in 2010. The increase is attributed to the regular annual salary adjustment, bonuses and incentives.

Provision for probable charges and expenses from claims increased to P7,644 million for the year ended December 31, 2011 from P4,120 million in 2010. The provisions represented legacy issues and commercial claims.

Depreciation and amortization for the year ended December 31, 2011 amounted to P5,360 million, 8% lower compared with P5,795 million in 2010.

Contracted services amounted to P3,835 million for the year ended December 31, 2011, 4% higher compared with P3,678 million in 2010 due to higher professional services costs, legal expenses and contractors for outsourced services.

Provision for doubtful accounts for the year ended December 31, 2011 increased to P2,239 million, or 135% from P952 million in 2010.

Taxes, fees and permits decreased by P442 million from P817 million for the year ended December 31, 2010 to P375 million in 2011 due to decrease in *ERC* regulation and supervision fees and permits. In 2010, the *ERC* assessed *MERALCO* for additional regulation and supervision fees to include the amount of outstanding preferred shares in the base.

Other expenses consisted of other operations and maintenance expenses such as rent and utilities, materials and supplies, transportation and travel, insurance, marketing and advertising, communications and other corporate expenses. Beginning 2011, the actual company use (administrative loss) of electricity is recorded as part of operations and maintenance expenses in accordance with the rules promulgated by the *ERC*. Previously, this is accounted for in the difference between Net System Input and Electric Sales Statistics.

Other Expenses (Income)

For the year ended December 31, 2011, other income, net of expenses of the power segment amounted to P1,689 million, 6% lower compared with P1,811 million in 2010 mainly due to higher interest and financial charges despite higher interest and other financial income.

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

(Amounts in millions)	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Interest and other financial income	(P2,186)	129	(P1,597)	88	P589	37
Interest and other financial charges	1,299	(77)	310	(17)	989	319
Equity in net earnings of associates and a joint venture	(914)	54	(1,012)	56	(98)	(10)
Derivative mark-to-market loss	17	(1)	7	-	10	143
Foreign exchange loss	9	-	29	(2)	(20)	(69)
Accretion of present value impact on customers' refund	136	(8)	226	(12)	(90)	(40)
Others	(50)	3	226	(12)	276	122
Total	(P1,689)	100	(P1,811)	100	(P122)	(7)

Interest and other financial income amounted to P2,186 million for the year ended December 31, 2011, 37% higher compared with P1,597 million in 2010 due to higher interest income earned brought about by higher cash placements in banks.

Interest and other financial charges increased by P989 million to P1,299 million for the year ended December 31, 2011 from P310 million in 2010. In 2010, *MERALCO* adjusted the interest on customers' deposit based on the applicable interest rate on customers' bill deposits, which was at the Land Bank of the Philippines savings account rate of 0.5% beginning January 2011, consistent with the provisions of the amended *DSOAR*.

Net Income Attributable to Equity Holders of the Parent

Net income from the power segment attributable to equity holders of the parent for the year ended December 31, 2011 amounted to P12,708 million, 35% higher compared with P9,398 million in 2010. The increase is largely due to the delayed implementation of rate adjustments for the 4th RY of the 2nd RP and lower generation cost and system loss charges. The distribution rates were lower beginning October 2011 with the implementation of the rates for the 1st RY of the 3rd RP.

Services and Others**Revenues**

Revenues generated from services and others business segment increased to P3,923 million, or 14% higher compared with P3,444 million in 2010. The increase is due to higher *MIESCOR*'s transmission lines/substation maintenance contracts executed in 2011 and higher volume of payment services business of *CIS Bayad Center, Inc.*

Costs and Expenses

The services and others business segment reported cost and expenses for the year ended December 31, 2011 of P2,769 million, 10% higher compared with P2,512 million in 2010. The details are as follows:

(Amounts in millions)	2011	%	2010	%	Increase (Decrease)	
					Amount	%
Salaries, wages and employee benefits	P1,075	39	P972	39	P103	11
Reversal of provision for probable charges and expenses from claims	(1)	—	—	—	1	
Depreciation and amortization	144	5	116	5	28	24
Contracted services	602	22	544	22	58	11
Provision for doubtful accounts	5	—	9	—	(4)	(44)
Taxes, fees and permits	23	1	27	1	(4)	(15)
Other expenses	921	33	844	33	77	9
Total	P2,769	100	P2,512	100	P257	10

Salaries, wages and employee benefits amounted to P1,075 million for the year ended December 31, 2011, 11% higher compared with P972 million in 2010 due to regular adjustment of salaries, wages and employee benefits of subsidiaries.

Depreciation and amortization for the year ended December 31, 2011 amounted to P144 million, 24% higher compared with P116 million in 2010 attributed to amortization of leasehold improvements related to the lease of a new office and facilities of eMERALCO Ventures, Inc. or e-MVI.

Contracted services for the year ended December 31, 2011 amounted to P602 million, 11% increase from last year's P544 million.

Net Income Attributable to Equity Holders of the Parent

Net income from services and others business segment attributable to the equity holders of the parent is P888 million, 43% higher compared with P623 million in 2010 due to new contracts closed by *MIESCOR* and increase in third party volume of the payment services of *CIS Bayad Center, Inc.*

Liquidity and Capital Resources

The following table shows *MERALCO*'s consolidated cash flows for each of the three years in the period ended December 31, 2011, as well as the consolidated capitalization and other consolidated selected financial data as at December 31, 2011 and 2010:

(Amounts in millions)	Year Ended December 31		
	2011	2010	2009
Cash Flows			
Net cash provided by operating activities	P32,116	P20,358	P29,270
Net cash used in investing activities	(6,997)	(6,292)	(8,770)
Capital Expenditures	8,997	9,053	8,890
Net cash used in financing activities	(4,579)	(6,764)	(8,834)
Net increase in cash and cash equivalents (including cash and cash equivalents of discontinued operations of P769 million)	20,540	7,302	11,666

	As at December 31, 2011	As at December 31, 2010	As at December 31, 2010
Capitalization			
Interest-bearing long-term financial liabilities			
Current portion	P4,560	P5,574	P4,069
Noncurrent portion	19,816	15,498	17,234
Notes payable	67	149	513
Equity attributable to equity holders of the parent	P63,788	P58,969	P57,369
Other Selected Financial Data			
Total assets	P210,388	P178,968	P172,129
Utility plant and others - net	105,510	103,250	101,858
Cash and cash equivalents	44,141	24,370	17,068

As at December 31, 2011, *MERALCO Group's* consolidated cash and cash equivalents totalled P44,141 million, P19,771 million higher compared with P24,370 million as at December 31, 2010. Significant sources and uses of consolidated cash and cash equivalents in 2011 were cash flows from operating activities of P32,116 million, proceeds from long-term debt of P11,720 million, proceeds from short-term notes of P2,150 million, decreased by payment of cash dividends amounting to P9,866 million, settlement of debt principal and interest of P9,662 million and, capital expenditures of P8,907 million.

Operating Activities

Consolidated net cash provided by operating activities for the year ended December 31, 2011 increased to P32,116 million, P11,758 million higher compared with P20,358 million in 2010 due to higher net income posted during the period and recovery of certain generation and transmission under-recoveries covering periods from 2003 to 2010.

Investing Activities

Consolidated net cash flows used in investing activities for the year ended December 31, 2011 totalled P6,996 million, P704 higher compared with P6,292 million provided in 2010. Capital expenditures stayed at the same level, P8,907 million in 2011 compared with P8,920 million in 2010.

Financing Activities

Consolidated net cash used in financing activities amounted to P4,580 million for the year ended December 31, 2011, P2,184 million lower compared with P6,764 million used in 2010. In 2011, *MERALCO* drew P13,870 million loans from local banks. *MERALCO* paid P7,702 million of maturing debts, P1,960 million of interests and financial charges and P9,866 million of dividends.

Debt Financing

Consolidated debt, including notes payable, increased by P3,222 million or 15.2% to P24,443 million as at December 31, 2011 from P21,221 million as at December 31, 2010.

In 2010, Standard & Poor's re-rated and upgraded *MERALCO* to 'B+' with 'stable' outlook to reflect the significant and sustained improvement in *MERALCO's* financial risk profile arising from higher tariffs and stronger electricity sales.

In January 2011, *MERALCO* drew a P2,500 million 7-year floating rate term loan from a local bank. Interest rate is repriced every six months based on 6-month *PDST-F* plus a spread. The principal is repaid through nominal annual amortizations with a balloon payment on maturity date.

In June 2011, *MERALCO* entered into a Fixed Rate Note Facility Agreement for the issuance of P500 million 7-Year Notes and P4,500 million 10-Year Notes due in 2018 and 2021, respectively. The principal is repaid through nominal annual amortizations with a balloon payment on maturity date.

In December 2010, *MERALCO* signed a Fixed Rate Note Facility Agreement for the issuance of P23 million, 5-year fixed rate notes with maturity in December 2015 and P4,977 million, 5.5-year fixed rate notes due in June 2016. The 5-year fixed rate notes are payable at maturity while the 5.5-year fixed rate notes have nominal annual amortizations with a balloon payment on maturity date.

In November 2010, *MERALCO* signed a Fixed Rate Note Facility Agreement for the issuance of P1,997 million, 7-year fixed rate notes and P2,803 million, 10-year fixed rate notes. The notes were issued on December 2, 2010 and have nominal annual amortizations with a balloon payment on maturity date.

On July 19, 2007, *Rockwell Land* entered into a Note Facility Agreement with a consortium of local banks. Under the agreement, the P2.0 billion fixed rate corporate notes were drawn to finance the development of the *BPO* buildings located within the *MERALCO* compound. The notes consist of two tranches at P1,000 million each. Out of the total amount, P1,400 million is payable in 20 quarterly installments starting August 2009 and the balance of P600 million is due in August 2014. The facility agreement was pre-terminated on February 2, 2011 and was refinanced by a bridge loan from a local bank.

Rockwell Land signed a P4.0 billion Fixed Rate Note Facility Agreement with a consortium of local banks to finance the acquisition of properties for development and refinance certain obligations. The fixed rate notes consist of Tranche 1 and Tranche 2 amounting to P2,500 million and P1,500 million, respectively. Tranche 1 was drawn in April 2011 while Tranche 2 will be availed in April 2012. Tranche 1 is payable in 22 quarterly payments starting January 2013 until April 2018.

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

As at December 31, 2011, *MERALCO* is in compliance with all covenants of the loan agreements.

The interest-bearing financial obligations of *Rockwell Land* are secured by the assignment of receivables from the sale of *One Rockwell* and *The Grove* units and Mortgage Participation Certificates on a Mortgage Trust Indenture and its amendments and supplements over the Rockwell Power Plant Mall.

Equity Financing

Consistent with the provisions of PAS 32, "Financial Instruments: Disclosure and Presentation", *MERALCO*'s preferred shares are presented as debt while the dividends declared are recorded as interest expense. Accumulated and unpaid dividends were accrued and classified as accrued interest payable. Coupon rate on such preferred share is fixed at 10%. The preferred shares were issued to service applications, which would require extension or new distribution facilities beyond a specific distance. Beginning April 8, 2005, such requirement was discontinued. Instead, as provided in the "Implementing Guidelines of the Magna Carta for Residential Electricity Consumers", customers were required to advance the costs of extension of lines and installation of additional facilities.

As at December 31, *MERALCO*'s capital stock consists of:

<i>(Amounts in millions, except par value)</i>	2011	2010
Common stock – P10 par value		
Authorized – 1,250,000,000 shares	P12,500	P12,500
Issued – 1,127,271,117 shares	11,273	11,273
Treasury – 146,023 shares	(9)	–

Of the total authorized common shares of 1,250 million, 1,127 million shares are issued and outstanding as at December 31, 2011.

On March 28, 2011, the *BOD* approved the acquisition into treasury shares, including related rights of employees who have opted to withdraw from the *ESPP* in accordance with the provisions of the Employee Stock Purchase Plan or *ESPP*. As at December 31, 2011, a total of 146,023 shares were acquired from the cancellation of employee participation in the *ESPP*.

Consolidated cash dividends declared to shareholders as at December 31, 2011 and 2010 amounted to P8,792 million and P7,834 million, respectively.

The table below summarizes the cash dividends declared in 2011 and 2010:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
<i>(In Millions)</i>				
February 28, 2011	March 28, 2011	April 20, 2011	P2.65	P2,987
July 25, 2011	August 17, 2011	September 13, 2011	3.45	3,888
November 2, 2011	December 2, 2011	December 27, 2011	1.70	1,916
				<u>P8,791</u>
March 22, 2010	April 21, 2010	May 11, 2010	P3.15	P3,551
July 26, 2010	August 23, 2010	September 16, 2010	2.50	2,818
December 13, 2010	December 29, 2010	January 17, 2011	1.30	1,465
				<u>P7,834</u>

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Audit and Risk Management Committee Report

The Audit and Risk Management Committee operates under a written charter adopted by the Board of Directors. Its primary role and responsibility is to assist the MERALCO Board of Directors in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit process, the risk management process, and the company's process of monitoring compliance with laws and regulations.

During the year, the Audit and Risk Management Committee attended to the following tasks.

- Held seven (7) meetings during the year with an average members' attendance of 94%;
- Reviewed and discussed the quarterly unaudited consolidated financial statements and the audited consolidated annual financial statements of the Company, including management's significant judgments and estimates that formed part of the financial statements. Responsibilities on the financial reporting are further defined as follows:
 - Management has the primary responsibility for preparing the financial statements and the financial reporting process; and
 - The external auditors are responsible for expressing an opinion on whether the Company's consolidated audited financial statements conform with Philippine Financial Reporting Standards;
- Evaluated the independence and effectiveness of the external auditors, SGV & Co. CPAs and re-nominated them as the external auditors for 2011 to the Board of Directors;
- Considered and approved the audit fee payable to the external auditors in respect of the audit for the year ended December 31, 2011 as well as their terms of engagement, taking into consideration factors such as the timing of the audit, the extent of work required and the scope of the audit;
- Discussed and reviewed the results of the audit findings and recommendations of the internal and external auditors and their assessment of the Company's internal controls and the overall quality of the financial reporting process;
- 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;
- Performed and reviewed the assessments on the overall effectiveness of the Audit and Risk Management Committee vis-à-vis its Charter; and
- Reviewed and enhanced the Audit and Risk Management Committee Charter to adopt leading practices in good governance.

Based on the reviews and discussions undertaken, and subject to the limitations on the roles and responsibilities referred to above, the Audit and Risk Management Committee recommended to the Board of Directors the approval of the audited consolidated financial statements of the Company for the year ended December 31, 2011 and their filing with the Securities and Exchange Commission and other regulatory bodies.

On behalf of the Audit and Risk Management Committee,


Former Chief Justice ARTEMIO V. PANGANIBAN
Chairman, Audit and Risk Management Committee

February 27, 2012

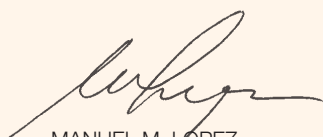
MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Statement of Management's Responsibility

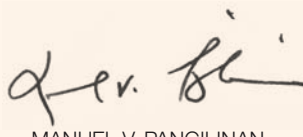
The management of Manila Electric Company is responsible for the preparation and fair presentation of the consolidated financial statements as at December 31, 2011 and 2010 and for each of the three years in the period ended December 31, 2011, including the following components attached therein: Retained Earnings Available for Dividend Declaration, Tabular Schedule of Standards and Interpretations, Supplementary Schedules required by Annex 68-E, and Map of the Relationships of the Companies within the Group, in accordance with the prescribed financial reporting framework indicated therein. This responsibility includes designing and implementing internal controls relevant to the preparation and fair presentation of the consolidated 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.

The Board of Directors reviews and approves the financial statements and submits the same to the stockholders.

SyCip Gorres Velayo & Co., the independent auditors, appointed by the stockholders has examined the consolidated financial statements of the Company in accordance with Philippine Standards on Auditing, and in its report to the stockholders, has expressed its opinion on the fairness of presentation upon completion of such examination.



MANUEL M. LOPEZ
Chairman of the Board



MANUEL V. PANGILINAN
President & CEO



RAFAEL L. ANDRADA
Treasurer

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Independent Auditors' Report

The Stockholders and the Board of Directors
Manila Electric Company

We have audited the accompanying consolidated financial statements of Manila Electric Company and Subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011 and 2010, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2011, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 present fairly, in all material respects, the financial position of Manila Electric Company and Subsidiaries as at December 31, 2011 and 2010, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2011 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.



Gemilo J. San Pedro

Partner

CPA Certificate No. 32614

SEC Accreditation No. 0094-AR-2 (Group A),

February 11, 2010, valid until February 10, 2013

Tax Identification No. 102-096-610

BIR Accreditation No. 08-001998-34-2009,

June 1, 2009, valid until May 31, 2012

PTR No. 3174825, January 2, 2012, Makati City

February 27, 2012

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Consolidated Statements of Financial Position

		December 31	
	Note	2011	2010
(Amounts in Millions)			
ASSETS			
Noncurrent Assets			
Utility plant and others - net	8, 10 and 18	P105,510	P103,250
Investments in associates and a joint venture	9	844	321
Investment properties - net	6, 8, 10, 18 and 20	1,642	8,037
Deferred tax assets - net	4 and 31	25	42
Other noncurrent assets - net	12, 14, 29, 30 and 32	6,594	7,315
Total Noncurrent Assets		114,615	118,965
Current Assets			
Cash and cash equivalents	13 and 30	44,141	24,370
Trade and other receivables - net	2, 12, 14, 20, 21 and 30	29,108	25,609
Inventories - at lower of cost or net realizable value	15	1,675	2,043
Deferred pass-through fuel costs	11	—	1,222
Land and development costs - at lower of cost or net realizable value	10 and 16	—	1,708
Other current assets	17 and 30	2,500	5,051
		77,424	60,003
Assets of discontinued operations	6	18,349	—
Total Current Assets		95,773	60,003
		P210,388	P178,968
EQUITY AND LIABILITIES			
Equity Attributable to Equity Holders of the Parent			
Common stock	18	P11,273	P11,273
Subscriptions receivable		(521)	(738)
Additional paid-in capital		4,111	4,111
Excess of acquisition cost over carrying value of non-controlling interest acquired		(328)	(328)
Employee stock purchase plan	19	915	743
Unrealized fair value gains on available-for-sale or AFS investments	12	85	96
Unrealized fair value gains on AFS investments of discontinued operations	6	14	—
Share in cumulative translation adjustments of a subsidiary and an associate	9	12	12
Cost of treasury shares held	18	(9)	—
Retained earnings:	5 and 18		
Appropriated		6,000	6,000
Unappropriated		42,236	37,800
Equity Attributable to Equity Holders of the Parent		63,788	58,969
Non-controlling Interests		4,713	4,227
Total Equity (Total Carried Forward)		68,501	63,196
Noncurrent Liabilities			
Interest-bearing long-term financial liabilities - net of current portion	10, 14, 20, 28 and 30	19,816	15,498
Customers' deposits - net of current portion	14, 21, 25, 28 and 30	24,080	23,761
Provisions	22 and 32	16,919	12,875
Long-term employee benefits	29	8,226	9,547
Refundable service extension costs - net of current portion	25 and 30	3,794	3,271
Deferred tax liabilities - net	4 and 31	595	3,322
Other noncurrent liabilities	25 and 30	6,302	2,352
Total Noncurrent Liabilities		79,732	70,626

(Forward)

		December 31	
	Note	2011	2010
(Amounts in Millions)			
Current Liabilities			
Notes payable	24, 28 and 30	P67	P149
Trade payables and accrued expenses	18, 19, 20, 21, 25, 26 and 30	40,011	31,138
Customers' refund	2, 23 and 30	6,250	7,131
Deposits from pre-selling of condominium units	16	—	741
Income tax payable		2,154	413
Current portion of interest-bearing long-term financial liabilities	10, 14, 20, 28 and 30	4,560	5,574
		53,042	45,146
Liabilities of discontinued operations	6	9,113	—
Total Current Liabilities		62,155	45,146
Total Liabilities		141,887	115,772
		P210,388	P178,968

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Consolidated Statements of Income

Years Ended December 31				
	Note	2011	2010 (As restated - Note 6)	2009 (As restated - Note 6)
(Amounts in Millions, Except Per Share Data)				
REVENUES				
Sale of electricity	2, 5, 11, 25, 26, 27 and 33	P253,989	P239,077	P178,686
Sale of services and others	5 and 10	2,819	1,856	2,072
		256,808	240,933	180,758
COSTS AND EXPENSES				
Purchased power	26, 27 and 33	205,674	200,916	150,928
Salaries, wages and employee benefits	19, 28 and 29	10,911	9,152	8,570
Provision for probable charges and expenses from claims	22 and 32	8,065	4,119	2,172
Depreciation and amortization	8, 10 and 12	5,504	5,911	4,831
Contracted services		3,333	2,877	3,413
Provision for doubtful accounts		2,243	961	746
Taxes, fees and permits		399	844	344
Other expenses	26 and 28	2,887	3,860	2,121
		239,016	228,640	173,125
OTHER EXPENSES (INCOME)				
Interest and other financial income	28 and 30	(2,264)	(1,605)	(3,300)
Interest and other financial charges	20, 21, 24 and 28	1,445	561	3,799
Equity in net earnings of associates and a joint venture	9	(67)	(283)	(245)
Derivative mark-to-market gain (loss)		16	7	(71)
Foreign exchange gain (loss)		7	32	(280)
Others		(44)	263	(325)
		(907)	(1,025)	(422)
INCOME BEFORE INCOME TAX FROM CONTINUING OPERATIONS		18,699	13,318	8,055
PROVISION FOR (BENEFIT FROM) INCOME TAX	31			
Current		8,454	4,960	2,926
Deferred		(2,515)	(937)	(595)
		5,939	4,023	2,331
INCOME FROM CONTINUING OPERATIONS		12,760	9,295	5,724
INCOME FROM DISCONTINUED OPERATIONS, NET OF INCOME TAX	6	966	822	632
NET INCOME		P13,726	P10,117	P6,356
Attributable To				
Equity holders of the Parent	34	P13,227	P9,685	P6,005
Non-controlling interests		499	432	351
		P13,726	P10,117	P6,356
Earnings Per Share Attributable to Equity Holders of the Parent	34			
Basic		P11.73	P8.59	P5.42
Diluted		11.73	8.59	5.42
Earnings Per Share Attributable to Equity Holders of the Parent of Continuing Operations	34			
Basic		P11.28	P8.21	P5.13
Diluted		11.28	8.21	5.13

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

		Years Ended December 31		
		2011	2010 (As restated - Note 6)	2009 (As restated - Note 6)
	Note			
(Amounts in Millions)				
NET INCOME FOR THE YEAR		P13,726	P10,117	P6,356
OTHER COMPREHENSIVE INCOME				
Unrealized fair value gains on available-for-sale investments	12	4	44	27
Income tax effect		(1)	(4)	(3)
		3	40	24
Share in cumulative translation adjustment of a subsidiary and an associate	9	–	(672)	682
OTHER COMPREHENSIVE INCOME (LOSS) FOR THE YEAR, NET OF INCOME TAX		3	(632)	706
TOTAL COMPREHENSIVE INCOME FOR THE YEAR, NET OF INCOME TAX		P13,729	P9,485	P7,062
Attributable To				
Equity holders of the Parent		P13,230	P9,038	P6,711
Non-controlling interests		499	447	351
		P13,729	P9,485	P7,062

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

	Equity Attributable to Equity Holders of the Parent										
	Common Stock (Note 18)	Subscriptions Receivable	Additional Paid-in Capital	Non-controlling Interest	Employee Stock Purchase Plan (Note 19)	Unrealized Fair Value Gains on Available-Investments (Note 12)	Unrealized Fair Value Gains on Available-Investments Discontinued Operations (Note 6)	Share in Revaluation Increment of an Associate (Note 9)	Share in Cumulative Translation Adjustment of a Subsidiary and an Associate (Note 9)	Cost of Treasury shares Held (Note 18)	Equity Attributable to Equity Holders of the Parent
<i>(Amounts in Millions)</i>											
At January 1, 2011	₱11,273	(₱738)	₱4,111	(₱328)	₱743	₱96	₱-	₱-	₱12	₱-	₱58,969
Net income	-	-	-	-	-	3	-	-	-	-	13,227
Other comprehensive income	-	-	-	-	-	-	-	-	-	-	3
Total comprehensive income	-	-	-	-	-	3	-	-	-	-	13,227
Treasury shares	-	-	-	-	-	-	-	-	-	(9)	(9)
Collection of subscriptions receivable	-	217	-	-	-	-	-	-	-	-	217
Share-based payments	-	-	-	-	172	-	-	-	-	-	172
Discontinued operations	-	-	-	-	-	(14)	14	-	-	-	-
Dividends	-	-	-	-	-	-	-	-	-	-	-
	-	217	-	-	172	-	-	-	-	-	(8,791)
At December 31, 2011	₱11,273	(₱521)	₱4,111	(₱328)	₱915	₱85	₱14	₱-	₱12	(₱9)	(₱3,411)
At January 1, 2010	₱11,273	(₱960)	₱4,112	(₱328)	₱569	₱71	₱-	₱-	₱684	₱-	₱57,369
Net income	-	-	-	-	-	-	-	-	-	-	9,685
Other comprehensive income	-	-	-	-	-	25	-	-	(672)	-	(647)
Total comprehensive income	-	-	-	-	-	25	-	-	(672)	-	9,038
Appropriations - net of reversal	-	-	-	-	-	-	-	-	1,802	-	(1,802)
Collection of subscriptions receivable	-	222	(1)	-	174	-	-	-	-	-	221
Share-based payments	-	-	-	-	-	-	-	-	-	-	174
Dividends	-	-	-	-	-	-	-	-	-	-	(7,833)
	-	222	(1)	-	174	-	-	-	1,802	-	(9,635)
At December 31, 2010	₱11,273	(₱738)	₱4,111	(₱328)	₱743	₱96	₱-	₱-	₱12	₱-	₱58,969
At January 1, 2009	₱11,038	₱-	₱2,932	(₱328)	₱268	₱47	₱-	₱129	₱2	₱-	₱52,607
Net income	-	-	-	-	-	-	-	-	-	-	6,005
Other comprehensive income	-	-	-	-	-	24	-	-	682	-	706
Total comprehensive income	-	-	-	-	-	24	-	-	682	-	6,711
Share on depreciation of revaluation increment of an associate transferred to unappropriated retained earnings	-	-	-	-	-	-	-	(129)	-	-	129
Issuance of shares	235	(960)	1,481	-	-	-	-	-	-	-	756
Share-based payments	-	-	(301)	-	301	-	-	-	-	-	-
Dividends	-	-	-	-	-	-	-	-	-	-	(2,705)
	235	(960)	1,180	-	301	-	-	(129)	-	-	(2,576)
At December 31, 2009	₱11,273	(₱960)	₱4,112	(₱328)	₱569	₱71	₱-	₱-	₱684	₱-	₱57,369

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Consolidated Statements of Cash Flows

		Years Ended December 31		
	Note	2011	2010	2009
		(Amounts in Millions)		
CASH FLOWS FROM OPERATING ACTIVITIES				
Income before income tax of continuing operations		P18,699	P14,437	P8,978
Income before income tax of discontinuing operations		1,288	—	—
Income before income tax		19,987	14,437	8,978
Adjustments for:				
Depreciation and amortization	8, 10 and 12	5,637	6,219	5,064
Provision for probable charges and expenses from claims	22 and 32	8,065	4,119	2,172
Interest and other financial income	28	(2,264)	(2,176)	(3,623)
Interest and other financial charges	28	1,445	714	3,884
Provision for doubtful accounts	14	2,243	961	746
Loss on disposal of utility plant and others - net		461	1,033	—
Cost of guaranteed service levels payout		241	388	216
Employee share-based payments	19	172	174	301
Equity in net earnings of associates and a joint venture	9	(67)	(283)	(245)
Loss (gain) on disposal of investment		(24)	—	46
Reversal of write-down of inventory to net realizable value		(18)	(3)	(41)
Gain on disposal of investment property		—	(4)	—
Donation of investment property		—	2	—
Foreign exchange loss (gain)		—	51	(266)
Operating income before working capital changes		35,878	25,632	17,232
Decrease (increase) in:				
Trade and other receivables		(4,964)	(503)	15,741
Inventories		323	(130)	(168)
Land and development costs		(3,331)	(517)	(531)
Deferred pass-through fuel costs		1,222	1,939	631
Other current assets		(2,180)	955	(1,854)
Increase (decrease) in:				
Trade payables and accrued expenses		11,163	44	8,175
Customers' refund		(881)	(2,241)	(2,889)
Customers' deposits		1,967	1,298	2,913
Deposits from pre-selling of condominium units		(457)	398	307
Long-term employee benefits		(1,301)	(1,424)	(1,555)
Provisions		(196)	(140)	(4,935)
Net cash generated from operations		37,243	25,311	33,067
Income tax paid		(5,309)	(4,953)	(3,797)
Net cash generated from operations		31,934	20,358	29,270
CASH FLOWS FROM INVESTING ACTIVITIES				
Additions to:				
Utility plant and others	8	(8,343)	(8,510)	(8,101)
Intangibles	12	(209)	(300)	(127)
Investment properties	10	(42)	(110)	(662)
Investment in an associate	9	(517)	—	—
Interest and other financial income received		1,450	1,058	1,332
Proceeds from:				
Return of investment		65	752	—
Disposal of utility plant and others		107	82	—
Disposal of investment property		—	28	—
Settlement of deliverable currency forwards		—	5	—
Dividends received from associates	9	20	96	445
Dividends paid by subsidiaries attributable to non-controlling interests		—	(15)	—
Decrease (increase) in other noncurrent assets		653	622	(1,657)
Net cash used in investing activities		(6,816)	(6,292)	(8,770)

(Forward)

		Years Ended December 31		
	Note	2011	2010	2009
		(Amounts in Millions)		
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from:				
Interest-bearing long-term financial liabilities, net of issue costs		P11,720	P10,528	P12,398
Notes payable		2,150	380	2,936
Collection of subscriptions receivable		217	221	445
Payments of:				
Interest-bearing long-term financial liabilities		(5,620)	(10,748)	(8,295)
Dividends		(9,866)	(6,187)	(2,820)
Interest and other financial charges		(1,960)	(2,044)	(1,524)
Notes payable		(2,082)	(744)	(12,251)
Acquisition of treasury shares		(9)	–	–
Increase in other noncurrent liabilities		870	1,830	277
Net cash flows used in financing activities		(4,580)	(6,764)	(8,834)
NET INCREASE IN CASH AND CASH EQUIVALENTS		20,540	7,302	11,666
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		24,370	17,068	5,402
CASH AND CASH EQUIVALENTS OF DISCONTINUED OPERATIONS AT END OF YEAR		(769)	–	–
CASH AND CASH EQUIVALENTS AT END OF YEAR	13	P44,141	P24,370	P17,068

See accompanying Notes to Consolidated Financial Statements.

MANILA ELECTRIC COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Corporate Information

Manila Electric Company or *MERALCO*, holds a congressional franchise under Republic Act or *RA* No. 9209 effective June 28, 2003. *RA* No. 9209 grants *MERALCO* a 25-year franchise valid up to June 28, 2028 to construct, operate, and maintain the electric distribution system in the cities and municipalities of Bulacan, Cavite, Metro Manila, and Rizal and certain cities, municipalities, and barangays in the provinces of Batangas, Laguna, Pampanga, and Quezon. On October 20, 2008, the Energy Regulatory Commission or *ERC*, granted *MERALCO* a consolidated Certificate of Public Convenience and Necessity for the operation of electric service within its franchise coverage, effective until the end of *MERALCO*'s congressional franchise. *MERALCO* is the largest power distribution utility or *DU*, in the Philippines.

The power segment, primarily power distribution, consists of operations of *MERALCO* and its subsidiary, Clark Electric Distribution Corporation or *CEDC*. *CEDC* is registered with Clark Development Corporation or *CDC*, under *RA* No. 9400, *Bases Conversion Development Act of 1992*, as a Clark Special Economic Zone or *CSEZ*, enterprise primarily engaged in owning, operating, and maintaining a power distribution system within *CSEZ*.

Separately, *MERALCO* organized a segment for its re-entry into power generation through its wholly-owned subsidiary, *MERALCO* PowerGen Corporation, or *MGen*, and another segment for its entry into retail electricity supply through its local retail electricity supply or *RES*. The *MERALCO RES*, otherwise known as *MPower* is a business unit within *MERALCO*. Through several other subsidiaries, its other business segments provide engineering, construction and consulting services, bill collection services, energy management services and information systems and technology services. *MERALCO*'s investment in common equity shares of Rockwell Land Corporation or *Rockwell Land*, has been declared as property dividends on February 27, 2012 to stockholders of record as at March 23, 2012. The details of the declaration are in *Note 6 – Discontinued Operations*. *MERALCO* and its subsidiaries are collectively referred to as *MERALCO Group*.

MERALCO is owned by three major shareholder groups and the public. As at December 31, 2011, Beacon Electric Asset Holdings, Inc. or *Beacon Electric* owns 45.36% of the common shares. *Beacon Electric* is jointly owned by Metro Pacific Investments Corporation or *Metro Pacific* and PLDT Communications and Energy Ventures, Inc. or *PCEV*, both of which are domestic corporations, and are affiliates of First Pacific Company Limited, a Hong Kong-based investment and management company. San Miguel Corporation or *SMC*, together with its subsidiaries, San Miguel Purefoods Company, Inc. and San Miguel Global Power Holdings, owns 33.2% of the outstanding common shares of *MERALCO*. First Philippine Holdings Corporation or *First Holdings*, and First Philippine Utilities Corporation collectively own 6.61%. The balance of *MERALCO*'s common shares is held by the public.

The common shares of *MERALCO* are listed on and traded in the Philippine Stock Exchange, or *PSE*, with security symbol *MER*.

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

The accompanying consolidated financial statements as at December 31, 2011 and 2010 and for each of the three years in the period ended December 31, 2011 were reviewed and recommended for approval by the Audit and Risk Management Committee on February 27, 2012. On the same date, these consolidated financial statements were approved and authorized for issue by the Board of Directors or *BOD*.

2. Rate Regulations

As *DUs*, *MERALCO* and *CEDC* are subject to the rate-making regulations and regulatory policies of the *ERC*. Billings of *MERALCO* and *CEDC* to customers are itemized or “unbundled” into a number of bill components that reflect the various activities and costs incurred in providing electric service. The adjustment to each bill component is governed by mechanisms promulgated and enforced by the *ERC*, mainly: [i] the “Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities,” which govern the recovery of pass-through costs, including over- or under-recoveries of the bill components, namely, (a) generation charge, (b) transmission charge, (c) system loss or *SL*, charge, (d) lifeline and interclass rate subsidies, (e) local franchise tax or *LFT*, and (f) business tax; and [ii] the “Rules for the Setting of Distribution Wheeling Rates or *RDWR*,” as modified by *ERC* Resolution No. 20, Series of 2008, which govern the determination of *MERALCO*'s distribution, supply, and metering charges.

The rate-setting mechanism of *CEDC* is likewise in accordance with *ERC* regulations. In 2009, *CEDC* filed its unbundling application and supporting documents with the *ERC* pursuant to Section 36 of *RA* No. 9136, *Electric Power Industry Reform Act of 2001* or *EPIRA*.

On May 14, 2010, the *ERC* approved *CEDC*'s unbundling application with modifications. On September 6, 2010, *CEDC* filed its motion for partial reconsideration thereof. *CEDC* received an *ERC* Order on August 19, 2011 to implement certain revisions of its schedule of rates effective on its August 2010 billing cycle, and to submit its proposed Refund Scheme to its customers for the difference between its existing rates and the rates approved by the *ERC*. The Refund Scheme and supporting worksheets were submitted to the *ERC* on September 26, 2011.

As at February 27, 2012, *ERC* has not yet issued a decision on *CEDC*'s submitted Refund Scheme.

The following is a discussion of matters related to rate-setting of *MERALCO* and *CEDC*:

Rate Applications

Performance-Based Regulations or PBR

a. MERALCO

MERALCO was among the first entrants to the *PBR*, together with Dagupan Electric Corporation and Cagayan Electric Power & Light Company, Inc.

Rate-setting under *PBR* is governed by the *RDWR*. The *PBR* scheme sets tariffs based on the *DU*'s asset base, and the required operating and capital expenditures once every regulatory period or *RP*, to meet a level of operational performance and service level requirements approved by the *ERC*. The *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

As part of the *PBR*, *MERALCO* implemented payouts to customers for instances where its performance was beyond the guaranteed service levels or *GSL*. See *Note 25 – Trade Payables and Accrued Expenses*.

Rate filings and settings are done on an *RP* basis. One *RP* consists of four Regulatory Years or *RYs*. An *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. As at December 31, 2011, *MERALCO* is operating in the first half of the first *RY* of the third *RP*. The third *RP* is from July 1, 2011 to June 30, 2015.

b. CEDC

CEDC was among the four Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. The *RP* of *CEDC* began on October 1, 2011 and ends on September 30, 2015.

Maximum Average Price or MAP for RY 2008 and RY 2009 of MERALCO

On January 11 and April 1, 2008, *MERALCO* filed separate applications for the approval of its proposed translation of the *MAP* for *RY 2008* and *RY 2009* into different rate schedules for its various customer segments. A portion of the distribution charge under-recoveries as a result of the delayed implementation of the *PBR* was incorporated in the proposed *MAP* for *RY 2009*.

In April 2009, the *ERC* approved the implementation of *MERALCO*'s average distribution rate for *RY 2009* of ₱1.2227 per kWh effective billing periods starting May 2009. This rate is inclusive of ₱0.1285 per kWh representing the under-recoveries for calendar year 2007.

On May 28, 2009, certain electricity consumer groups filed a Petition with the Court of Appeals, or *CA*, questioning the decision and Order of the *ERC* on *MERALCO*'s rate translation application for *RY 2009*. In a decision dated January 27, 2010, the *CA* denied the Petition. Consequently, the consumer groups brought the case to the Supreme Court of the Philippines or *SC*. Comments and responses were filed by both parties with a manifestation filed by *MERALCO* on January 26, 2011. As at February 27, 2012, there has been no decision rendered by the *SC* on this case yet.

MAP for RY 2010 of MERALCO

On August 7, 2009, *MERALCO* filed a petition for the verification of its *RY 2010 MAP* and its translation into tariffs by customer category. In accordance with the *ERC*'s Guidelines for *RY 2010 Rate Reset for First Entrant Distribution Utilities*, the *MAP* for *RY 2010* was computed to be ₱1.4917 per kWh. Subsequently, on January 26, 2010, *MERALCO* filed a manifestation with the *ERC* voluntarily suspending the implementation of the *ERC*'s December 14, 2009 decision to allow the regulator time to resolve issues raised by the intervenors. On March 10, 2010, the *ERC* resolved the Motion for Reconsideration and approved a new rate schedule affirming that there is no rate distortion or no cross-subsidies, other than the lifeline subsidy, in *MERALCO*'s rates. Consequently, *MERALCO* implemented the new rate schedule effective on its April 2010 billing cycle.

Certain electricity consumer groups likewise filed a Petition for Certiorari with the *SC* questioning the decision rendered by the *ERC*. On July 3, 2011, the *SC* dismissed the petition. Thereafter, on December 14, 2011, a motion for reconsideration filed by the same intervenors was denied with finality by the *SC*.

MAP for RY 2011 of MERALCO

On December 6, 2010, the *ERC* approved *MERALCO*'s application for *MAP* for *RY 2011* of ₱1.6464 per kWh and ordered *MERALCO* to implement, starting its January 2011 billing cycle, the approved distribution, supply and metering charges. The 2011 *MAP* rates were implemented accordingly through September 2011.

Third RP Reset Application of MERALCO

On June 18, 2010, *MERALCO* filed its application for the approval of its proposed Annual Revenue Requirement or *ARR* and Performance Incentive Scheme or *PIS*, for the third *RP* (July 1, 2011 to June 30, 2015), the Final Determination of which was approved on June 6, 2011. The approved *MAPs* were P1.5828 per kWh, P1.5824 per kWh, P1.5821 per kWh and P1.5817 per kWh for the *RYs* 2012, 2013, 2014 and 2015, respectively.

MERALCO's MAP was translated into a distribution rate structure for the various customer classes. The *PIS*, which sets the performance measures and targets that apply throughout the third *RP*, was also approved.

On June 21, 2011, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2012 and its translation into rate tariffs by customer category. On October 6, 2011, the *ERC* provisionally approved the *MAP* for *RY* 2012 of P1.6012 per kWh and the rate translation per customer class was reflected commencing with the October 2011 customer bills. Hearings for the final approval of application are ongoing.

A Petition for Review of the *ERC's* decision for the provisional approval was filed by an intervenor with the *CA*. On February 3, 2012, the *CA* denied such appeal.

MAP for RY 2012 of CEDC

In compliance with the *ERC's PBR* rate setting mechanism, on September 24, 2010, *CEDC* filed its *ARR* and *PIS* with the *ERC*. *CEDC* filed its revised application on November 3, 2010 and underwent a series of hearings and public consultations of the *ERC* in 2011. The *ERC* issued *CEDC's* Final Determination on August 5, 2011. Subsequently, *CEDC* filed with the *ERC* its application for *RY* 2012 Rate Translation into different customer classes.

As at February 27, 2012, the application is still pending approval by the *ERC*.

SC Decision on Unbundling Rate Case

On May 30, 2003, the *ERC* issued an Order approving *MERALCO's* unbundled tariffs that resulted in a total increase of P0.17 per kWh over the May 2003 tariff levels. However, on August 4, 2003, certain consumer and civil society groups filed a Petition for Review with the *CA* on the *ERC's* ruling. On July 22, 2004, the *CA* set aside the *ERC's* ruling on *MERALCO* rate unbundling and remanded the case back to the *ERC*. Further, the *CA* opined that the *ERC* should have asked the Commission on Audit or *COA*, to audit the books of *MERALCO*. The *ERC* and *MERALCO* subsequently filed separate motions asking the *CA* to reconsider its decision. On January 24, 2005, as a result of the denial by the *CA* of the motions, the *ERC* and *MERALCO* elevated the case to the *SC*.

In an En Banc decision promulgated on December 6, 2006, the *SC* set aside and reversed the *CA* ruling saying that a *COA* audit was not a prerequisite in the determination of a utility's rates. However, while the *SC* affirmed *ERC's* authority in rate-fixing, the *SC* directed the *ERC* to request *COA* to undertake a complete audit of the books, records and accounts of *MERALCO*. On January 15, 2007, in compliance with the directive of the *SC*, the *ERC* requested *COA* to conduct an audit of the books, records and accounts of *MERALCO* using calendar year 2004 and 2007 as test years.

The *COA* audit, which began in September 2008, was completed in August 2009.

On February 17, 2010, the *ERC* issued its Order directing *MERALCO* and all intervenors in the case to submit within 15 days from receipt their respective comments on the *COA's* "Report No. 2009-01 Rate Audit Unbundled Charges."

On July 1, 2011, the *ERC* maintained and affirmed its findings and conclusions in its Order dated March 20, 2003. The *ERC* stated that the *COA* recommendation to apply disallowances under *PBR* to rate unbundling violates the principle against retroactive rate-making. An intervenor group has filed a motion for reconsideration. On September 5, 2011, *MERALCO* filed its comments to the intervenors' motion for reconsideration. *MERALCO* is awaiting resolution of the *ERC*.

Applications for the Recovery of Generation Costs and SL Charges

MERALCO filed separate applications for the full recovery of generation costs, including value-added tax, or *VAT*, incurred for the supply months of August 2006 to May 2007 or total under-recoveries of P12,679 million for generation charges and P1,295 million for *SL* charges.

The separate applications for the full recovery of generation charges have been approved by the *ERC* in its decisions released on January 18, 2008, September 3, 2008 and August 16, 2010.

As at December 31, 2011, the remaining balance of P2,156 million of such unrecovered generation costs will be billed in 2012 at the rate of P0.0314 per kWh until fully recovered. The amount recoverable within 12 months is included in the "Trade and other receivables" account while the long-term portion is included in the "Other noncurrent assets" account.

With respect to the P1,295 million *SL* charge under-recoveries, the *ERC* ordered *MERALCO* to file a separate application for the recovery of *SL* adjustments after the *ERC* confirms the transmission rate to be used in the calculation of the *SL* rate in accordance with the *SL* rate formula of the Automatic Generation Rate Adjustments Guidelines. *MERALCO* has filed the

application for recovery of the P1,295 million *SL* charge under-recoveries with the *ERC*. This was included in the Consolidated Application of under/over recoveries in generation, transmission, *SL* and lifeline charges filed on March 31, 2011 with the *ERC*. Hearings were completed on October 25, 2011. As at February 27, 2012, *MERALCO* is awaiting the resolution of the application by the *ERC*.

Application for Recovery of Inter-Class Cross Subsidy and Lifeline Subsidy

MERALCO filed separate applications to recover inter-class cross subsidy (on November 14, 2007) and lifeline subsidy (on February 19, 2008).

In a decision dated November 16, 2009, the *ERC* authorized *MERALCO* to recover the inter-class cross subsidy under-recoveries covering the period June 2003 to October 2006 amounting to P1,049 million and total lifeline subsidy under-recoveries covering the period June 2003 to December 2007 amounting to P856 million.

In December 2009, *MERALCO* implemented the decisions of the *ERC* on the inter-class cross and lifeline subsidies. As at December 31, 2011, the total amount of billed inter-class cross subsidy and lifeline subsidy amounted to P645 million and P426 million, respectively. The unbilled balance of inter-class cross subsidy is P404 million and is expected to be recovered within the next 16 months from January 2012. The balance of lifeline subsidy is P430 million and will be billed within the next 26 months from January 2012. The amount recoverable within 12 months is included in the "Trade and other receivables" account while the long-term portion is included in the "Other noncurrent assets" account.

Consolidated Applications for the Recovery of Pass-through Charges

On March 31, 2011, *MERALCO* filed a consolidated application with the *ERC* to confirm its under- or over-recoveries accumulated from June 2003 to December 2010 in compliance with Resolution No. 21, Series of 2010. Hearings were completed on October 25, 2011. On December 12, 2011, *MERALCO* filed an Omnibus Motion praying, among other things, for the admission of the Supplemental Application. In an Order dated January 2, 2012, the *ERC* granted *MERALCO*'s Omnibus Motion and admitted its Supplemental Application. Accordingly, a hearing on the Supplemental Application was held on February 1, 2012 where *MERALCO* presented additional evidence. The *ERC* is yet to issue an Order on the recovery of the foregoing.

The consolidated filing includes net generation charge under-recoveries of P1,000 million, net transmission charge over-recoveries of P111 million, net lifeline subsidy under-recoveries of P9 million and net *SL* over-recoveries of P425 million, excluding any applicable carrying charges.

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

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

On October 18, 2010, the *ERC* promulgated *ERC* Resolution No. 21, Series of 2010, amending certain formula contained in *ERC* Resolution No. 16, Series of 2009, and setting March 31, 2011 (covering adjustments implemented until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) as the new deadlines for *DUs* in Luzon to file their respective applications. Subsequent filings shall be made every three years thereafter.

Petition to Implement a Lower Generation Charge for the February 2010 Supply Month

MERALCO's generation cost abruptly increased to P15,934 million for the supply month of February 2010. This translated to a generation charge of P6.76 per kWh to its customers for the March 2010 billing. The sharp increase in generation cost was mainly due to abnormally high prices in the Wholesale Electricity Spot Market or *WESM*. A Petition was filed by *MERALCO* to mitigate the effects of the abrupt increase in generation cost through a voluntary deferral of a portion of generation costs, with the differential to be recovered over a period, which shall be approved by the *ERC*. In an Order dated March 10, 2010, the *ERC* provisionally approved a lower generation charge of P5.8417 per kWh representing P13,773 million generation cost for the subject month. *MERALCO* was also provisionally allowed to charge over a six month period starting April 2010 the generation charge at the rate of P0.07 per kWh, corresponding to the incremental costs of the condensate fuel used by Sta. Rita and San Lorenzo power plants during the said month. In its decision dated July 25, 2011, the *ERC* authorized *MERALCO* to collect the additional generation cost for the period January 26, 2010 to February 25, 2010 including carrying charges. The approved recovery was implemented starting September 2011 billing. As at December 31, 2011, the remaining balance is recoverable within the next 10 months.

SC Decision on the P0.167 per kWh Refund

Following the *SC*'s final ruling that directed *MERALCO* to refund affected customers P0.167 per kWh covering the billing period from February 1994 to April 30, 2003, the *ERC* approved the release of the refund in four phases. The refund is still ongoing. See Note 23 – Customers' Refund.

3. Basis of Preparation and Statement of Compliance

The accompanying consolidated financial statements have been prepared on a historical cost basis, except for *MERALCO*'s utility plant and others and investment properties acquired before January 1, 2004, which are carried at deemed cost and for derivative financial instruments and available-for-sale, or *AFS*, financial assets, which are measured at fair value. Derivative financial instruments are shown as part of "Other current assets," or "Trade payables and accrued expenses" accounts, as applicable, in the consolidated statement of financial position. *AFS* financial assets are included as part of "Other noncurrent assets" account in the consolidated statement of financial position.

The accompanying consolidated financial statements are presented in Philippine peso, the *MERALCO Group*'s functional and presentation currency. All values are rounded to the nearest million peso (P000,000), except when otherwise indicated.

Statement of Compliance

The consolidated financial statements of *MERALCO* and its subsidiaries have been prepared in compliance with Philippine Financial Reporting Standards or *PFRS*. *PFRS* includes statements named *PFRS* and Philippine Accounting Standards or *PAS*, including Interpretations issued by the Philippine Financial Reporting Standards Council or *PFRSC*.

Basis of Consolidation

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

The consolidated financial statements include the financial statements of *MERALCO* and the following directly and indirectly-owned subsidiaries:

Subsidiaries	Place of Incorporation	Principal Business Activity	Percentage of Ownership	
			Direct	Indirect
Corporate Information Solutions, Inc., or <i>CIS</i>	Philippines	e-Transactions	100	–
<i>CIS Bayad Center, Inc.</i> , or <i>Bayad Center</i>	Philippines	Bills payment collection	–	100
<i>Customer Frontline Solutions, Inc.</i> or <i>CFSI</i> (formerly <i>Outsourced Telleserve Corporation</i>)	Philippines	Telling services	–	100
Meralco Energy, Inc., or <i>MEI</i>	Philippines	Energy systems management	100	–
e <i>MERALCO</i> Ventures, Inc., or e- <i>MVI</i>	Philippines	e-Business development	100	–
<i>Paragon Vertical Corporation</i> ¹	Philippines	Information technology and multi-media services	–	100
<i>MGen</i>	Philippines	Development of power generation plants	100	–
<i>Calamba Aero Power Corporation</i> ²	Philippines	Power generation	–	100
<i>Atimonan Land Ventures Development</i> ³	Philippines	Real estate	–	100
Meralco Financial Services Corporation or <i>Finserve</i>	Philippines	Financial services provider	100	–
Republic Surety and Insurance Company, Inc. or <i>RSIC</i>	Philippines	Insurance	100	–
Lighthouse Overseas Insurance Limited or <i>LOIL</i>	Bermuda	Insurance	100	–
<i>MIESCOR</i>	Philippines	Engineering, construction and consulting services	99	–
<i>Miescor Builders Inc.</i> , or <i>MBI</i>	Philippines	Electric transmission and distribution operation and maintenance	–	99
<i>Landbees Corporation</i> , or <i>Landbees</i>	Philippines	General services, manpower/maintenance	–	99
<i>Miescorrail, Inc.</i> or <i>Miescorrail</i>	Philippines	Engineering and construction of mass transit system	–	60
<i>CEDC</i>	Philippines	Power distribution	65	–
<i>Rockwell Land</i> ⁴	Philippines	Real estate	51	–

¹ Acquired on July 20, 2011.

² Incorporated on February 15 2011 and has not started commercial operations as at December 31 2011.

³ Incorporated on December 7, 2011 and has not started commercial operations as at December 31, 2011.

⁴ Presented as discontinued operations.

Subsidiaries are fully consolidated from the date of acquisition, being the date at which *MERALCO* obtains control, and continue to be consolidated until the date that such control ceases. Control is the power to govern the financial and operating policies of the entity.

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

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

Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit.

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

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

4. Significant Accounting Policies

Changes in Accounting Policies and Disclosures

The accounting policies adopted in the preparation of consolidated financial statements are consistent with those of the previous financial year except for the adoption of the following Philippine Interpretations and amendments and improvements to existing standards, which were effective beginning January 1, 2011. The adoption of these changes and improvements did not have any significant effect on the consolidated financial statements.

Amendments to PFRS

Revised PAS 24, Related Party Disclosures

PAS 24 clarifies the definitions of a related party. The new definitions emphasize a symmetrical view of related party relationships and clarify the circumstances in which persons and key management personnel affect related party relationships of an entity. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity.

Amendment to PAS 32, Financial Instruments: Presentation - Classification of Rights Issues

The definition of a financial liability in the standard has been amended to classify rights issues (and certain options or warrants) as equity instruments if: (a) the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, and (b) the instruments are used to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency.

Philippine Interpretation International Financial Reporting Interpretations Committee or IFRIC 14, Prepayments of a Minimum Funding Requirement

The interpretation has been amended to permit an entity to treat the prepayment of a minimum funding requirement as an asset. The amendment should be applied to the beginning of the earliest period presented in the first financial statements in which the entity applied the original interpretation.

Philippine Interpretation IFRIC 19, Extinguishing Financial Liabilities with Equity Instrument

The interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability are consideration paid. As a result, the financial liability is derecognized and the equity instruments issued are treated as consideration paid to extinguish that financial liability. The interpretation states that equity instruments issued in a debt for equity swap should be measured at the fair value of the equity instruments issued, if this can be determined reliably. If the fair value of the equity instruments issued is not reliably determinable, the equity instruments should be measured by reference to the fair value of the financial liability extinguished as of the date of extinguishment. Any difference between the carrying amount of the financial liability that is extinguished and the fair value of the equity instruments issued is recognized immediately in profit or loss.

Improvements to PFRS

The *PFRSC* approved in its meeting in July 2010 the adoption of Improvements to International Financial Reporting Standards issued by the International Accounting Standards Board in May 2010. There are separate transitional provisions for the improvements in each standard, which are all effective beginning January 1, 2011.

PFRS 3, Business Combinations

The improvements include: (a) clarification that the amendments to *PFRS 7, Financial Instruments: Disclosures*, *PAS 32, Financial Instruments: Presentation*, and *PAS 39, Financial Instruments: Recognition and Measurement*, that eliminates the exemption for contingent consideration, do not apply to contingent consideration that arose from business combinations whose acquisition dates precede the application of *PFRS 3* (as revised in 2008); (b) guidance that the choice of measuring non-controlling interest at fair value or at the proportionate share of the acquiree's net assets applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of non-controlling interest are measured at fair value unless another measurement basis is required by *PFRS*; and (c) clarification that the application guidance in *PFRS 3* applies to all share-based payment transactions that are part of a business combination, including un-replaced and voluntarily replaced share-based payment awards.

PFRS 7, Financial Instruments

The amendment was intended to simplify the disclosures provided by reducing the volume of disclosures around collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context.

PAS 1, Presentation of Financial Statements

The amendment clarifies that an entity shall present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements.

PAS 27, Consolidated and Separate Financial Statements

The improvement clarifies that the consequential amendments from *PAS 27* made to *PAS 21, The Effect of Changes in Foreign Exchange Rates*, *PAS 28, Investments in Associates*, and *PAS 31, Interests in Joint Ventures*, shall be applied prospectively.

PAS 34, Interim Financial Reporting

The amendment provides guidance on how to apply disclosure principles in *PAS 34* and additional disclosure requirements around (a) the circumstances likely to affect fair values of financial instruments and their classification; (b) transfers of financial instruments between different levels of the fair value hierarchy; (c) changes in classification of financial assets; and (d) changes in contingent liabilities and assets.

Philippine Interpretation IFRIC 13, Customer Loyalty Programmes

The amendment clarifies the meaning of fair value in the context of measuring award credits under customer loyalty programmes.

New Accounting Standards and Interpretations to Existing Standards Effective Subsequent to December 31, 2011

The *MERALCO Group* will adopt the following revised standards and interpretations, which are relevant when these become effective. Except as otherwise indicated, it does not expect the adoption of these revised standards and amendments to *PFRS* to have a significant impact on the consolidated financial statements.

*Effective 2012**PFRS 7, Financial Instruments: Disclosures - Enhanced Derecognition Disclosure Requirements*

The amendment requires additional disclosure about financial assets that have been transferred but not derecognized to enable the user of the consolidated financial statements to understand the relationship with those assets that have not been derecognized and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognized assets to enable the user to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognized assets. The amendment becomes effective for annual periods beginning on or after July 1, 2011.

Amendment to PAS 12, Income Taxes – Deferred Income Tax: Recovery of Underlying Assets

The amendment clarified the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in *PAS 40, Investment Property* should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in *PAS 16, Property, Plant and Equipment* always be measured on a sale basis of the asset. The amendment becomes effective for annual periods beginning on or after January 1, 2012.

*Effective 2013**PFRS 10, Consolidated Financial Statements*

PFRS 10 replaces the portion of *PAS 27, Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in *Standards Interpretation Committee or SIC 12, Consolidation - Special Purpose Entities*. *PFRS 10* establishes a single control model that applies to all entities including special purpose entities. The changes introduced by *PFRS 10* will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by the parent, compared with the requirements in *PAS 27*. This standard becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 11, Joint Arrangements

PFRS 11 replaces *PAS 31, Interests in Joint Ventures* and *SIC-13, Jointly-controlled Entities - Non-monetary Contributions by Venturers*. *PFRS 11* removes the option to account for jointly controlled entities or *JCEs* using proportionate consolidation. Instead, *JCEs* that meet the definition of a joint venture must be accounted for using the equity method. This standard becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 12, Disclosure of Interests in Other Entities

PFRS 12 includes all of the disclosures that were previously in *PAS 27* related to consolidated financial statements, as well as all of the disclosures that were previously included in *PAS 31* and *PAS 28*. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. This standard becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 13, Fair Value Measurement

PFRS 13 establishes a single source of guidance under *PFRS* for all fair value measurements. *PFRS 13* does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under *PFRS* when fair value is required or permitted. This standard becomes effective for annual periods beginning on or after January 1, 2013.

Revised PAS 27, Separate Financial Statements

As a consequence of the new *PFRS 10* and *PFRS 12*, the scope of *PAS 27* is limited to accounting for subsidiaries, jointly controlled entities, and associates in the separate financial statements. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

Revised PAS 28, Investments in Associates and Joint Ventures

PAS 28, Investments in Associates, has been renamed *PAS 28, Investments in Associates and Joint Ventures* as a consequence of the new *PFRS 11* and *PFRS 12*. *PAS 28* describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

PAS 1, Financial Statement Presentation – Presentation of Items of Other Comprehensive Income

The amendments to *PAS 1* change the grouping of items presented in other comprehensive income. Items that could be reclassified (or “recycled”) to profit or loss at a future point in time would be presented separately from items that will never be reclassified. The amendment becomes effective for annual periods beginning on or after July 1, 2012.

PAS 19, Employee Benefits (Amendments)

Amendments to *PAS 19* range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The amendment will result in full recognition of *MERALCO Group's* actuarial gains or losses in the consolidated statement of income and change in the measurement of expected return on plan assets. The amendment becomes effective retrospectively for annual periods beginning on or after January 1, 2013. See *Note 29 – Long-term Employee Benefits*.

Amendments to PFRS 7, Financial Instruments: Disclosures – Offsetting of Financial Assets and Financial Liabilities

These amendments require an entity to disclose information about rights of offset and related arrangements (such as collateral agreements). The new disclosures are required for all recognized financial instruments that are offset in accordance with *PAS 32*. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or ‘similar agreement’, irrespective of whether they are offset in accordance with *PAS 32*. The amendments require entities to disclose, in a tabular format unless another format is more appropriate, the following minimum quantitative information.

This is presented separately for financial assets and financial liabilities recognized at the end of the reporting period:

- a) The gross amounts of those recognized financial assets and recognized financial liabilities;
- b) The amounts that are offset in accordance with the criteria in *PAS 32* when determining the net amounts presented in the statement of financial position;
- c) The net amounts presented in the statement of financial position;
- d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:
 - i. amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in *PAS 32*; and
 - ii. amounts related to financial collateral (including cash collateral); and
- e) The net amount after deducting the amounts in (d) from the amounts in (c) in the foregoing.

The amendments to *PFRS 7* are to be retrospectively applied for annual periods beginning on or after January 1, 2013.

Effective 2014

PAS 32, Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities

These amendments to *PAS 32* clarify the meaning of “currently has a legally enforceable right to offset” and also clarify the application of the *PAS 32* offsetting criteria to settlement systems, which apply gross settlement mechanisms that are not simultaneous. The amendments to *PAS 32* are to be retrospectively applied for annual periods beginning on or after January 1, 2014.

Effective 2015

PFRS 9, Financial Instruments: Classification and Measurement

PFRS 9, as issued in 2010, reflects the first phase of the work on the replacement of *PAS 39* and applies to classification and measurement of financial assets and financial liabilities as defined in *PAS 39*. The standard is effective for annual periods beginning on or after January 1, 2015. In subsequent phases, hedge accounting and impairment will be addressed. The *MERALCO Group* has decided not to early adopt *PFRS 9* for its 2011 financial reporting. The adoption of the first phase of *PFRS 9* will have an effect on the classification and measurement of financial assets. The *MERALCO Group* will quantify the effect on the consolidated financial statements in conjunction with the other phases, when issued, to present a comprehensive picture.

Significant Accounting Policies

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

Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value. Acquisition-related costs in a business combination are expensed.

As at the acquisition date, the *MERALCO Group* recognizes, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Identifiable assets acquired and liabilities assumed are measured at acquisition-date fair values. For each business combination, it has the option to measure the non-controlling interest in the acquiree at fair value or the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

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

If the business combination is achieved in stages, the acquirer's previously held equity interest in the acquiree is remeasured at fair value as at acquisition date.

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

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

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

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

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

Prior to January 1, 2010, business combinations were accounted for using the purchase method. Transaction costs directly attributable to the acquisition formed part of the acquisition cost. Non-controlling interests were measured at the proportionate share of the acquiree's identifiable net assets.

Utility Plant and Others

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

Land is stated at cost less any impairment in value.

MERALCO's utility plant and others are stated at deemed cost. The revalued amount recorded as at January 1, 2004 was adopted as deemed cost as allowed by the transitional provisions of *PFRS 1*. The balance of revaluation increment was closed to retained earnings. See *Note 18 – Equity* for the related discussion.

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

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

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

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

Construction in Progress

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

Borrowing Costs

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

have been undertaken and expenditures and borrowing costs have been incurred. Borrowing costs are capitalized until the asset is substantially available for its intended use.

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

All other borrowing costs are expensed as incurred.

Investment Properties

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

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

Land is carried at cost less any impairment in value.

MERALCO's investment properties acquired before January 1, 2004 are stated at deemed cost. See *Note 18 – Equity* for the related discussions.

Investment properties, except land, are being depreciated on a straight-line basis over the useful life of 5 to 35 years.

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

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

Asset Retirement Obligations

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

Intangible Assets

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

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

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

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

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

Investments in Associates

An associate is an entity over which *MERALCO* has significant influence and which is neither a subsidiary nor a joint venture. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost.

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

The share in profits and losses of associates is shown on the face of the consolidated statement of income. This is the profit or loss attributable to equity holders of the associate and is therefore profit or loss after tax and net of non-controlling interest in the subsidiaries of the associates.

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

After application of the equity method, the *MERALCO Group* determines whether it is necessary to recognize an impairment loss on the investments in associates. At the end of each reporting date, the *MERALCO Group* determines whether there is any objective evidence that each of the investments in associates is impaired. If this is the case, the *MERALCO Group* calculates the amount of impairment as the difference between the recoverable amount of the investment in associate and its carrying value and recognizes the amount in the consolidated statement of income.

Upon loss of significant influence over the associate, the *MERALCO Group* measures and recognizes any remaining investment at its fair value. Any difference between the carrying amount of the investment in associate upon loss of significant influence, and the aggregate of the fair value of the remaining investment and proceeds from disposal, is recognized in the consolidated statement of income.

Interest in a Joint Venture

The *MERALCO Group's* ownership interest in Indra Philippines, Inc. or *Indra Philippines*, a jointly controlled entity, is accounted for using the equity method of accounting in the consolidated financial statements. The interest in a joint venture is carried at cost plus post-acquisition changes in the *MERALCO Group's* share in the net assets of the joint venture, less any impairment in value. The *MERALCO Group's* share in 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. 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 that of the *MERALCO Group*, using consistent accounting policies.

Adjustments are made in the consolidated financial statements to eliminate the *MERALCO Group's* share of unrealized gains and losses on transactions between the *MERALCO Group* and the jointly controlled entity. The joint venture is carried at equity method until the date on which the *MERALCO Group* ceases to have joint control over the jointly controlled entity.

The *MERALCO Group* measures and recognizes the remaining investment at fair value upon loss of control and provided the jointly controlled entity does not become a subsidiary or associate. Any difference between the carrying amount of the jointly controlled entity upon loss of joint control, and the aggregate of the fair value of the remaining investment and proceeds from disposal, is recognized in the consolidated statement of income. When the remaining investment constitutes significant influence, it is accounted for as investment in an associate.

Deferred Pass-through Fuel Costs

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

Impairment of Nonfinancial Assets

The *MERALCO Group* assesses at each reporting date whether there is an indication that a nonfinancial asset, other than goodwill and intangible assets with indefinite useful life, may be impaired. If any such indication exists, the *MERALCO Group* makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an individual asset's or,

if the individual asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, a cash-generating unit's fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The fair value is the amount obtainable from the sale of the asset in an arm's-length transaction. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multipliers, quoted share prices for publicly traded securities or other available fair value indicators. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in the consolidated statement of income.

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

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

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

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

Inventories

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

Condominium units which are completed and for sale are stated at the lower of cost and net realizable value. Cost includes the cost of the land, expenditures for the construction of the condominium units and borrowing costs incurred during construction. 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 land is stated at the lower of cost and net realizable value. Expenditures for development such as construction materials, labor and overhead are capitalized as part of the cost of the land. Borrowing costs are capitalized while development is in progress. Net realizable value is the estimated selling price in the ordinary course of business less estimated costs to complete and to sell.

Disposal group classified as discontinued operations

Disposal group classified as discontinued operations is measured at the lower of its carrying amount and fair value less costs to sell.

In the consolidated statement of income, income and expenses from discontinued operations are reported separately from income and expenses from continuing operations, down to the level of profit after taxes. The resulting profit or loss (after taxes) is reported separately in the consolidated statement of income.

Financial Assets

Initial Recognition

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

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

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

The *MERALCO Group's* financial assets include cash and cash equivalents, trade and other receivables, unbilled receivables, advance payments to suppliers, notes receivable, quoted and unquoted equity securities and embedded derivatives that are not accounted for as effective accounting hedges.

Subsequent Measurement

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

Financial Assets at FVPL

Financial assets at *FVPL* include financial assets held-for-trading and financial assets designated upon initial recognition as at *FVPL*. Financial assets are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Derivative assets, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments. Financial assets designated as at *FVPL* are carried in the consolidated statement of financial position at fair value with gains or losses on fair value changes recognized in the consolidated statement of income under "Interest and other financial income" or "Interest and other financial charges" account, respectively. Interest earned and dividends received from investment designated at *FVPL* are also recognized in the consolidated statement of income under "Interest and other financial income" account.

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

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

Loans and Receivables

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

HTM Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as *HTM* when the *MERALCO Group* has the positive intention and ability to hold these assets to maturity. After initial measurement, *HTM* investments are measured at amortized cost using the effective interest method. Gains or losses are recognized in the consolidated statement of income. Assets in this category are included in the current assets except for maturities beyond 12 months from the reporting date, which are classified as noncurrent assets. The *MERALCO Group* has no *HTM* investments as at December 31, 2011.

AFS Financial Assets

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

Financial Liabilities

Initial Recognition

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

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

The *MERALCO Group's* financial liabilities include notes payable, interest-bearing long-term financial liabilities, trade payables and accrued expenses (excluding output VAT, accrued taxes and leases), customers' deposits, refundable service extension costs, customers' refund, other noncurrent liabilities and derivatives that are not accounted for as effective accounting hedges.

Subsequent Measurement

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

Financial Liabilities at FVPL

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

Financial liabilities may be designated at initial recognition as at *FVPL*, if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognizing gains or losses on them on a different bases; (ii) the financial liabilities are part of a group which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial liabilities contain one or more embedded derivatives that would need to be recorded separately. The *MERALCO Group* does not have financial liabilities designated as at *FVPL* as at December 31, 2011 and 2010.

Other Financial Liabilities

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

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

Derivative Financial Instruments

Initial Recognition and Subsequent Measurement

MERALCO has separated embedded foreign currency forwards, while *Rockwell Land* has foreign currency forwards, which are derivative financial instruments used to hedge risks associated with foreign currency fluctuations.

Derivative instruments, including separated embedded derivatives, are initially recognized at fair value on the date at which a derivative transaction is entered into or separated, and are subsequently re-measured at fair value. Changes in fair value of

derivative instruments, other than those accounted for as effective hedges, are recognized immediately in the consolidated statement of income. Changes in fair value of derivative instruments accounted as effective hedges are recognized in other comprehensive income. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. *MERALCO Group* does not have hedge accounting.

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

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

The fair values of freestanding currency forward transactions of *Rockwell Land* are calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

See Note 30 – *Financial Assets and Liabilities*.

Offsetting of Financial Instruments

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

Fair Value of Financial Instruments

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

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

Amortized Cost of Financial Instruments

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

'Day 1' Profit or Loss

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

Impairment of Financial Assets

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

Financial Assets Carried at Amortized Cost

For financial assets carried at amortized cost, the *MERALCO Group* first assesses whether objective evidence of impairment exists individually. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that

group of financial assets is collectively assessed for impairment based on historical loss experience. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. *MERALCO* and *CEDC* consider termination or disconnection of service and significant financial difficulties of debtors as objective evidence that a financial asset or group of financial assets is impaired. For *Rockwell Land*, consideration is given to breach of contract, such as default or delinquency in interest or principal payments as objective evidence that a financial asset or group of financial assets is impaired. For both specific and collective assessments, any deposits, collateral and credit enhancement are considered in determining the amount of impairment loss.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). If a loan is subject to variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The carrying amount of the asset is reduced either directly or through the use of an allowance account and the amount of the loss is recognized in the consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. The financial asset together with associated allowance 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 *MERALCO Group*.

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

AFS Financial Assets

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

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

Assets Carried at Cost

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

Derecognition of Financial Instruments

Financial Assets

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

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

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

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

Financial Liabilities

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

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

Redeemable Preferred Stock

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

Provisions

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

Retirement Benefits

MERALCO and substantially all of its subsidiaries have distinct, funded, noncontributory defined benefit retirement plans covering all permanent employees. The provisions of *MERALCO*'s retirement plan provide for post-retirement benefits to employees hired up to 2003. Retirement benefits for employees hired commencing 2004 were amended to a defined lump-sum payment. *MERALCO* also has a contributory Provident Plan introduced in January 2009 in which employees hired commencing 2004 have the option to participate.

On the other hand, *MIESCOR* has a defined contribution retirement plan in addition to its noncontributory defined benefit plan.

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

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

MIESCOR records retirement expenses based on its contribution to the defined contribution plan as the employee renders service to *MIESCOR*.

Employee Stock Purchase Plan or ESPP

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

The cost of equity-settled transactions with employees is measured by reference to the difference between the fair value of the shares on the grant date and the pre-agreed price. In valuing equity-settled transactions, no account is taken of any performance conditions other than market conditions.

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

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

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

Long-term Incentive Plan

Liability arising from the long-term incentive plan is determined using the projected unit credit actuarial valuation method.

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

Revenue Recognition

Revenues are stated at amounts invoiced to customers, net of discounts, rebates, value-added tax or VAT and duty, where applicable. Revenue is recognized to the extent that it is probable that the economic benefits will flow to the *MERALCO Group* and the revenue can be reliably measured. In addition, collectibility is reasonably assured and the delivery of the goods or rendering of the service has occurred. The *MERALCO Group* assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The *MERALCO Group* concluded that it is acting as principal in all of its revenue arrangements. The following specific recognition criteria must also be met before revenue is recognized:

Sale of Electricity

Revenues are recognized upon supply of power to the customers. The Uniform Filing Requirements or *UFR*, on the rate unbundling released by the *ERC* on October 30, 2001 specified the following bill components: (a) generation charge, (b) transmission charge, (c) *SL* charge, (d) distribution charge, (e) supply charge, (f) metering charge, (g) Currency Exchange Rate Adjustment or *CERA* I and II and (h) interclass and lifeline subsidies. VAT and *LFT*, the Power Act Reduction (for residential customers) adjustment and the universal charges are also separately presented in the customer's billing statement. VAT, *LFT* and universal charges are billed and collected on behalf of the national and local governments and do not form part of *MERALCO* and *CEDC*'s revenues.

Sale of Real Estate

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

Rockwell Land accounts for cash received as "Deposits from condominium units pre-sold" 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 revenue recognition under percentage-of-completion method are met. Collections received in excess of receivables recognized under the percentage-of-completion method are shown separately as part of "Trade payables and accrued expenses" account in the consolidated statement of financial position.

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

Sale of Services

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

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

Service and consulting fees are recognized when the services are rendered.

Interest Income

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

Dividends

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

Lease Income

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

Lease income is included under "Revenues – Sale of services and others" in the consolidated statement of income.

Leases

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

Company as Lessee

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

Company as Lessor

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

Foreign Currency-Denominated Transactions and Translations

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

The functional currency of *LOIL* is the United States or *U.S.* dollar.

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

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

Income Taxes

Current Income Tax

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

Deferred Income Tax

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

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

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

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

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

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

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

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

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

Earnings per Share

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

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

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. These are disclosed in the notes to consolidated financial statements unless the possibility of an outflow of resources embodying economic benefits is remote.

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

Events After the Reporting Date

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

Equity

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

Employee stock purchase plan represents the cumulative compensation expense recognized based on the amount determined using an option pricing model.

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

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

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

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

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

Judgments

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

Determination of Functional Currency

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

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

Discontinued Operations

On December 12, 2011, the *BOD* of *MERALCO* approved the plan to divest all of its investment in common shares of *Rockwell Land* through the declaration of property dividends. Consequently, in 2011, *MERALCO* reclassified the related assets, liabilities and accumulated other comprehensive income of *Rockwell Land* as "Assets of discontinued operations", "Liabilities of discontinued operations" and "Unrealized fair value gains on *AFS* investments of discontinued operations", respectively, in the consolidated statement of financial position. Based on *MERALCO's* assessment, the transaction met the criteria for recognition of discontinued operations.

See *Note 6 - Discontinued operations*.

Operating Lease Commitments

As Lessor

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

As Lessee

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

Arrangement that Contains a Lease

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

Components of purchased power expense, which have been accounted for similar to a lease amounted to P20,135 million, P19,960 million and P20,900 million in 2011, 2010 and 2009, respectively. This is recognized as "Purchased power" in the consolidated statements of income.

See *Note 27 – Revenues and Purchased Power*.

Contingencies

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

See *Note 32 – Contingencies*.

Estimates and Assumptions

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

Estimating Useful Lives of Utility Plant and Others and Investment Properties

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

The total depreciation and amortization of utility plant and others amounted to P5,466 million, P5,958 million and P4,882 million for the years ended December 31, 2011, 2010 and 2009, respectively. The depreciation and amortization is inclusive of the depreciation and amortization of the utility plant and others of *Rockwell Land*. Total carrying values of utility plant and others, net of accumulated depreciation and amortization, amounted to P105,510 million and P103,250 million as at December 31, 2011 and 2010, respectively.

Total depreciation of investment properties amounted to P138 million, P219 million and P163 million for the years ended December 31, 2011, 2010 and 2009, respectively. The depreciation is inclusive of the depreciation of investment of *Rockwell Land*. Total carrying value of investment properties, net of accumulated depreciation amounted to P1,642 million and P8,037 million as at December 31, 2011 and 2010, respectively.

See *Note 8 – Utility Plant and Others* and *Note 10 – Investment Properties*.

Impairment of Nonfinancial Assets

PFRS requires that an impairment review be performed when certain impairment indicators are present. These conditions include obsolescence, physical damage, significant changes in the manner by which an asset is used, worse than expected economic performance, drop in revenues or other external indicators, among others. In the case of goodwill, at a minimum,

such asset is subject to an annual impairment test and more frequently whenever there is an indication that such asset may be impaired. This requires an estimation of the value in use of the cash-generating unit to which the goodwill is allocated. Estimating the value in use requires preparation of an estimate of the expected future cash flows from the cash-generating unit and choosing an appropriate discount rate in order to calculate the present value of those cash flows.

Determining the recoverable amount of utility plant and others, investment properties, investments in associates and a joint venture, goodwill and other noncurrent assets, requires (i) the determination of future cash flows expected to be generated from the continued use as well as ultimate disposition of such assets and (ii) making estimates and assumptions that can materially affect the consolidated financial statements. Future events could cause management to conclude that utility plant and others, construction in progress, investment properties, investments in associates and a joint venture, and other noncurrent assets are impaired. Any resulting impairment loss could have a material adverse impact on the *MERALCO Group's* consolidated financial position and results of operations.

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

The carrying values of nonfinancial assets as at December 31, 2011 and 2010 subject to impairment review are as follows:

	2011	2010
	<i>(Amounts in Millions)</i>	
Utility plant and others - net	P105,510	P103,250
Investment properties - net	1,642	8,037
Investments in associates and a joint venture	844	321
Pass through VAT - net	1,644	3,024
Deferred input VAT	1,054	1,006
Receivable from the Bureau of Internal Revenue, or <i>BIR</i>	577	577
Intangible assets	689	513
Goodwill	36	36

See *Note 8 – Utility Plant and Others*, *Note 9 – Investments in Associates and a Joint Venture*, *Note 10 – Investment Properties*, *Note 11 – Deferred Pass-Through Fuel Costs*, *Note 12 – Other Noncurrent Assets* and *Note 17 – Other Current Assets*.

Goodwill

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

Realizability of Deferred Tax Assets

The *MERALCO Group* reviews the carrying amounts of deferred tax assets at the end of each reporting period and reduces these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred income tax assets to be utilized. Assessment on the recognition of deferred tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income for the subsequent reporting periods. This forecast is based on past results and future expectations on revenues and expenses as well as future tax planning strategies. Management believes that sufficient taxable profit will be generated to allow all or part of the deferred tax assets to be utilized. The amounts of the deferred tax assets considered realizable could be adjusted in the future if estimates of taxable income are revised.

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

	2011	2010
	<i>(Amounts in Millions)</i>	
Recognized deferred tax assets	P10,073	P7,991
Unrecognized deferred tax assets	34	12

See *Note 31 – Income Taxes and Franchise Taxes*.

Determination of Fair Values of Financial Assets and Liabilities

Where fair value of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The

inputs to these models are taken from observable markets where possible, but when this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Total fair values of financial assets and liabilities as at December 31, 2011 amounted to P81,935 million and P97,279 million, respectively, while the total fair values of financial assets and liabilities as at December 31, 2010 amounted to P54,630 million and P81,959 million, respectively.

See *Note 30 – Financial Assets and Liabilities*.

Estimating Allowance for Doubtful Accounts

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

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

Total asset impairment provision for trade and other receivables recognized in the consolidated statement of income amounted to P463 million, P982 million and P746 million for the years ended December 31, 2011, 2010 and 2009, respectively. Trade and other receivables, net of asset impairment, amounted to P29,108 million and P25,609 million as at December 31, 2011 and 2010, respectively.

See *Note 14 – Trade and Other Receivables*.

Estimating Net Realizable Value of Inventories and Materials and Supplies

Inventories consist of condominium units for sale in 2010 (In 2011, as a result of approved plan to divest of *MERALCO's* investment in *Rockwell Land*, such inventories were reclassified to 'Asset of discontinued operations'.) and, materials and supplies used in the power distribution and services segments. The excess of cost over net realizable value relating to inventories consists of collective and specific provisions. The cost of inventories is written down whenever the net realizable value of inventories becomes lower than the cost due to damage, physical deterioration, obsolescence, change in price levels or other causes. The lower of cost or net realizable value of inventories is reviewed on a periodic basis. Inventory items identified to be obsolete and unusable are written-off and charged as expense in the consolidated statement of income.

The carrying values of inventories amounted to P1,675 million and P2,043 million as at December 31, 2011 and 2010, respectively.

See *Note 15 – Inventories*.

Estimation of Retirement Benefit Costs

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

Total consolidated defined pension benefit costs amounted to P1,461 million, P1,750 million and P1,863 million for the years ended December 31, 2011, 2010 and 2009, respectively. Unrecognized net actuarial gains as at December 31, 2011 amounted to P3,899 million while net actuarial losses as at December 31, 2010 amounted to P1,521 million. Except for *Rockwell Land*, consolidated net pension liability as at December 31, 2011 and 2010 amounted to P5,359 million and P8,227 million, respectively. The net pension asset of *Rockwell Land* as at December 31, 2010 amounted to P50 million.

See Note 28 – Expenses and Income and Note 29 – Long-term Employee Benefits.

Stock Purchase Plan Transactions

MERALCO's ESPP grants qualified participants the right to purchase its common shares at a grant price. The ESPP recognizes the services received from the eligible employees and an equivalent adjustment to the equity account over the vesting period. The cost of equity-settled transactions with the participants is measured by reference to the fair value of the equity instrument at the date when such right to purchase is granted. Estimating the fair value requires the determination of the most appropriate valuation model for a grant of equity instrument depending on the terms and conditions of the grant. This also requires determining the most appropriate inputs to the valuation model and making certain assumptions. The estimates and assumptions are described in Note 19 – Employee Stock Purchase Plan and include, among other things, annual stock volatility, risk-free interest rate, dividends yield, and the remaining life of options. While management believes that the estimates and assumptions used are reasonable and appropriate, significant differences in actual experience or significant changes in the estimates and assumptions may materially affect the stock compensation costs charged to operations.

The amounts recognized as stock compensation expense for the years ended December 31, 2011, 2010 and 2009, with a corresponding charge to the equity account are P172 million, P174 million and P301 million, respectively. As at December 31, 2011 and 2010, the balances of total amount of ESPP expense recognized in the equity section of the consolidated statements of financial position amounted to P915 million and P743 million, respectively.

See Note 19 – Employee Stock Purchase Plan.

Insurance Liabilities Arising from Insurance Contracts

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

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

As at December 31, 2011 and 2010, gross carrying values of insurance liabilities arising from insurance contracts (included in "Other noncurrent liabilities" account) amounted to P622 million and P293 million, respectively.

Provision for Asset Retirement Obligations

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

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

Revenue Recognition

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

Revenues from sale of electricity by MERALCO and CEDC are billed based on customer-specific billing cycles reflecting a fixed cycle cut-off date for each customer, while take-up of related power purchase cost in the accounts is based on calendar month. The recognition of unbilled revenues for billing cycles that have earlier than month-end cut-off dates requires the use of estimates.

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

Revenues and costs from real estate transactions of Rockwell Land and construction contracts of MIESCOR are recognized based on the percentage of completion method. This is measured principally on the basis of the estimated completion of a physical proportion of the contract work as determined from the reports of the contractors and project consultants. There is no assurance that such use of estimates may not result in material adjustments in future periods.

6. Discontinued Operations

On December 12, 2011, the *BOD* of *MERALCO* approved the plan to divest all of its investment in common shares of *Rockwell Land* through the declaration of property dividends. Consequently, in 2011, *MERALCO* reclassified the related assets, liabilities and cumulative other comprehensive income of *Rockwell Land* as “Assets of discontinued operations”, “Liabilities of discontinued operations” and “Unrealized fair value gains on *AFS* investments of discontinued operations”, respectively, in the consolidated statement of financial position.

On February 27, 2012, the *BOD* of *MERALCO* approved the declaration of its investment in common shares of *Rockwell Land* as property dividends in favor of common stockholders as of March 23, 2012, except for foreign common stockholders who will be paid the cash equivalent of the property dividends, payable within five trading days after approval of the property dividend by the *SEC* and registration of the *Rockwell Land* shares under the Securities Regulation Code and the listing thereof with the *PSE*.

The assets and liabilities of *Rockwell Land* classified as “Assets of discontinued operations” and “Liabilities of discontinued operations”, respectively, in the consolidated statement of financial position as at December 31, 2011 are as follows:

	Amount (In Millions)
<i>Noncurrent Assets:</i>	
Property and equipment	P465
Investment properties	6,297
Other noncurrent assets	362
<i>Current Assets:</i>	
Cash and cash equivalents	769
Trade and other receivables	2,782
Land and development costs	5,950
Other current assets	1,724
	P18,349
<i>Noncurrent Liabilities:</i>	
Interest bearing long-term financial liabilities	P2,867
Deposits from pre-selling condominium units	284
Deferred tax liabilities - net	146
Other noncurrent liabilities	470
<i>Current Liabilities:</i>	
Trade and other payables	5,258
Income tax payable	88
	P9,113

Included in accumulated other comprehensive income is an unrealized fair value gains on *AFS* investments amounting to P14 million.

The results of operations of *Rockwell Land* for the years ended December 31, 2011, 2010 and 2009 are presented as “Net income from discontinued operations, net of income tax” in the consolidated statements of income. The details are presented as follows:

	2011	2010	2009
	(Amounts in Millions, Except Per Share Data)		
Revenues	P5,834	P4,378	P3,791
Cost and expenses	4,887	3,687	3,102
Gross profit	947	691	689
Interest and other financial income	520	571	323
Interest and other financial expenses	(183)	(153)	(85)
Others	4	10	(4)
Income before income tax	1,288	1,119	923
Provision for income tax	(322)	(297)	(291)
Net income from discontinued operations	P966	P822	P632
Earnings Per Share of Discontinued Operations			
Basic	P0.86	P0.73	P0.57
Diluted	0.86	0.73	0.57

The net cash flows for the years ended December 31, 2011, 2010 and 2009 are as follows:

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
Operating activities	P398	(P39)	P359
Investing activities	(214)	157	257
Financing activities	(58)	(187)	(698)
Net cash flows	P126	(P69)	(P82)

7. Segment Information

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

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

- **Power**

The Power segment consists of (a) power distribution, (b) power generation and (c) *RES*. The *MERALCO Group* re-entered into power generation business in 2010. In June 2011, *MERALCO* notified the *ERC* of its intent to set up a local retail electricity supplier, or *local RES* to participate in the forthcoming Open Access and Retail Competition or *OARC*.

Power distribution – This is principally power distribution and supply of electricity covering franchise areas in the Luzon islands. Power distribution within the franchise area accounts for 54% of the requirements of the country. This is primarily provided by *MERALCO* and *CEDC*, the latter covering the *CSEZ*.

Power generation – The *MERALCO Group*'s re-entry into power generation is through its ongoing development of a 2 x 300MW Circulating Fluidized Bed or *CFB*, coal-fired power generation plant. The *MERALCO Group* is also undertaking pre-development of other power generation projects.

RES – This is principally the supply of electricity to qualified contestable customers upon the start of Open Access and Retail Competition. For the *MERALCO group*, it gave notice to the *ERC* to serve as a local *RES* only within its franchise area under the brand *MPower*. Since then, *MPower* has been assisting customers in preparing for the upcoming changes in the power industry.

- **Services and others** — The services segment is involved principally in electricity-related services such as engineering, construction and consulting services, e-transaction and bill collection services, insurance and e-Business development and energy systems management. These services are provided by *MIESCOR*, *MBI*, *Landbees* and *Miescorrail* (collectively known as "*MIESCOR Group*"), *CIS*, *Bayad Center* and *CFSI* (collectively referred to as "*CIS Group*") *MEI*, *e-MVI*, *RSIC*, *LOIL* and *Finserve*.

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

EBITDA is measured as net income excluding depreciation and amortization, impairment of noncurrent assets, interest and other financial charges, interest and other financial income, equity in net earnings of associates and a joint venture, foreign exchange gain or loss, mark-to-market gain or loss, provision for income tax and other non-recurring gain or loss, if any.

Core net income for the year is measured as net income attributable to equity holders of *MERALCO* adjusted for foreign exchange gain or loss, mark-to-market gain or loss, impairment of noncurrent assets, one time approvals of carrying charges of *ERC*-approved under or over-recoveries, and other non-recurring gain or loss, net of tax effect of the foregoing adjustments.

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

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

		Power			Services and Others			Inter-segment Transactions			Total		
	Note	2011	2010	2009	2011	2010	2009	2011	2010	2009	2011	2010	2009
		(In Millions)											
Revenues		P253,989	P239,077	P178,686	P3,923	P3,444	P2,788	(P1,104)	(P1,588)	(P716)	P256,808	P240,933	P180,758
Segment results		22,041	16,899	12,285	1,329	1,045	799	(35)	(35)	(15)	23,335	17,909	13,069
Depreciation and amortization		(5,360)	(5,795)	(4,743)	(144)	(116)	(88)	—	—	—	(5,504)	(5,911)	(4,831)
Interest and other financial income	28	2,186	1,596	3,225	78	9	75	—	—	—	2,264	1,605	3,300
Equity in net earnings of associates and a joint venture	9	913	1,012	953	—	—	—	(846)	(729)	(708)	67	283	245
Interest and other financial charges	28	(1,435)	(534)	(3,798)	(10)	(27)	(1)	—	—	—	(1,445)	(561)	(3,799)
Derivative mark-to-market gain (loss)		(16)	(7)	71	—	—	—	—	—	—	(16)	(7)	71
Provision for income tax – net		(5,577)	(3,729)	(2,112)	(364)	(294)	(219)	—	—	—	(5,941)	(4,023)	(2,331)
Non-controlling interests		—	—	—	—	—	—	(46)	(38)	(42)	(46)	(38)	(42)
Net income attributable to equity holders of the Parent		P12,752	P9,442	P5,881	P889	P617	P566	—	—	—	P12,714	P9,257	P5,682

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

	2011	2010 (As restated – see Note 6)	2009 (As restated – see Note 6)
(Amounts in Millions)			
Consolidated <i>EBITDA</i>	P24,602	P18,841	P13,169
<i>EBITDA</i> of discontinued operations	(1,262)	(900)	(380)
<i>EBITDA</i> of continuing operations	23,340	17,941	12,789
Depreciation and amortization	(5,504)	(5,911)	(4,831)
Interest and other financial income	2,264	1,605	3,300
Interest and other financial charges	(1,445)	(561)	(3,799)
Equity in net earnings of associates and a joint venture	67	283	245
Derivative mark-to-market gain (loss)	(16)	(7)	71
Foreign exchange gain (loss)	(7)	(32)	280
Consolidated income before income tax	18,699	13,318	8,055
Provision for income tax	(5,939)	(4,023)	(2,331)
Income from continuing operations	12,760	9,295	5,724
Income from discontinued operations, net of income tax	966	822	632
Reported consolidated net income	P13,726	P10,117	P6,356

The following table shows the reconciliation of the consolidated core net income to the consolidated net income:

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
Reported consolidated core net income for the year	P14,887	P12,155	P7,003
Add (deduct) non-core items, net of tax:			
Approved pass-through charges and related costs	(1,568)	(3,903)	(1,241)
Day "1" loss of advance payment to suppliers	(95)	—	—
Gain on return of an investment	17	248	—
Mark-to-market gain (loss)	(12)	2	57
Foreign exchange gain (loss)	(2)	(36)	186
Reversal of interest on bill deposits	—	1,219	—
Net income for the year attributable to equity holders of the Parent	13,227	9,685	6,005
Net income for the year attributable to non-controlling interest	499	432	351
Reported consolidated net income	P13,726	P10,117	P6,356

8. Utility Plant and Others

The movements in utility plant and others are as follows:

2011									
Note	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment	Transportation Equipment	Others	Construction in Progress	Total
<i>(Amounts in Millions)</i>									
Cost:									
Balance at beginning of year	P121,212	P14,870	P4,961	P5,893	P4,311	P2,325	P2,668	P2,241	P158,481
Transfers from construction in progress	5,896	—	202	324	—	—	6	(6,428)	—
Additions	995	—	22	124	34	286	224	6,658	8,343
Disposals/retirements	(1,796)	—	—	(88)	(44)	(51)	—	—	(1,979)
Discontinued operations	—	(21)	(307)	—	(629)	(118)	(168)	—	(1,243)
Reclassification and others	31	—	(12)	(5)	(14)	—	—	—	—
Balance at end of year	126,338	14,849	4,866	6,248	3,658	2,442	2,730	2,471	163,602
Less accumulated depreciation and amortization:									
Balance at beginning of year	43,353	—	1,914	4,095	3,075	1,426	1,368	—	55,231
Charge for the year	4,284	—	142	362	412	213	53	—	5,466
Disposals/retirements	(1,672)	—	—	(75)	(38)	(42)	—	—	(1,827)
Discontinued operations	—	—	(169)	—	(521)	(88)	—	—	(778)
Reclassification and others	3	—	—	(3)	—	—	—	—	—
Balance at end of year	45,968	—	1,887	4,379	2,928	1,509	1,421	—	58,092
	P80,370	P14,849	P2,979	P1,869	P730	P933	P1,309	P2,471	P105,510
2010									
Note	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment	Transportation Equipment	Others	Construction in Progress	Total
<i>(Amounts in Millions)</i>									
Cost:									
Balance at beginning of year	P117,752	P15,001	P4,727	P5,647	P4,974	P1,922	P2,336	P3,627	P155,986
Transfers from construction in progress	6,594	—	239	398	—	—	27	(7,258)	—
Additions	1,556	20	34	34	545	453	129	5,872	8,643
Disposals/retirements	(4,747)	—	—	(1)	(1,182)	(65)	(1)	—	(5,996)
Transfer to investment properties	—	(151)	—	—	—	—	—	—	(151)
Reclassification and others	57	—	(39)	(185)	(26)	15	177	—	(1)
Balance at end of year	121,212	14,870	4,961	5,893	4,311	2,325	2,668	2,241	158,481
Less accumulated depreciation and amortization:									
Balance at beginning of year	42,244	—	1,802	3,882	3,758	1,105	1,337	—	54,128
Charge for the year	4,649	—	121	426	482	157	123	—	5,958
Disposals/retirements	(3,645)	—	—	(1)	(1,182)	(52)	(1)	—	(4,881)
Reclassification and others	105	—	(9)	(212)	17	216	(91)	—	26
Balance at end of year	43,353	—	1,914	4,095	3,075	1,426	1,368	—	55,231
	P77,859	P14,870	P3,047	P1,798	P1,236	P899	P1,300	P2,241	P103,250

A significant portion of *MERALCO* and *CEDC*'s utility plant and others are purchased from foreign suppliers. Such transactions are concluded in currencies other than the Philippine peso, principally the U.S. dollar. *MERALCO* and *CEDC* record the assets and liabilities in Philippine peso using the exchange rate at the date of the transaction. The outstanding amount of foreign currency-denominated liabilities is restated at each reporting date. See *Note 25 – Trade Payables and Accrued Expenses* and *Note 30 – Financial Assets and Liabilities*.

The construction in progress pertains to electric capital projects, or *ECPs* and non-electric capital projects, or *NEPs*. *ECPs* are capital projects involving construction of new facilities and the upgrade and major rehabilitation of existing electrical facilities. In 2011, major *ECPs* under construction in progress include 115kV subtransmission lines (Balintawak-Sta. Mesa). *NEPs* relate to construction of non-network structures and/or major renovation of existing non-network facilities.

Total interest capitalized amounted to P82 million, P119 million and P98 million as at December 31, 2011, 2010 and 2009, respectively.

The average annual range of interest rates used for capitalization in 2011, 2010 and 2009 ranged from 5.26 % to 6.19%, 7.6% to 8.6% and 8.6% to 8.8%, respectively.

9. Investments in Associates and a Joint Venture

This account consists of the following as at December 31, 2011 and 2010:

	Country of Incorporation	Principal Activities	Percentage of Ownership
Associates			
Redondo Peninsula Energy, Inc., or <i>RP Energy</i>	Philippines	Power Generation	47
Buang Private Power Corporation, or <i>BPPC</i>	Philippines	Power Generation	38
General Electric Philippines Meter and Instrument Company, Inc. or <i>GEPMICI</i>	Philippines	Sale of metering products and services	35
Joint Venture			
<i>Indra Philippines</i>	Philippines	Management and information technology, or <i>IT</i> , consultancy	50

The movements in the investments in associates and a joint venture account follow:

	2011	2010
	<i>(Amounts in Millions)</i>	
Acquisition costs:		
Balance at beginning of year	P62	P459
Additions	517	–
Return of capital	(41)	(397)
Balance at end of year	538	62
Accumulated equity in net earnings:		
Balance at beginning of year	247	60
Equity in net earnings	67	283
Dividends received	(20)	(96)
Balance at end of year	294	247
(Forward)		
Share in cumulative translation adjustments of an associate:		
Balance at beginning of year	12	684
Movements	–	(672)
Balance at end of year	12	12
	P844	P321

Investment in RP Energy

On July 22, 2011, *MGen* signed a Shareholders' Agreement with Therma Power Inc. or *TPI*, and Taiwan Cogeneration International Corporation – Philippine Branch or *TCIC* for the construction and operation of a 2 x 300MW *CFB* coal-fired power plant to be located in the Subic Bay Freeport Zone. *RP Energy* is the joint venture company of *TPI*, *MPG* and *TCIC* for the development and for implementation of the proposed coal-fired power plant project.

As at February 27, 2012, site preparation work is ongoing and *RP Energy* is awaiting submission by selected bidders of their engineering, procurement and construction bids.

Investment in BPPC

BPPC was organized in October 1992 to engage in the power generation business.

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

On July 26, 2010, *FPPC* turned-over the *Bauang Plant* to National Power Corporation, or *NPC* without any compensation and free of any liens. Thereafter, *FPPC* and *BPPC* were legally merged, with *BPPC* as the surviving entity. Subsequent thereto, *BPPC* began winding down operations.

The merger resulted in a 2% dilution of *MERALCO's* interest in *BPPC*.

Investment in GEPMICI

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

Investment in Indra Philippines

Indra Philippines is an *IT* service provider in the country and in the Asia Pacific region, with a wide range of services across various industries. *Indra Philippines* supports *MERALCO's* information technology requirements in the area of system development, outsourcing of *IS* and *IT* operations and management consulting.

See Note 26 – *Related Party Transactions* for details of transactions.

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

	2011	2010
	(Amounts in Millions)	
<i>RP Energy</i>	P516	P–
<i>Indra Philippines</i>	216	174
<i>GEPMICI</i>	64	58
<i>BPPC</i>	48	89
	P844	P321

The condensed financial information of *RP Energy*, *BPPC*, *GEPMICI* and *Indra Philippines* follow:

2011				
	<i>RP Energy</i>	<i>BPPC</i>	<i>GEPMICI</i>	<i>Indra Philippines</i>
<i>(Amounts in Millions)</i>				
Current assets	P628	P56	P235	P507
Noncurrent assets	419	1	14	142
Current liabilities	(4)	(1)	(66)	(206)
Noncurrent liabilities	—	—	—	(10)
Net assets	P1,043	P56	P183	P433
2010				
		<i>BPPC</i>	<i>GEPMICI</i>	<i>Indra Philippines</i>
<i>(Amounts in Millions)</i>				
Current assets		P251	P205	P554
Noncurrent assets		—	22	128
Current liabilities		(15)	(61)	(324)
Noncurrent liabilities		—	—	(10)
Net assets		P236	P166	P348
2011				
	<i>RP Energy</i>	<i>BPPC</i>	<i>GEPMICI</i>	<i>Indra Philippines</i>
<i>(Amounts in Millions)</i>				
Revenues	P—	P—	P172	P964
Costs and expenses	(39)	—	(116)	(880)
Net income (loss)	(P39)	P—	P56	P84

2010			
	<i>BPPC</i>	<i>GPMICI</i>	<i>Indra Philippines</i>
<i>(Amounts in Millions)</i>			
Revenues	P442	P115	P948
Costs and expenses	(451)	(100)	(888)
Net income (loss)	(P9)	P15	P60

2009			
	<i>BPPC</i>	<i>GPMICI</i>	<i>Indra Philippines</i>
<i>(Amounts in Millions)</i>			
Revenues	P973	P377	P922
Costs and expenses	(436)	(335)	(834)
Net income	P537	P42	P88

10. Investment Properties

The movements in investment properties are as follows:

2011				
	<i>Note</i>	<i>Land</i>	<i>Buildings and Improvements</i>	<i>Total</i>
<i>(Amounts in Millions)</i>				
Cost:				
Balance at beginning of year		P3,280	P6,128	P9,408
Additions during the year		–	42	42
Disposals		(2)	–	(2)
Discontinued operations	6	(1,743)	(5,964)	(7,707)
Balance at end of year		1,535	206	1,741
Less accumulated depreciation:				
Balance at beginning of year		–	1,371	1,371
Charge for the year		–	138	138
Discontinued operations	6	–	(1,410)	(1,410)
Balance at end of year		–	99	99
		P1,535	P107	P1,642

2010				
	<i>Note</i>	<i>Land</i>	<i>Buildings and Improvements</i>	<i>Total</i>
<i>(Amounts in Millions)</i>				
Cost:				
Balance at beginning of year		P3,155	P6,018	P9,173
Additions during the year		–	110	110
Transfer from utility plant and others	8	151	–	151
Disposals		(26)	–	(26)
Balance at end of year		3,280	6,128	9,408
Less accumulated depreciation:				
Balance at beginning of year		–	1,152	1,152
Charge for the year		–	219	219
Balance at end of year		–	1,371	1,371
		P3,280	P4,757	P8,037

Investment properties are stated at cost. These consist of real properties held for capital appreciation, future or previous substation sites, and real properties, mainly the Rockwell Power Plant Mall at Rockwell Center, Makati City and BPO buildings within the MERALCO compound, which are being leased out.

As at December 31, 2011 and 2010, unamortized borrowing costs capitalized as part of investment properties amounted to P252 million and P261 million, respectively.

The aggregate fair value of the investment properties are as follows:

	2011	2010
	<i>(Amounts in Millions)</i>	
Rockwell Power Plant Mall	P6,267	P5,947
BPO buildings	2,506	2,408
Land	2,026	2,026

Investment properties of *Rockwell Land* with carrying amount of ₱6,297 million and aggregate fair value of ₱10,546 million as of December 31, 2011 are included in "Assets of discontinued operations" account in the 2011 consolidated statement of financial position.

Rockwell Land's long-term interest bearing financial liabilities are partly collateralized by the Rockwell Power Plant Mall.

See *Note 20 – Interest-bearing Long-term Financial Liabilities*.

Land pertains to unused non-regulatory asset based properties and the properties where the *BPO* building, and "Strip" mall are located.

The fair values of investment properties were determined by independent, professionally qualified appraisers. The fair values represent 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.

11. Deferred Pass-through Fuel Costs

Deferred pass-through fuel costs represent amounts paid for the quantity and the cost of natural gas that was contracted for but not yet consumed as of the reporting date by *MERALCO's* major *IPPs*, namely, *FGPC* and *FGP* collectively referred to as "*First Gas*." See *Notes 25 – Trade Payables and Accrued Expenses*, *Note 26 – Related Party Transactions* and *Note 32 – Contingencies*. Any unconsumed gas is the result of lower dispatch of the *First Gas* plants vis-a-vis their stipulated capacity factors.

In 2005, *First Gas* billed *MERALCO* for 44 million giga-joules in gross calorific value representing unconsumed gas for the years 2002 to 2004. *MERALCO'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 PNOG Exploration Corporation) under the Gas Sale and Purchase Agreements or *GSPA*. *FGP* and *FGPC* have distinct *GSPA* with the *Gas Sellers* for the supply of natural gas in connection with the operations of the power plants. The *GSPAs* with *FGPC* and *FGC* expire on August 17, 2025 and October 1, 2027, respectively.

Under the *GSPAs*, *FGP* and *FGPC* are each obligated to consume (or pay for, if not consumed) a minimum quantity of gas for each contract year (which runs from December 26 of a particular year up to December 25 of the immediately succeeding year), called the '*Take-or-Pay*' Quantity or *TOPQ*. Thus, if the *TOPQ* is not consumed within a particular contract year, *FGP* and *FGPC* will incur an "annual deficiency" for that contract year equivalent to the total volume of unused gas. *FGP* and *FGPC* are required to make payments to the *Gas Sellers* for such annual deficiency after the end of the contract year. After paying for annual deficiency, *First Gas* can, subject to the terms of the *GSPA*, "make-up" such annual deficiency by consuming the unused-but-paid-for gas (without further charge) within 10-contract years after the contract year for which the annual deficiency was incurred, in the order that it arose.

On December 29, 2006, the *Gas Sellers* issued the Annual Reconciliation Statements or *ARS*, of *FGP* and *FGPC* for contract year 2006. The *Gas Sellers* then claimed annual deficiency payments amounting to \$3.9 million for *FGP* and \$5.4 million for *FGPC*. Both *FGP* and *FGPC* disagreed that such Annual Deficiency payments are due and each claimed for among others, relief due to events of force majeure or *EFM* that affected the San Lorenzo and Sta. Rita plants, respectively. *FGP's* and *FGPC's* position is that the power plants actually consumed more than their respective *TOPQs* and are entitled to make-up its outstanding balance of annual deficiency.

Pursuant to the terms of the *GSPAs*, the dispute on the foregoing matter was subjected to arbitration in Hong Kong Special Administrative Region under the *International Chamber of Commerce* or *ICC* Rules of Arbitration, whereby a Partial Final Award was rendered on August 11, 2009. The Tribunal determined that the transmission-related events claimed by *FGP* and *FGPC* constitute *EFM* under the *GSPAs*. The Tribunal was not persuaded, however, that the government-related events claimed by *FGP* and *FGPC* for contract year 2006 constitute *EFM* under the *GSPAs* based on the evidence presented. Any settlement to *FGP* and *FGPC* shall be billed to *MERALCO*.

On June 9, 2010, *FGP*, *FGPC*, and the *Gas Sellers* executed a Settlement Agreement or *SA* to settle the *GSPA* dispute for Contract Year 2006. On July 29, 2010, *MERALCO* fully settled the amount of ₱104 million (\$2.2 million) billed by *First Gas*.

On September 15, 2010, *FGP* and *FGPC* received the Final Award by Consent rendered by the Tribunal on September 13, 2010, incorporating by reference the terms of the June 9, 2010 *SA*, including all exhibits thereto, and forming an inseparable part of the Final Award by Consent, as per *FGP*, *FGPC*, and the *Gas Sellers*, written request dated June 16, 2010 to the Tribunal and *ICC*.

As at December 31, 2011, the balance of the prepaid natural gas has been fully consumed.

12. Other Noncurrent Assets

This account consists of:

	Note	2011	2010
		(Amounts in Millions)	
Unbilled receivables - net	14	P3,321	P3,843
Deferred input VAT		1,054	1,006
Intangible assets - net		689	513
Receivable from BIR	32	577	577
Advance payments to suppliers		239	253
Deferred reinsurance premium		193	214
AFS investments	30	140	403
Goodwill		36	36
Pension asset	29	—	50
Installment contracts receivable - net of current portion	14	—	39
Others		345	381
		P6,594	P7,315

Unbilled Receivables

Unbilled receivables represent unbilled generation and other pass-through costs incurred by MERALCO and CEDC, which are covered by an approved recovery mechanism of the ERC. This also includes other unbilled generation and pass-through charges of current and prior years, which are the subject of applications for recovery with the ERC.

Deferred Input VAT

The amount includes portion of input VAT incurred and paid in connection with purchase of capital assets in excess of P1 million per month. As provided for in RA No. 9337 or "EVAT Law", said portion of input VAT shall be deferred and credited evenly over the estimated useful life of the related capital assets or 60 months, whichever is shorter, against the output VAT due.

Intangible Assets

The movements of intangible assets are as follows:

2011			
	Software	Franchise	Total
	(Amounts in Millions)		
Cost:			
Balance at beginning of year	P525	P49	P574
Additions	209	—	209
Balance at end of year	734	49	783
Less accumulated amortization:			
Balance at beginning of year	61	—	61
Amortization	33	—	33
Balance at end of year	94	—	94
	P640	P49	P689
2010			
	Software	Franchise	Total
	(Amounts in Millions)		
Cost:			
Balance at beginning of year	P274	P—	P274
Additions	251	49	300
Balance at end of year	525	49	574
Less accumulated amortization:			
Balance at beginning of year	19	—	19
Amortization	42	—	42
Balance at end of year	61	—	61
	P464	P49	P513

13. Cash and Cash Equivalents

This account consists of:

	2011	2010
	(Amounts in Millions)	
Cash on hand and in banks	P2,704	P3,631
Cash equivalents	41,437	20,739
	P44,141	P24,370

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

14. Trade and Other Receivables

This account consists of:

	Note	2011	2010
		(Amounts in Millions)	
Trade:			
Electricity:			
Billed		P23,299	P17,776
Unbilled	2 and 12	5,440	5,011
Service contracts		821	817
Insurance receivable		319	384
Cost and estimated earnings in excess of billings on uncompleted contracts		168	124
Current portion of installment contracts receivable	12	–	2,183
Nontrade		1,193	1,015
		31,240	27,310
Less allowance for doubtful accounts		2,132	1,701
		P29,108	P25,609

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

	2011	2010
	(Amounts in Millions)	
Residential	P7,009	P6,007
Commercial	6,043	8,058
Industrial	9,415	3,300
Flat streetlights	832	411
	23,299	17,776
Less allowance for doubtful accounts	1,952	1,518
	P21,347	P16,258

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

	2011			
	Balance at beginning of year	Provisions	Write-offs/ Others	Balance at end of year
	(Amounts in Millions)			
Billed trade receivables:				
Residential	P361	P142	P25	P528
Commercial	858	91	(38)	911
Industrial	57	31	(14)	74
Flat streetlights	242	199	(2)	439
	1,518	463	(29)	1,952
Other receivables	183	–	(3)	180
	P1,701	P463	(P32)	P2,132

2011						
	Residential	Commercial	Industrial	Flat Streetlights	Others	Total
(Amounts in Millions)						
Individually impaired	P371	P128	P5	P302	P180	P986
Collectively impaired	157	783	69	137	–	1,146
Total	P528	P911	P74	P439	P180	P2,132
2010						
	Balance at beginning of year			Provisions	Write-offs	Balance at end of year
(Amounts in Millions)						
Billed trade receivables:						
Residential			P529	P180	(P348)	P361
Commercial			1,007	484	(633)	858
Industrial			259	96	(298)	57
Flat streetlights			293	101	(152)	242
			2,088	861	(1,431)	1,518
Other receivables			234	121	(172)	183
			P2,322	P982	(P1,603)	P1,701
2010						
	Residential	Commercial	Industrial	Flat Streetlights	Others	Total
(Amounts in Millions)						
Individually impaired	P247	P73	P41	P2	P183	P546
Collectively impaired	114	785	16	240	–	1,155
Total	P361	P858	P57	P242	P183	P1,701

Trade Receivables – Electricity

Trade receivables of *MERALCO* and *CEDC* include charges for pass-through costs. Pass-through costs consist of generation and transmission charges, which represent 62% and 13%, respectively, of the total billed amount in 2011. Billed receivables are generally due 10 days after bill date.

Unbilled receivables represent electricity consumed after the meter reading cut-off dates, which will be billed to customers in the immediately following billing period. This also includes the current portion of pass-through cost under-recoveries net of over-recoveries, which are billed to the customers over the period approved by the *ERC*. *MERALCO*'s and *CEDC*'s trade receivables are noninterest-bearing and are substantially secured by bill deposits. See *Note 21 – Customers' Deposits* and *Note 30 – Financial Assets and Liabilities*.

Service Contracts

Service contracts receivable arise from contracts entered into by *MIESCOR* and subsidiaries, *e-MVI*, *RSIC*, *CIS* and *Bayad Center* for construction, engineering, consulting, insurance underwriting, bills collection, tellering, data transport and e-business development and energy management services to third parties.

Receivables from service contracts and others are noninterest-bearing and are generally on 30 to 60-day terms.

Installment Contracts Receivable

Installment contracts receivable represent receivables from sale of condominium units with credit terms ranging from one to five years. As at December 31, 2011 and 2010, the gross undiscounted trade receivables (both recognized and future receivables) from the sale of condominium units at the "Number One Rockwell" or *One Rockwell*, "The Grove by Rockwell" or *The Grove*, and "Edades" projects amounting to P174 million and P1,144 million, respectively, have been assigned as security for interest-bearing long-term financial liabilities. Under the terms of the assignment, *Rockwell Land* will deliver all Contracts to Sell and customers' copies of the Condominium Certificates of Title covered by these receivables to be held in custody by the counterparty until the receivables are paid and/or repurchased by *Rockwell Land*. Installment contracts receivable amounting to P2,368 million as of December 31, 2011 is included in "Assets of discontinued operations" account in the 2011 consolidated statement of financial position.

See *Note 20 – Interest Bearing Long-term Financial Liabilities*.

15. Inventories

	2011	2010
	<i>(Amounts in Millions)</i>	
Materials and supplies:		
At net realizable value	P1,675	P2,030
At cost	1,927	2,088
Condominium units for sale:		
At net realizable value	–	13
At cost	–	13
Total inventories at the lower of cost or net realizable value	P1,675	P2,043

Condominium units for sale amounting to P63 million is included in “Assets of discontinued operations” account in the 2011 consolidated statement of financial position. As at December 31, 2011, the condominium units for sale are stated at cost.

See *Note 5 – Management’s Use of Judgments, Estimates and Assumptions*.

16. Land and Development Costs

This account represents land and development costs of *Rockwell Land*. Land and land development costs are stated at net realizable value of P1,708 million, which is lower than its cost of P1,717 million as at December 31, 2010. The development costs pertain to the Greater Rockwell, Edades Tower and Garden Villas Project or *Edades*, and *The Grove* located in Pasig City.

Total cash received from pre-selling activities of *Edades* and *The Grove* projects amounted to P741 million as at December 31, 2010. These are shown under “Deposits from pre-selling of condominium units” account in the 2010 consolidated statements of financial position.

The balances of the following accounts related to land and development cost as at December 31, 2011 are included in the “Asset of discontinued operations” account in the 2011 consolidated statement of financial position:

	Amount
	<i>(In Millions)</i>
Land and land development	P5,950
Deposit from pre-selling of condominium units	284

Specific borrowings capitalized as part of development costs amounted to P175 million and P135 million in 2011 and 2010, respectively. Capitalization rates used are 7.9% and 7.8% in 2011 and 2010, respectively.

17. Other Current Assets

	Note	2011	2010
		<i>(Amounts in Millions)</i>	
Pass-through VAT - net		P1,644	P3,024
Creditable withholding tax		312	172
Prepaid expenses		249	512
Advances to suppliers		123	847
Input VAT		24	156
Derivative assets	30	4	24
Others		144	316
		P2,500	P5,051

Pass-through VAT pertains to VAT on pass-through generation and transmission costs. Remittance of such deferred VAT is based on collection of billed receivables from the customers. The balance represents VAT on unpaid billed receivables.

18. Equity*Common Stock*

The movements in *MERALCO's* common stock are as follows:

	Number of Shares	Amount
	<i>(In Millions)</i>	
Authorized - P10 par value a share	1,250	P12,500
Issued and outstanding:		
Balance as at January 1, 2010	1,127	P11,273
Issuances	—	—
Balance as at December 31, 2010	1,127	P11,273
Balance as at January 1, 2011	1,127	P11,273
Treasury shares held	—	—
Balance as at December 31, 2011	1,127	P11,273

See *Note 19 – Employee Stock Purchase Plan* for discussion of common stock issuances.

On January 8, 1992, the *PSE* approved *MERALCO's* application to list its common shares. There are 49,150 and 51,125 shareholders of *MERALCO's* common share as at December 31, 2011 and 2010, respectively.

Unappropriated Retained Earnings

The unappropriated retained earnings include undeclared accumulated earnings of subsidiaries, associates and joint ventures and the balance of revaluation increment in utility plant and others and investment properties carried at deemed cost, amounting to P18,264 million and P18,375 million as at December 31, 2011 and 2010, respectively. Such amounts are restricted for dividend declaration purposes.

The following are cash dividends declared on common shares in 2011 and 2010:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				<i>(In Millions)</i>
November 2, 2011	December 2, 2011	December 27, 2011	P1.70	P1,916
July 25, 2011	August 17, 2011	September 13, 2011	3.45	3,888
February 28, 2011	March 28, 2011	April 20, 2011	2.65	2,987
December 13, 2010	December 29, 2010	January 17, 2011	1.30	1,465
July 26, 2010	August 23, 2010	September 16, 2010	2.50	2,818
March 22, 2010	April 21, 2010	May 11, 2010	3.15	3,550
October 29, 2009	November 31, 2009	December 11, 2009	1.50	1,617
May 26, 2009	June 9, 2009	June 30, 2009	1.00	1,088

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

Appropriated Retained Earnings

Retained earnings of P6,000 million have been appropriated for planned business expansion of *MERALCO*. Plans for business expansion are being developed.

Treasury Shares

On March 28, 2011, the *BOD* approved the acquisition into treasury of the subscribed shares and the related rights of employees who have opted to withdraw from the *ESPP* in accordance with the provisions of the *ESPP*. As at December 31, 2011, a total of 146,023 shares were acquired from the cancellation of employee participation in the *ESPP*.

19. Employee Stock Purchase Plan

MERALCO has an *ESPP*, which entitles participants to purchase its common shares subject to certain terms and conditions, during a nominated offer period. Following are the salient features of the *ESPP*:

Participants	<ul style="list-style-type: none"> Qualified regular employees of <i>MERALCO</i> and subsidiaries Retirees of <i>MERALCO</i>
Purchase Price	<ul style="list-style-type: none"> No less than 80% of the weighted average daily closing market price at the <i>PSE</i> during a 30-day calendar period that ends two weeks before the start of the offer period.
Holding Period	<ul style="list-style-type: none"> Maximum of three years (as approved by the Board of Administrators or <i>BOA</i>, for each offering)
Cancellation	<ul style="list-style-type: none"> Cancellation allowed at anytime prior to full payment of the purchase price with amount paid refundable, net of dividends received

Movements in the number of outstanding common shares purchased by employees under the *ESPP* are as follows:

	2011			
	13 th	13 th A	14 th	Total
Balances at beginning of year	1,548,404	407,137	12,410,516	14,366,057
Issued	(357,083)	–	–	(357,083)
Cancelled	(2,015)	(17,782)	(126,226)	(146,023)
Balances at end of year	1,189,306	389,355	12,284,290	13,862,951

	2010			
	13 th	13 th A	14 th	Total
Balances at beginning of year	1,911,319	407,137	12,416,994	14,735,450
Issued	(362,915)	–	(6,478)	(369,393)
Balance at end of year	1,548,404	407,137	12,410,516	14,366,057

MERALCO allotted a total of 55 million common shares for *ESPP* awards. As at December 31, 2011, 13.8 million common shares are available for any future offerings.

The fair value of the offerings was estimated at the dates of the grant using the Black-Scholes Option Pricing Model, which considered annual stock volatility, risk-free interest rate, expected life of the offering, exercise price of P51.00 to P74.00 a share for the 13th and the 14th offerings. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome.

Below are the grant dates and inputs to the models used for each of the grants:

	13 th	13 th A	14 th
Grant dates	May 31, 2007	January 12, 2009	April 28, 2009
Historical volatility (%)	52.62	46.77	50.99
Weighted average share price on grant date (P)	62.00	51.00	74.00
Risk-free interest rate (%)	4.67	5.60	5.77
Expected life of option (years)	3.17	3.22	3.43

Total expense arising from the employee stock purchase plan amounted to P172 million in 2011, P174 million in 2010 and P301 million in 2009.

See *Note 28 – Expenses and Income*.

20. Interest-bearing Long-term Financial Liabilities

This account consists of the following:

	2011	2010
	<i>(Amounts in Millions)</i>	
Long-term portion of interest-bearing financial liabilities:		
Long-term debt	P19,816	P15,498
Current portion of interest-bearing financial liabilities:		
Long-term debt	2,909	3,654
Redeemable preferred stock	1,651	1,920
	4,560	5,574
	P24,376	P21,072

All of MERALCO's redeemable preferred shares have been called for redemption as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. The balance of preferred shares called for redemption amounted to P1,651 million and P1,318 million as at December 31, 2011 and 2010, respectively, and is included as part of "Current portion of interest bearing financial liabilities". The unpaid dividends amounted to P261 million and P284 million as at December 31, 2011 and December 31, 2010, respectively. Interest is no longer accrued on the preferred shares, which have been called for redemption.

See Note 25 – Trade Payables and Accrued Expenses.

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

Description	2011	2010
	(Amounts in Millions)	
<i>Floating Rate Loan</i>		
MERALCO		
P2.5 Billion Term Loan Facility	P2,500	P–
P3.0 Billion Term Loan Facility	1,800	2,400
<i>Fixed Rate Loan</i>		
MERALCO		
P5.0 Billion Note Facility Agreement	5,000	–
P5.0 Billion Note Facility Agreement	4,950	5,000
P4.8 Billion Note Facility Agreement	4,800	4,800
P5.0 Billion Note Facility Agreement	2,172	2,443
P5.5 Billion Note Facility Agreement	1,600	1,600
Rockwell Land		
P2.0 Billion Note Facility Agreement	–	1,579
Bridge Facility Term Loan	–	1,444
Total long-term debt	22,822	19,266
Less unamortized debt issue costs	97	114
	22,725	19,152
<i>Redeemable Preferred Stock</i>	1,651	1,920
	24,376	21,072
Less portion maturing within one year	4,560	5,574
Long-term portion of interest-bearing financial liabilities	P19,816	P15,498

All of MERALCO's interest bearing long-term financial liabilities as at December 31, 2011 and 2010 are denominated in Philippine pesos. The scheduled maturities of MERALCO's outstanding long-term debt at nominal values as at December 31, 2011 are as follows:

Year	Amount
	(In Millions)
2012	P2,909
2013	736
2014	2,336
2015	159
2016	4,815
After 2016	11,867
Total	P22,822

Floating Rate Loans

P2.5 Billion Term Loan Facility

In January 2011, MERALCO drew a P2,500 million, 7-year floating rate term loan from a local bank. Interest rate is repriced every six months based on 6-month PDST-F plus a spread. The principal is payable in nominal annual amortizations with a balloon payment on maturity date.

P3.0 Billion Term Loan Facility

The P3,000 million, 5-year bilateral Floating Rate Term Loan Facility, was drawn in October 2009. The principal is payable over five years with final maturity in October 2014.

*Fixed Rate Loans**P5.0 Billion Note Facility Agreement*

In June 2011, *MERALCO* entered into a Fixed Rate Note Facility Agreement for its P500 million, 7-year notes and P4,500 million, 10-year notes due in 2018 and 2021, respectively. The principal is payable in nominal annual amortizations with balloon payment on each of the two maturity dates.

P5.0 Billion Note Facility Agreement

In December 2010, *MERALCO* entered into a Fixed Rate Note Facility Agreement for the issuance of P23 million, 5-year fixed rate notes with maturity in December 2015 and P4,977 million, 5.5-year fixed rate notes due in June 2016. The 5-year fixed rate notes are payable in full at maturity date while the 5.5-year fixed rate notes are payable in nominal annual amortizations with a balloon payment on maturity date.

P4.8 Billion Note Facility Agreement

In November 2010, *MERALCO* signed a Fixed Rate Note Facility Agreement for its P1,997 million, 7-year fixed rate notes and P2,803 million, 10-year fixed rate notes. The notes were issued on December 2, 2010 and are payable in nominal annual amortizations with a balloon payment on each of the two maturity dates.

P5.0 Billion Note Facility Agreement

In January 2009, *MERALCO* entered into a Note Facility Agreement for its P2,715 million fixed rate notes with final maturity in January 2014 and P2,285 million floating rate due in January 2010. The floating rate notes were prepaid in October 2009 while the fixed rate notes are payable in annual installments of 10% of the original principal amount from 2010 to 2013 with the remaining balance payable in 2014. The fixed rate notes were prepaid in January 2012.

P5.5 Billion Note Facility Agreement

On December 9, 2009, *MERALCO* signed a P5,500 million Note Facility Agreement covering its fixed and floating rate notes. The P1,600 million fixed rate notes are payable in full on maturity date in 2014. The P3,900 million floating rate notes were prepaid in December 2010 without penalty.

P2.0 Billion Note Facility Agreement

On July 19, 2007, *Rockwell Land* entered into a Note Facility Agreement with a consortium of local banks. Under this agreement, the P2.0 billion fixed rate corporate notes were drawn to finance the development of the *BPO* buildings located within the *MERALCO* compound. The notes consist of two tranches at P1,000 million each, P1,400 million of which is payable in 20 quarterly installments starting August 2009 and the balance of P600 million is due in August 2014. The facility agreement was pre-terminated on February 2, 2011 and was refinanced by a bridge loan from a local bank.

P3.0 Billion Note Facility Agreement

On January 5, 2012, *MERALCO* signed a P3,000 million Fixed Rate Note Facility Agreement for its P1,000 million in 7-year notes and P2,000 million in 10-year notes due in 2019 and 2022, respectively. The notes were priced off the relevant 7-year and 10-year benchmarks plus a spread and issued on January 9, 2012. Principal repayments are through annual nominal amortizations and a balloon payment on maturity date.

P4.0 Billion Note Facility Agreement

Rockwell Land signed a P4.0 billion Fixed Rate Note Facility Agreement with a consortium of local banks to finance the acquisition of properties for development and refinance certain obligations. The fixed rate notes consist of Tranche 1 and Tranche 2 amounting to P2,500 million and P1,500 million, respectively. Tranche 1 was drawn in April 2011 while Tranche 2 will be availed in April 2012. Tranche 1 is payable in 22 quarterly payments starting January 2013 until April 2018. The balance of the Tranche 1 notes of P2,500 million is included under "Liabilities of discontinued operations" in the 2011 consolidated statement of financial position.

Loans from Various Local Banks and Financial Institutions

Peso denominated loans from various local banks and financial institutions of *Rockwell Land* consist of bridge facilities mostly payable by the end of 2011 and a term loan payable in December 2014.

All interest-bearing loans and borrowings outstanding as of December 31, 2011 and 2010 are secured by assignment of *One Rockwell* and *The Grove* receivables, a parcel of land and Mortgage Participation Certificates on a Mortgage Trust Indenture and its amendments and supplements over the Power Plant Mall. The balance of the various denominated loans from various local banks amounting to P1,060 million is included under "Liabilities of discontinued operations" account in the 2011 consolidated statement of financial position.

Installment Payable

In November 2011, *Rockwell Land* entered into a Deed of Sale with a third party for the purchase of land for development adjacent to the Rockwell Center. This will house the latest residential condominium projects of *Rockwell Land* called the "Greater Rockwell".

Under the Deed of Sale, *Rockwell Land* will pay for the cost of the property in installment until 2015 and a one-time payment in 2020. Schedule of payments of the remaining installment payable based on undiscounted amounts are as follows:

Year	Amount (In Millions)
2012	P792
2013	800
2014	800
2015	800
2020	656
Total	P3,848

The installment payable and the corresponding land held for development were recorded at present value using the discount rate of 8%.

Installment payable is partially secured by standby letters of credit from various financial institutions.

As at December 31, 2011, the carrying value of installment payable amounted to P3 billion and is included under "Liabilities of discontinued operations" account in the 2011 consolidated statement of financial position.

See *Note 6 – Discontinued Operations* and *Note 10 – Investment Properties*.

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

	2011		2010	
	Fixed Rate Note	Floating Rate Note	Fixed Rate Note	Floating Rate Note
<i>MERALCO</i>	4.00% to 8.79%	1.71% to 4.60%	4.00% to 8.79%	4.60% to 5.88%
<i>Rockwell Land</i>	7.30% to 7.50%	–	8.5% to 8.8%	–

Debt Covenants and Security Arrangements

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

As at December 31, 2011 and 2010, *MERALCO* is in compliance with all covenants of the loan agreements.

The interest-bearing financial obligations of *Rockwell Land* are secured by the assignment of receivables from the sale of *One Rockwell* and *The Grove* units and Mortgage Participation Certificates on a Mortgage Trust Indenture and its amendments and supplements over the Rockwell Power Plant Mall.

Unamortized Debt Issue Costs

Unamortized debt issue costs included in the balance of interest-bearing long-term financial liabilities amounted to P97 million and P114 million as at December 31, 2011 and 2010, respectively.

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

	Note	2011 (Amounts in Millions)	2010
Unamortized debt issue costs at beginning of year		P114	P123
Additions		38	67
Accretions charged to interest and other financial charges	28	(34)	(76)
Unamortized debt issue costs of discontinued operations		(21)	–
Unamortized debt issue costs at end of year		P97	P114

Redeemable Preferred Stock

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

	2011	2010
Balance at beginning of year	191,964,025	210,928,655
Redemptions	(26,834,378)	(18,964,630)
Balance at end of year	165,129,647	191,964,025

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

21. Customers' Deposits

This account consists of:

	2011			2010		
	Current Portion (see Note 25)	Long-term Portion	Total	Current Portion (see Note 25)	Long-term Portion	Total
<i>(Amounts in Millions)</i>						
Meter deposits	P2,266	P–	P2,266	P2,401	P–	P2,401
Bill deposits	2,349	24,080	26,429	678	23,761	24,439
	P4,615	P24,080	P28,695	P3,079	P23,761	P26,840

Meter Deposits

Meter deposits serve to guarantee the cost of meters installed.

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

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

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

Interests due on meter deposits are calculated at 6% or 10% depending on when such deposits were paid.

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

As at December 31, 2011 and 2010, total meter deposits refunded by *MERALCO* amounted to P827 million (inclusive of P425 million interest) and P691 million (inclusive of P354 million interest), respectively.

Bill Deposits

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

As required under the *Magna Carta* and *DSOAR*, residential and non-residential customers, respectively, are required to deposit with the *DU* an amount equivalent to the estimated monthly bill calculated based on applied load, which shall be recognized as bill deposit of the customer.

On February 22, 2010, the amended *DSOAR*, which became effective on April 1, 2010, was promulgated by the *ERC*. Under such amended *DSOAR*, interest on bill deposits for both residential and non-residential customers shall be computed using the equivalent peso savings account interest rate of the Land Bank of the Philippines or *Land Bank*, or other government banks on the first working day of the year, subject to the confirmation of the *ERC*. Based on the foregoing, the interest rate effective April 1, 2010 through December 31, 2010 was 0.75% per annum. Effective January 1, 2011, the interest rate on bill deposits is 0.5% per annum.

The following are the movements of bill deposits account:

	2011	2010
	<i>(Amounts in Millions)</i>	
Balance at beginning of year	P24,439	P24,459
Additions	2,506	1,857
Payments	(516)	(551)
Reversals	–	(1,326)
Balance at end of year	26,429	24,439
Less portion maturing within one year	2,349	678
Long-term portion of bill deposits and interest	P24,080	P23,761

22. Provisions

Provisions consist of amounts provided for probable charges and expenses from claims, among others.

Movements in 2011 and 2010 are as follow:

	2011	2010
	<i>(Amounts in Millions)</i>	
Balance at beginning of year	P12,875	P7,492
Provisions	7,571	5,523
Reclassification	(3,401)	–
Settlements	(126)	(140)
Balance at end of year	P16,919	P12,875

The amount accrued for possible refund of over-recoveries of transmission charges previously included in the “Provisions” account was reclassified to the “Other noncurrent liabilities” account in the 2011 consolidated statement of financial position.

See *Note 5 – Management’s Use of Judgments, Estimates and Assumptions* and *Note 32 – Contingencies*.

23. Customers’ Refund

This account represents the balance of the unclaimed refund related to the *SC* decision promulgated on April 30, 2003.

In June 2003, the *ERC*, in the implementation of the *SC* decision, ordered *MERALCO* to refund to its customers an equivalent P0.167 per kWh for billings covering the period February 1994 to April 2003, which was to have been completed by 2010.

On February 7, 2011, the *ERC* approved *MERALCO*’s proposal for the extension of the *SC* refund process for five years up to December 31, 2015, in view of difficulties encountered by (i) the customers in meeting the necessary documentation requirements for approval and payment of the refund and (ii) *MERALCO* in contacting or locating customers entitled to the refund.

24. Notes Payable

Notes payable represent unsecured, peso-denominated, interest-bearing working capital loans obtained by *MIESCOR* and subsidiaries from various local banks. Annual interest rates ranged from 6.5% to 6.7% in 2011 and 8.5% to 11% in 2010.

Interest expense on notes payable amounted to P6 million, P26 million and P170 million in 2011, 2010 and 2009, respectively. See *Note 28 – Expenses and Income*.

25. Trade Payables and Accrued Expenses

This account consists of the following:

	Note	2011	2010
		<i>(Amounts in Millions)</i>	
Trade accounts payable	26	P22,475	P15,538
Output VAT - net		2,470	2,435
Accrued expenses:			
Employee benefits		1,940	1,300
Taxes		1,440	1,387
Liability for <i>GSL</i> payout		580	446
Interest	20	192	487
Current portions of:			
Meter deposits and related interest	21	2,266	2,401
Bill deposits and related interest	21	2,349	678
Derivative liability	30	6	1
Deferred lease income		—	50
Security deposits		—	192
Refundable service extension costs		1,145	774
Dividends payable on:			
Common stock	18	598	1,672
Redeemable preferred stock	20	261	284
Universal charges payable		573	219
Regulatory fees payable		208	318
Reinsurance liability		198	225
Refundable transmission charges		130	131
Excess collections over recognized receivables		—	185
Accrued development costs		—	525
Other current liabilities		3,180	1,890
		P40,011	P31,138

Trade Accounts Payable

Trade accounts payable mainly represent obligations to power suppliers, namely, *NPC*/Power Sector Assets and Liabilities Management Corporation, or *PSALM*, (including *NPC* successor generating companies or *SGCs*,/Independent Power Plant Administrators or *IPPAs*), *NGCP*, Philippine Electricity Market Corporation or *PEMC*, *FGPC* and *FGP*, Quezon Power (Philippines) Limited Company or *QPPL*, Philippine Power Development Corporation, Montalban Methane Power Corporation or *MMPC*, Bacavalley Energy, Inc. or *BEI*, for costs of power purchased. In addition, this account also includes liabilities due to local and foreign suppliers for purchase of goods and services, which are mainly transformers, poles, materials and supplies and, contracted services.

Trade payables are noninterest-bearing and are generally settled within the 15 to 60-day trade term. Other payables are noninterest-bearing and are due in no more than six months from incurrence.

See Note 26 – *Related Party Transactions* and Note 33 – *Significant Contracts and Commitments*.

Refundable Service Extension Costs

Article 14 of the *Magna Carta*, specifically, “Right to Extension of Lines and Facilities” requires a customer requesting for an extension of lines and facilities beyond 30-meter serving distance from the nearest voltage facilities of the *DU* to advance the cost of the project. Up to March 31, 2010 such advances from customers were being refunded at the rate of 25% of the distribution revenue generated from the extension lines and facilities until such amounts are fully refunded or five years, whichever is shorter. The related asset forms part of the rate base only at the time a refund has been paid out. The customer advances are noninterest-bearing.

The amended *DSOAR*, which became effective April 1, 2010, increased the refund rate from 25% to 75% of the gross distribution revenue generated from the extension lines and facilities until such amounts are fully refunded.

As at December 31, 2011 and 2010, the noncurrent portion of refundable service extension costs of P3,794 million and P3,271 million, respectively, is presented as “Refundable Service Extension Costs - net of current portion” account in the consolidated statement of financial position.

26. Related Party Transactions

The following provides the total amount of transactions, which have been provided and/or contracted by the *MERALCO Group* with related parties for the relevant financial year. The outstanding balances are unsecured, non-interest bearing and settled in cash. See *Note 11 – Deferred Pass-Through Fuel Costs* and *Note 33 – Significant Contracts and Commitments* for the related discussions.

PPAs with FGPC and FGP

MERALCO has distinct *PPAs* with *FGPC* and *FGP*. The total power purchased from *FGCP* and *FGP* amounted to P58,537 million, P53,322 million and P48,519 million for the years ended December 31, 2011, 2010, and 2009, respectively. As at December 31, 2011 and 2010, outstanding accounts payable to *FGPC* and *FGP* under the *PPAs* amounted to P6,678 million and P2,038 million, respectively.

Pole Attachment Contracts with Philippine Long Distance Telephone Company, or PLDT

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

For the years ended December 31, 2011, 2010 and 2009, total amount billed under this contract amounted to P179 million P199 and P67 million, respectively. As at December 31, 2011 and 2010, there is no outstanding receivable of *MERALCO* from *PLDT* under this contract.

Sale of Electricity under Various Service Contracts

MERALCO sells electricity to shareholders and affiliates for the latter's facilities which are within *MERALCO*'s franchise area. The rates charged to related parties are the same *ERC*-mandated rates applicable to all customers within the franchise area.

Total revenues billed to its shareholders, *PLDT*, *Metro Pacific*, *SMC* and *First Holdings* and their respective subsidiaries are as follows:

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
<i>PLDT Group</i>	P2,669	P2,104	P719
<i>SMC Group</i>	945	1,026	105
<i>Metro Pacific Group</i>	594	518	1,004
<i>First Holdings Group</i>	471	295	81
	P4,679	P3,943	P1,909

Purchase of Telecommunication Services from PLDT and Subsidiaries

The *MERALCO Group*'s primary telecommunications carriers are *PLDT* for its wireline and *SMART* for its wireless services. Such services are covered by standard service contracts between the telecommunications carriers and each legal entity within the *MERALCO Group*.

The total amount of services purchased by *MERALCO* from *PLDT* and *SMART* for the years ended December 31, 2011 and 2010 is as follows:

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
<i>PLDT</i>	P33	P53	P33
<i>SMART</i>	19	8	6
	P52	P61	P39

Purchase of Goods and Services

In the ordinary course of business, the *MERALCO Group* purchases goods and services from its affiliates and sells power to such affiliates. The details of the transactions are as follows:

Related Party	Relationship	Nature of Transaction	Year	Purchases	Amount Owed by Related Party	Amount Owed to Related Party
<i>(Amounts in Millions)</i>						
<i>GEPMICI</i>	Associate	Purchase of meters and devices	2011	P314	P–	P7
			2010	52	–	–
			2009	194	–	–
<i>Indra Philippines</i>	Associate	IT solutions provider	2011	451	–	45
			2010	510	5	13
			2009	571	6	15
Philippine Electric Corporation	Affiliate	Purchase of power transformers	2011	1,029	–	61
			2010	1,070	–	25
			2009	957	–	24

Compensation of Key Management Personnel

The compensation of key management personnel of the *MERALCO Group* by benefit type is as follows:

	2011	2010	2009
<i>(Amounts in Millions)</i>			
Short-term employee benefits	P413	P376	P312
Long-term and retirement benefits	112	133	66
Share-based payments	16	14	11
Total compensation to key management personnel	P541	P523	P389

Each of the directors is entitled to a director's fee of P120,000 for every *BOD* meeting attended. Each member or advisor of the Audit and Risk Management, Remuneration and Leadership Development (formerly Compensation and Benefits), Finance, Governance and Nomination Committees is entitled to a fee of P20,000 for every committee meeting attended.

There are no agreements between the *MERALCO Group* and any of its key management personnel providing for benefits upon termination of employment or retirement, except with respect to benefits provided under the retirement and pension plans. The Pension Plan covers employees hired up to 2004 only. The Provident Plan covers employees hired after 2004.

27. Revenues and Purchased Power*Electricity Revenue*

Electricity revenues account for 99% of the total revenues in 2011, 2010 and 2009. Following is a breakdown of electricity revenues:

	2011	2010	2009
<i>(Amounts in Millions)</i>			
Pass-through charges:			
Generation charge	P157,850	P158,850	P106,327
Transmission charge	32,340	25,456	23,279
System loss charge	15,500	11,567	16,108
Power Act Reduction adjustment	(106)	(219)	(660)
Interclass, lifeline subsidies and others	(201)	(233)	1,837
Distribution service charges	48,606	43,656	31,795
	P253,989	P239,077	P178,686

Distribution revenue accounted for 19% of total revenues in 2011 and 18% in 2010 and 2009.

See Note 7 – Segment Information.

Purchased Power

Actual purchased power costs are pass-through costs and revenue-neutral to *MERALCO* and *CEDC*. The details are as follows:

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
Generation charge	P170,410	P172,946	P127,116
Transmission charge	35,264	27,970	23,812
	P205,674	P200,916	P150,928

Generation charge is inclusive of line rentals and must-run unit charges billed by *PEMC*.

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*, "Determining whether an arrangement contains a lease". The total amount billed by the suppliers, which is, and are presented as part of "Purchased power" account in the consolidated statements of income amounted to P20,135 million, P19,960 million and P20,900 million in 2011, 2010 and 2009, respectively. This also includes the allowable *SL* charge up to 8.5% in 2011 and 2010 and 9.5% in 2009. *MERALCO*'s actual *SL* rates were 7.3%, 7.9% and 8.6%, in 2011, 2010 and 2009, respectively.

Purchased power cost is inclusive of the volume of banked gas consumed effectively reducing the cost of purchased power as these were sourced at lower prices then. In 2011, the balance of banked gas was fully utilized.

See Note 11 - *Deferred Pass-through Fuel Costs*.

The details of purchased power follow:

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
<i>FGPC</i> and <i>FGP</i>	P58,537	P53,322	P48,519
<i>NPC/PSALM</i> (including <i>NPC SGCs/IPPAs</i>)	75,775	65,170	51,807
<i>TransCo/NGCP</i>	35,229	27,970	23,812
<i>PEMC/ WESM</i>	20,265	39,140	11,284
<i>QPPL</i>	15,687	15,238	15,477
Others	181	76	29
	P205,674	P200,916	P150,928

28. **Expenses and Income***Salaries, Wages and Employee Benefits*

	Note	2011	2010 (As restated - see Note 6)	2009 (As restated - see Note 6)
		<i>(Amounts in Millions)</i>		
Salaries and wages		P6,648	P6,412	P6,193
Pension expense	29	1,465	1,752	1,864
Health, medical and related benefits		287	129	103
Employee stock payment plan expense	19	172	174	301
Other long-term post-employment benefits	29	2,339	685	109
		P10,911	P9,152	P8,570

Other Expenses

	Note	2011	2010 (As restated - see Note 6)	2009 (As restated - see Note 6)
		<i>(Amounts in Millions)</i>		
Materials and supplies		P735	P846	P490
Transportation and travel		475	349	398
Rent and utilities		412	179	86
Insurance		259	222	174
Corporate expenses		258	297	295
Advertising expenses		197	188	175
Communication expenses	26	62	61	54
Others		489	1,718	449
		P2,887	P3,860	P2,121

Interest and Other Financial Charges

		2011	2010 (As restated - see Note 6)	2009 (As restated - see Note 6)
	Note			
(Amounts in Millions)				
Interest expense on interest-bearing long-term financial liabilities, net of interest capitalized	20	P1,163	P1,182	P1,258
Interest expense on bill deposits	21	83	(1,326)	1,115
Amortization of:				
Debt issue costs	20	23	73	51
Loan premium		—	(24)	(27)
Carrying charge on ERC-approved over-recoveries	2	20	108	543
Interest expense on notes payable	24	6	26	170
Interest expense on meter deposits	21	3	76	81
Interest expense on deferred pass-through fuel costs		—	9	15
Others		147	437	593
		P1,445	P561	P3,799

Interest and Other Financial Income

		2011	2010 (As restated - see Note 6)	2009 (As restated - see Note 6)
	Note			
(Amounts in Millions)				
Interest income on placements		P1,379	P535	P413
Carrying costs on ERC-approved under-recoveries	2	791	723	2,782
Gain on return of investment		24	355	—
Others		70	(8)	105
		P2,264	P1,605	P3,300

29. Long-term Employee Benefits

Accrued long-term employee benefits consist of the following:

	2011	2010
(Amounts in Millions)		
Pension asset (included in "Assets of discontinued operations in 2011 and "Other noncurrent assets" account in 2010)	P33	P50
Long-term employee benefits:		
Pension liability	P5,359	P8,227
Long-term incentives	1,680	400
Other long-term post-employment benefits	1,187	920
	P8,226	P9,547

Retirement Plan

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

Actuarial valuations are prepared annually by independent actuaries.

Net Pension Costs (included in "Salaries, wages and employee benefits" account)

	2011	2010 (As restated - see Note 6)	2009 (As restated - see Note 6)
(Amounts in Millions)			
Interest costs	P1,956	P2,011	P2,037
Current service costs	1,097	869	795
Expected return on plan assets	(1,595)	(1,133)	(723)
Past service costs	1	1	1
Actuarial loss	2	2	5
Settlement gain	—	—	(252)
Net pension costs	P1,461	P1,750	P1,863
Actual return on plan assets	P1,863	P4,178	P4,129

Pension Liability

	2011	2010
	<i>(Amounts in Millions)</i>	
Defined benefit obligation	P28,763	P32,728
Fair value of plan assets	(27,301)	(23,004)
Unrecognized net actuarial gains (losses)	3,899	(1,521)
Unrecognized past service costs	(2)	(26)
Pension liability	P5,359	P8,177

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

	2011	2010
	<i>(Amounts in Millions)</i>	
Defined benefit obligation at beginning of year	P32,728	P25,255
Interest costs	1,956	2,023
Current service costs	1,097	883
Benefits paid	(1,692)	(1,390)
Actuarial losses (gains) due to:		
Changes in assumptions	(4,023)	6,408
Experience adjustments	(1,135)	(451)
Defined benefit obligation of discontinued operations	(168)	–
Defined benefit obligation at end of year	P28,763	P32,728

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

	2011	2010
	<i>(Amounts in Millions)</i>	
Fair value of plan assets at beginning of year	P23,004	P16,348
Contributions by employer	4,332	3,820
Benefits paid	(1,690)	(1,386)
Expected return on plan assets	1,595	1,150
Actuarial gains	268	3,072
Fair value of plan assets of discontinued operations	(208)	–
Fair value of plan assets at end of year	P27,301	P23,004

MERALCO expects to contribute approximately P3,000 million to its defined benefit pension plan in 2012.

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

	2011	2010
	<i>(In Percentage)</i>	
Marketable equity securities	38	39
Government securities	26	26
Cash and cash equivalents	16	16
Bonds and commercial notes	14	14
Real properties	3	4
Receivables	3	1
	100	100

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

The overall expected rate of return on assets is determined based on the prevailing rates of return on equity and fixed income securities applicable to the period over which the obligation is to be settled.

The key information of the retirement plan is as follows:

	2011	2010	2009	2008	2007
	<i>(Amounts in Millions)</i>				
Present value of defined benefit obligation	P28,763	P32,728	P25,255	P22,694	P24,825
Fair value of plan assets	(27,301)	(23,004)	(16,348)	(10,408)	(11,857)
Excess of present value of defined benefit obligation over fair value of plan assets	1,462	9,724	8,907	12,286	12,968
Experience adjustments on plan liabilities	(1,135)	(451)	(467)	165	(748)
Experience adjustments on plan assets	268	3,072	3,423	(2,531)	5,518

Other Long-term Post-employment Benefits (included as part of "Salaries, wages and employee benefits" account)

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
Interest costs	P156	P151	P78
Current service costs	54	34	43
Actuarial loss	129	100	36
Settlement gain	—	—	(48)
Net other long-term post-employment benefits	P339	P285	P109

Other Long-term Post-employment Benefits Liability

	2011	2010
	<i>(Amounts in Millions)</i>	
Other long-term post-employment benefits obligation	P2,537	P2,471
Unrecognized net actuarial losses	(1,350)	(1,551)
Benefits liability at end of year	P1,187	P920

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

	2011	2010
	<i>(Amounts in Millions)</i>	
Balance at beginning of year	P2,471	P1,887
Interest costs	156	151
Current service costs	54	34
Benefits paid	(73)	(51)
Actuarial losses (gains)	(71)	450
Balance at end of year	P2,537	P2,471

The principal assumptions used as at January 1, 2011, 2010 and 2009 in determining pension and other long-term post-employment benefits obligations are shown below:

	2011	2010	2009
Annual discount rate	6%	6%–8%	8%–9.2%
Expected annual rate of return on assets	6%	7%–10%	6%–10%
Future range of annual salary increases	6%–8%	5%–9.6%	5%–10%

MERALCO Defined Contribution Provident Plan

MERALCO established a contributory Provident Plan effective January 1, 2009, intended to be a Supplemental Retirement Benefit for employees hired after 2004. Each qualified employee-member who opts to participate in the plan shall have the option to contribute up to a maximum of 25% of his base salary. MERALCO shall match the member's contribution up to the first 10% of the member's base salary. Upon resignation, the member shall be entitled to the total amount credited to his personal retirement account immediately preceding his actual retirement date, subject to provisions of the Provident Plan. Total amount contributed by MERALCO amounted to P3 million in 2011 and P1 million in 2010.

Defined Contribution Plan or Provident Fund

In addition to its defined benefit retirement plan, *MIESCOR* has a defined contribution retirement plan. The annual contribution of *MIESCOR* to the Provident Fund is equivalent to 6% of the current monthly basic salaries of covered employees. The Provident Fund is managed by a Board of Trustees. The employees' shares are represented by the units of the Provident Fund. Each unit is determined by dividing the net asset value of the Provident Fund by the aggregate number of units earned by the employee. *MIESCOR* regularly monitors compliance with RA 7641, otherwise known as "The Retirement Pay Law." As at December 31, 2011 and 2010, *MIESCOR* is in compliance with such law.

Pension expense under this plan amounted to P1 million in 2011, 2010 and 2009.

The investment portfolio of such defined contribution plan seeks to achieve regular income and consistent long-term capital growth over its own portfolio benchmark. In order to attain this objective, the trustee's mandate is to invest in a diversified portfolio of bonds and equities, primarily domestic instruments. The portfolio mix is kept at 75% to 100% for debt and fixed income securities while 0% to 25% is allotted to equity securities.

As at December 31, 2011 and 2010, the investment portfolio consists of bonds and commercial notes. There are no equity instruments held.

Consolidated Pension Benefit Costs

	2011	2010	2009
	<i>(Amounts in Millions)</i>		
Expense recognized for defined benefit plans	P1,461	P1,750	P1,863
Expense recognized for defined contribution plan	4	2	1
Consolidated pension benefit costs	P1,465	P1,752	P1,864

Long-term Incentive Plan or LTIP

On October 22, 2010, the *BOD* approved *MERALCO's LTIP* for selected executives with at least the rank of superintendent. The *LTIP* hinges on the achievement of a certain level of consolidated core net income determined on an aggregate basis for the three year period ending December 31, 2012. Executives invited to the plan have to serve a minimum uninterrupted period to be entitled to any pay-out under the plan.

30. Financial Assets and Liabilities

Financial assets consist of cash and cash equivalents and trade and non-trade receivables, which are generated directly from operations. The principal financial liabilities, other than derivatives, consist of bank loans, redeemable preferred shares, trade and non-trade payables, which are incurred to finance operations in the normal course of business. Accounting policies related to financial assets and liabilities are set out in *Note 4 – Significant Accounting Policies*.

The following table sets forth the financial and nonfinancial assets and liabilities as at December 31, 2011 and 2010:

	Loans and Receivables	Held-to-maturity Investments	Designated at Fair Value through Profit or Loss	Held-for-trading	Available-for-sale Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities	Non-financial Assets and liabilities	Total
	<i>(Amounts in Millions)</i>								
Assets as at December 31, 2011									
Noncurrent									
Utility plant and others - net	P–	P–	P–	P–	P–	P–	P–	P105,510	P105,510
Investments in associates and a joint venture	–	–	–	–	–	–	–	844	844
Investment properties - net	–	–	–	–	–	–	–	1,642	1,642
Deferred tax assets - net	–	–	–	–	–	–	–	25	25
Other noncurrent assets	3,587	–	–	–	140	–	3,727	2,867	6,594
Current									
Cash and cash equivalents	44,141	–	–	–	–	–	44,141	–	44,141
Trade and other receivables - net	29,108	–	–	–	–	–	29,108	–	29,108
Inventories - at net realizable value	–	–	–	–	–	–	–	1,675	1,675
Other current assets	–	–	4	–	–	–	4	2,496	2,500
Assets of discontinued operations	4,677	–	–	–	278	–	4,955	13,394	18,349
Total assets	81,513	–	4	–	418	–	81,935	128,453	210,388

	Loans and Receivables	Held-to- maturity Investments	Designated at Fair Value through Profit or Loss	Held-for- trading	Available- for-sale Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities	Non- financial Assets and liabilities	Total
(Amounts in Millions)									
Liabilities as at December 31, 2011									
Noncurrent									
Interest-bearing long-term financial liabilities									
- net of current portion	-	-	-	-	-	19,816	19,816	-	19,816
Customers' deposits - net of current portion	-	-	-	-	-	24,080	24,080	-	24,080
Deferred tax liabilities - net	-	-	-	-	-	-	-	595	595
Long-term employee benefits	-	-	-	-	-	-	-	8,226	8,226
Provisions	-	-	-	-	-	-	-	16,919	16,919
Refundable service extension costs - net of current portion	-	-	-	-	-	3,794	3,794	-	3,794
Other noncurrent liabilities	-	-	-	-	-	-	-	6,302	6,302
Current									
Notes payable	-	-	-	-	-	67	67	-	67
Trade payables and accrued expenses	-	-	-	-	-	30,981	30,981	9,030	40,011
Income tax payable	-	-	-	-	-	-	-	2,154	2,154
Customers' refund	-	-	-	-	-	6,250	6,250	-	6,250
Current portion of interest-bearing long-term financial liabilities	-	-	-	-	-	4,560	4,560	-	4,560
Liabilities of discontinued operations	-	-	-	-	-	7,413	7,413	1,700	9,113
Total liabilities	-	-	-	-	-	96,961	96,961	44,926	141,887
Net Assets (Liabilities)	₱81,513	₱-	₱ 4	₱-	₱ 418	(₱96,961)	(₱15,026)	₱83,527	₱68,501
Assets as at December 31, 2010									
Noncurrent									
Utility plant and others - net	₱-	₱-	₱-	₱-	₱-	₱-	₱-	₱103,250	₱103,250
Investments in associates and a joint venture	-	-	-	-	-	-	-	321	321
Investment properties - net	-	-	-	-	-	-	-	8,037	8,037
Deferred tax assets - net	-	-	-	-	-	-	-	42	42
Other noncurrent assets	4,163	61	-	-	403	-	4,627	2,688	7,315
Current									
Cash and cash equivalents	24,370	-	-	-	-	-	24,370	-	24,370
Trade and other receivables - net	25,609	-	-	-	-	-	25,609	-	25,609
Inventories - at net realizable value	-	-	-	-	-	-	-	2,043	2,043
Deferred pass-through fuel costs	-	-	-	-	-	-	-	1,222	1,222
Land and development costs	-	-	-	-	-	-	-	1,708	1,708
Other current assets	-	-	24	-	-	-	24	5,027	5,051
Total assets	54,142	61	24	-	403	-	54,630	124,338	178,968
Liabilities as at December 31, 2010									
Noncurrent									
Interest-bearing long-term financial liabilities									
- net of current portion	-	-	-	-	-	15,498	15,498	-	15,498
Customers' deposits - net of current portion	-	-	-	-	-	23,761	23,761	-	23,761
Deferred tax liabilities - net	-	-	-	-	-	-	-	3,322	3,322
Long-term employee benefits	-	-	-	-	-	-	-	9,547	9,547
Provisions	-	-	-	-	-	-	-	12,875	12,875
Refundable service extension costs - net of current portion	-	-	-	-	-	3,271	3,271	-	3,271
Other noncurrent liabilities	-	-	-	-	-	1,777	1,777	575	2,352
Current									
Notes payable	-	-	-	-	-	149	149	-	149
Trade payables and accrued expenses	-	-	1	-	-	23,913	23,914	7,224	31,138
Deposits from pre-selling condominium units	-	-	-	-	-	-	-	741	741
Income tax payable	-	-	-	-	-	-	-	413	413
Customers' refund	-	-	-	-	-	7,131	7,131	-	7,131
Current portion of interest-bearing long-term financial liabilities	-	-	-	-	-	5,574	5,574	-	5,574
Total liabilities	-	-	1	-	-	81,074	81,075	34,697	115,772
Net Assets (Liabilities)	₱54,142	₱61	₱23	₱-	₱403	(₱81,074)	(₱26,445)	₱89,641	₱63,196

The following table sets forth the consolidated carrying values and estimated fair values of the financial assets and liabilities recognized as at December 31, 2011 and 2010:

	Carrying Value		Fair Value	
	2011	2010	2011	2010
	(Amounts in Millions)			
Noncurrent Financial Assets				
AFS financial assets:				
Quoted equity securities	P121	P381	P121	P381
Unquoted equity securities	19	22	19	22
Other noncurrent assets:				
Unbilled receivables	3,321	3,843	3,321	3,843
Advance payments to suppliers	239	253	239	253
Installment contracts receivable	–	39	–	39
HTM	–	61	–	61
Notes receivable	27	28	27	28
Total noncurrent financial assets	3,727	4,627	3,727	4,627
Current Financial Assets				
Cash and cash equivalents:				
Cash on hand and in banks	2,704	3,631	2,704	3,631
Cash equivalents	41,437	20,739	41,437	20,739
Trade and other receivables - net:				
Billed electricity	21,347	16,258	21,347	16,258
Unbilled electricity	5,440	5,011	5,440	5,011
Service contracts and others	761	817	761	817
Insurance receivable	319	384	319	384
Cost and estimated earnings in excess of billings on uncompleted contracts	167	124	167	124
Current portion of installment contracts receivable	–	2,183	–	2,183
Nontrade receivables	1,074	832	1,074	832
Other current assets -				
Derivative assets	4	24	4	24
	73,253	50,003	73,253	50,003
Financial assets of discontinued operations	4,955	–	4,955	–
Total current financial assets	78,208	50,003	78,208	50,003
Total Financial Assets	P81,935	P54,630	P81,935	P54,630
Noncurrent Financial Liabilities				
Interest-bearing long-term financial liabilities	P19,816	P15,498	P20,134	P16,382
Customers' deposits - net of current portion	24,080	23,761	24,080	23,761
Refundable service extension costs	3,794	3,271	3,794	3,271
Other noncurrent liabilities	–	1,777	–	1,777
Total noncurrent financial liabilities	47,690	44,307	48,008	45,191
Current Financial Liabilities				
Trade payables and accrued expenses				
Trade accounts payable	22,475	15,538	22,475	15,538
Accrued expenses:				
Interest	192	487	192	487
Liability for GSL payout	580	446	580	446
Current portion of:				
Meter deposits and related interests	2,266	2,401	2,266	2,401
Bill deposits and related interests	2,349	678	2,349	678
Derivative liability	6	1	6	1
Security deposits	–	192	–	192
Retentions payable	–	23	–	23
Dividends payable	859	1,956	859	1,956
Refundable service extension costs	1,145	774	1,145	774
Accrued development costs	–	525	–	525
Regulatory fees	208	318	208	318
Reinsurance liabilities	198	225	198	225
Universal charges payable	573	219	573	219
Refundable transmission charges	130	131	130	131
Customers' refund	6,250	7,131	6,250	7,131
Interest-bearing financial liabilities:				
Notes payable	67	149	67	149
Current portion of long-term debt	4,560	5,574	4,560	5,574
	41,858	36,768	41,858	36,768
Financial liabilities of discontinued operations	7,413	–	7,413	–
	49,271	36,768	49,271	36,768
Total Financial Liabilities	P96,961	P81,075	P97,279	P81,959

The fair values of the financial assets and liabilities are included at the amounts at which the instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and Cash Equivalents, Trade and Other Receivables, Trade Payables and Accrued Expenses and Notes Payable

Due to the short-term nature of transactions, the fair values of these instruments approximate their carrying amounts as at reporting date. The balance of "Trade payables and accrued expenses" includes the value of bifurcated embedded currency forwards.

Installment Contracts Receivable

The fair values of installment contracts receivable were calculated by discounting the expected future cash flows at prevailing credit adjusted PDEX interest rates ranging from 3.7% to 7.3% in 2011 and 3.3% to 6.5% in 2010.

Bifurcated Foreign Currency Forward and Foreign Currency Forward

The fair values of embedded currency forwards and freestanding currency forwards were calculated by reference to forward exchange market rates.

Meter Deposits and Customers' Refund

Meter deposits and customers' refund are due and demandable. Thus, the fair values of these instruments approximate their carrying amounts.

AFS Investments

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

Bill Deposits

The fair values of bill deposits are not determinable since the timing of each refund is linked to the termination of service, which is not reasonably predictable. Bill deposits are presented at cost.

Preferred Stock

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

Fair Value Hierarchy

MERALCO held the following financial instruments measured at fair value. MERALCO uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
- Level 2: other techniques for all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly
- Level 3: techniques with inputs which have a significant effect on the recorded fair value that are not based on observable market data

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

	December 31, 2011			December 31, 2010		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	(Amounts in Millions)					
Noncurrent financial assets:						
AFS investments	P121	P19	P140	P275	P128	P403
Current financial assets -						
Derivative assets	—	4	4	—	24	24
Total	P121	P23	P144	P275	P152	P427
Current financial liability -						
Derivative liability	(P6)	P—	(P6)	P—	(P1)	(P1)

As at December 31, 2011 and 2010, the *MERALCO Group* does not have financial instruments with fair values determined using inputs that are not based on observable market data (Level 3).

For the years ended December 31, 2011 and 2010, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Derivative Financial Instruments

Embedded Currency Forward

MERALCO has bifurcated embedded currency forwards noted in various purchases and service agreements denominated in currencies other than Philippine peso, which includes U.S. dollar, Euro, among others. As at December 31, 2011 and 2010, these agreements represent 16% and 25% of *MERALCO*'s trade payables, respectively. As at December 31, 2011, the U.S. dollar and Euro-denominated agreements amounted to \$14 million (equivalent to P630 million) and €1 million (equivalent to P48 million), respectively. As at December 31, 2010, the U.S. dollar- and Euro-denominated agreements amounted to \$9 million (equivalent to P404 million) and €8 million (equivalent to P450 million), respectively. These are part of "Trade payables and accrued expenses" account in the consolidated statements of financial position. The net fair value of the embedded currency forward amounted to P2 million liability and P22 million asset as at December 31, 2011 and 2010, respectively.

Currency Forward

Rockwell Land entered into deliverable currency forward contracts to hedge its foreign currency exposure arising from its U.S. dollar-denominated receivables. As at December 31, 2010, *Rockwell Land* has outstanding currency forward contracts to sell U.S. dollar with an aggregate notional amount of \$0.09 million, and weighted average contracted forward rate of P43.88 to \$1.00. The outstanding derivative matured in 2011. The net fair value gain on the outstanding currency forward contracts amounted to P10 million as at December 31, 2010.

The net movements in fair value changes of the derivative instruments for the years ended December 31, 2011 and 2010 are as follows:

	2011	2010
	(Amounts in Millions)	
Balance at beginning of year	P23	P155
Net changes in fair value of derivatives not designated as accounting hedges	(18)	3
Fair value of settled instruments	(7)	(135)
Balance at end of year	(P2)	P23

The fair value changes of the derivative instruments in 2011 and 2010 are presented as follows:

	Note	2011	2010
		(Amounts in Millions)	
Derivative assets	17	P4	P24
Derivative liabilities	25	(6)	(1)
		(P2)	P23

Financial Risk Management Objectives and Policies

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

Cash Flow Interest Rate Risk

The *MERALCO Group*'s exposure to the changes in market interest rates relates primarily to the debt obligations with floating interest rates since the *MERALCO Group*'s interest-bearing short-term investments mature within 90 days or less.

The *MERALCO Group*'s policy is to manage its interest rate risk exposure using a mix of fixed and variable rate debts. The strategy, which yields a reasonably lower effective cost based on market conditions, is adopted. Refinancing of fixed rate loans may also be undertaken to manage interest cost. As at December 31, 2011 and 2010, approximately 81% and 85% of the borrowings bears fixed rate of interest, respectively.

Rockwell Land's policy is to source loans with fixed interest rates, as available.

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

	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>							
2011 Floating Rate	₱612	₱612	₱612	₱13	₱13	₱2,438	₱4,300
2010 Floating Rate	600	600	600	600	–	–	2,400

Floating interest rate on bank loans is repriced at intervals of less than one year. The other financial liabilities of the *MERALCO Group* that are not included in the foregoing have fixed interest rate, or are noninterest-bearing, or have no fixed or determinable maturity and are, therefore, not subject to cash flow interest rate risk. The short-term investments are not exposed to significant changes in market rates because they mature within 90 days or less to coincide with *MERALCO Group'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 *MERALCO* and *Rockwell Land's* profit before tax as at December 31, 2011 and 2010 through the impact on floating rate borrowings. There is no other impact on *MERALCO's* and *Rockwell Land's* equity other than those already affecting the consolidated statement of income.

	2011		2010	
	Increase (Decrease) in Basis Points	Effect on Profit before Tax	Increase (Decrease) in Basis Points	Effect on Profit before Tax
<i>(Amounts in Millions)</i>				
<i>MERALCO</i>				
Floating rate loans from various banks	+100 (100)	(₱43 million) 43 million	+100 (100)	(₱24 million) 24 million
<i>Rockwell Land</i>				
Floating rate loans from various banks	+100 (100)	(₱9 million) 9 million	+100 (100)	(₱9 million) 9 million

Interest expense on floating rate loans is computed for the year, taking into account actual principal movements during the year, based on management's best estimate of a +/-100 basis points change in interest rates. There has been no change in the methods and assumptions used by the management in the above analysis.

Foreign Currency Risk

The revaluation of any of foreign currency-denominated financial assets and liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the end of each reporting period. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency-denominated debt. While an insignificant percentage of the *MERALCO Group's* revenues and debt is denominated in U.S. dollars, a substantial portion of the *MERALCO Group's* capital expenditures for electricity capital projects and a portion of the operating expenses are denominated in foreign currencies, mostly in U.S. dollars. As such, a strengthening or weakening of the Philippine peso against the U.S. dollar will decrease or increase in Philippine peso terms, the principal amount of the *MERALCO Group's* foreign currency-denominated liabilities and the related interest expense, foreign currency-denominated capital expenditures and operating expenses as well as U.S. dollar-denominated revenues.

The following table shows the consolidated foreign currency-denominated financial assets and liabilities as at December 31, 2011 and 2010, translated to Philippine peso at the following exchange rates:

	2011	2010
U.S. Dollar (\$)	₱43.84	₱43.84
Yen (¥)	0.5638	–

December 31, 2011			
Foreign Currency			
	U.S. Dollar	Yen	Peso Equivalent
	(Amount in millions)		
Financial assets:			
Cash and cash equivalents	\$51	¥–	P2,219
Trade and other receivables	2	–	89
Advance payments to suppliers	5	–	240
	58	–	2,548
Financial liabilities -			
Trade payables and accrued expenses	(169)	(200)	(7,456)
	(\$111)	(¥200)	(P4,908)

December 31, 2010			
Foreign Currency			
	U.S. Dollar		Peso Equivalent
	(Amount in millions)		
Financial assets:			
Cash and cash equivalents		\$9	P395
Trade and other receivables		5	219
Advance payments to suppliers		7	307
		21	921
Financial liabilities -			
Trade payables and accrued expenses		(78)	(3,420)
		(\$57)	(P2,499)

- a. All of *MERALCO*'s long-term financial liabilities are denominated in Philippine Peso. However, an insignificant portion of its trade payables are denominated in U.S. dollars. Thus, the impact of P1 movement of the Philippine Peso against the U.S. dollar will not have a significant impact on *MERALCO*'s principal and interest payments. Further, *PBR* assumes a forecast level of foreign currency movements in its calculation of the regulatory asset base and expenditures. *PBR* also allows for adjustment of the rates *MERALCO* charges should there be significant deviations in the foreign exchange forecast from what is actually realized.
- b. *Rockwell Land* markets its developments in the United States. Thus, its statement of financial position may be affected significantly by movements in the U.S. dollar exchange rates.

It is *Rockwell Land*'s policy to limit its U.S. dollar-denominated receivables to an amount that approximately matches the U.S. dollar-denominated component of its development costs as well as its U.S. dollar-denominated borrowings. Also, *Rockwell Land* enters into deliverable currency forward contracts to hedge its foreign currency exposure should there be an excess in U.S. dollar-denominated assets over the U.S. dollar-denominated liabilities.

The following table demonstrates the sensitivity to a reasonably possible change in the U.S. dollar exchange rate vis-a-vis the peso, with all other variables held constant, of the *MERALCO Group*'s profit before tax as at December 31, 2011 and 2010 (due to changes in the fair value of financial assets and liabilities). There is no other impact on *MERALCO*'s equity other than those already affecting the profit and loss.

	2011		2010	
	Appreciation (Depreciation) of U.S. Dollar/Yen	Effect on Profit before Tax	Appreciation (Depreciation) of U.S. Dollar	Effect on Profit before Tax
	(In %)	(In Millions)	(In %)	(In Millions)
U.S. dollar-denominated financial assets and liabilities	+5 –5	(P243) 243	+5 –5	(P125) 125
Yen-denominated financial liabilities	+5 –5	(6) 6	– –	– –

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

Commodity Price Risk

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

Credit Risk

Credit risk is the risk that the *MERALCO Group* will incur a loss arising from customers, clients or counterparties who fail to discharge their contracted obligations. The *MERALCO Group* manages and controls credit risk by setting limits on the amount of risk that it is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

The *MERALCO Group* trades only with recognized, creditworthy third parties. It is the *MERALCO Group's* policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivables are monitored on an ongoing basis to reduce exposure to bad debt. Power distribution receivables are, to a certain extent, backed by bill deposits. Also, as a policy, disconnection notices are sent three days after the due date and disconnections are carried out on the third day after receipt of disconnection notice.

Rockwell Land trade receivables from sale of condominium units are secured with pre-completed condominium units, the legal title and ownership of which are transferred to the customers upon full payment of the contract price. Receivables from leases are secured by security deposits, while receivables from sale of *Rockwell Land* club shares are guaranteed by the shares held by *Rockwell Land* until full payment thereof.

With respect to placements of excess cash with financial institutions, these institutions are subject to the *MERALCO Group's* accreditation evaluation based on liquidity and solvency ratios and on the bank's credit rating. The *MERALCO Group* transacts derivatives only with similarly accredited financial institutions. In addition, the *MERALCO Group's* deposit accounts in banks are insured by the Philippine Deposit Insurance Corporation up to P500,000 per bank.

Credit risk on other financial assets, which include cash and cash equivalents, trade and other receivables, AFS financial assets and certain derivative instruments, arises from the potential default of the counterparty.

Finally, credit quality review procedures are in place to provide regular identification of changes in the creditworthiness of counterparties. Counterparty limits are established and reviewed periodically based on latest available financial information of counterparties, credit ratings and liquidity. The *MERALCO Group's* credit quality review process allows it to assess any potential loss as a result of the risks to which it may be exposed and to take corrective actions.

There are no significant concentrations of credit risk within the *MERALCO Group*.

The table below shows the maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives as at December 31, 2011 and 2010. The maximum exposure is equivalent to the nominal amount of the accounts.

	Gross Maximum Exposure	
	2011	2010
Cash and cash equivalents:		
Cash on hand and in banks	P2,704	P3,631
Cash equivalents	41,437	20,739
Trade and other receivables:		
Billed	21,347	16,258
Unbilled	5,440	5,011
Service contracts and others	761	817
Insurance receivable	319	384
Cost of estimated earnings in excess of billings on uncompleted contracts	167	124
Current portion of installment contracts receivables	–	2,183
Nontrade receivables	1,074	832
Other current assets -		
Derivative assets	4	24
Other noncurrent assets:		
AFS investments	140	403
Unbilled receivables	3,321	3,843
Advance payment to suppliers	239	253
HTM	–	61
Installment contracts receivable	–	39
Notes receivable	27	28
Financial assets of discontinued operations	4,955	–
	P81,935	P54,630

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

2011						
	Neither Past Due nor Impaired					
	High Grade	Standard Grade	Sub-standard Grade	Past Due but not Impaired	Impaired Financial Assets	Total
(Amounts in Millions)						
Cash and cash equivalents	P42,229	P–	P–	P–	P–	P42,229
Trade and other receivables:						
Trade:						
Billed	6,703	3,866	6,173	4,607	1,950	23,299
Unbilled	–	5,440	–	–	–	5,440
Nontrade:						
Related parties	21	14	15	294	–	344
Others	–	343	33	178	–	554
AFS investments	11	–	–	–	–	11
Derivative assets	4	–	–	–	–	4
Other noncurrent assets	–	–	3,588	–	–	3,588
	P48,968	P9,663	P9,809	P5,079	P1,950	P75,469

2010						
	Neither Past Due nor Impaired					
	High Grade	Standard Grade	Sub-standard Grade	Past Due but not Impaired	Impaired Financial Assets	Total
(Amounts in Millions)						
Cash and cash equivalents	P22,504	P–	P–	P–	P–	P22,504
Trade and other receivables:						
Trade:						
Billed	5,532	3,357	5,328	1,886	1,516	17,619
Unbilled	–	5,011	–	–	–	5,011
Nontrade:						
Related parties	1	3	12	304	–	320
Others	–	276	33	180	–	489
AFS investments	109	–	–	–	–	109
Derivative assets	23	–	–	–	–	23
Other noncurrent assets	–	–	4,121	–	–	4,121
	P28,169	P8,647	P9,494	P2,370	P1,516	P50,196

Credit ratings are determined as follows:

- “High Grade”

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

- “Standard Grade”

‘Standard’ grade financial assets include AFS investments that are not classified as “High Grade.” For trade receivables, these consist 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”

‘Substandard’ grade financial assets include trade receivables that consist of current month’s billings, which are not expected to be collected within 60 days.

The credit quality of financial assets of *Rockwell Land* is managed using an internal credit ratings method. The table below shows the credit quality by class of asset as at December 31, 2011 and 2010:

	2011		
	'A' Rating	'B' Rating	Total
	(Amounts in Millions)		
Cash and cash equivalents	P448	P–	P448
Trade receivables from:			
Sale of condominium units	1,252	675	1,927
Leases	62	29	91
Advances to officers and employees	9	–	9
Other receivables	–	68	68
AFS investments	262	–	262
	P2,033	P772	P2,805
	2010		
	'A' Rating	'B' Rating	Total
	(Amounts in Millions)		
Cash and cash equivalents	P321	P–	P321
Trade receivables from:			
Sale of condominium units	919	467	1,386
Leases	43	29	72
Advances to officers and employees	7	–	7
Other receivables	50	–	50
AFS investments	278	–	278
	P1,618	P496	P2,114

For trade receivables from sale of condominium units, customers who have no history of delayed payment are classified as having an 'A' credit rating while customers who have history of delayed payment but is currently updated are given a 'B' credit rating.

Trade receivables from leases are classified as having a credit rating of 'A' when tenants pay within the discount period and 'B' when tenants pay on or before due date.

The following table shows the aging analysis of financial assets as at December 31:

	2011					
	Neither Past Due nor Impaired	Past Due But Not Impaired			Impaired Financial Assets	Total
		31–60 Days	61–90 Days	Over 90 Days		
		(Amounts in Millions)				
Cash and cash equivalents:						
Cash on hand and in banks	P2,704	P–	P–	P–	P–	P2,704
Cash equivalents	41,437	–	–	–	–	41,437
Trade and other receivables:						
Trade:						
Billed electricity	16,700	2,149	564	1,934	1,952	23,299
Unbilled electricity	–	5,440	–	–	–	5,440
Service contracts and others	561	37	65	98	60	821
Insurance receivable	301	4	2	12	–	319
Cost and estimated earnings in excess of billings on uncompleted contracts	87	80	–	–	1	168
Nontrade receivables	210	203	130	531	119	1,193
Other current assets -						
Derivative assets	4	–	–	–	–	4
Other noncurrent assets:						
Unbilled receivables	3,321	–	–	–	–	3,321
AFS investments	140	–	–	–	–	140
Advance payment to suppliers	239	–	–	–	–	239
Notes receivable	27	–	–	–	–	27
Financial assets of discontinued operations	4,182	652	6	115	–	4,955
	P69,913	P8,565	P767	P2,690	P2,132	P84,067

2010						
	Neither Past Due nor Impaired	Past Due But Not Impaired			Impaired Financial Assets	Total
		31-60 Days	61-90 Days	Over 90 Days		
(Amounts in Millions)						
Cash and cash equivalents:						
Cash on hand and in banks	P3,631	P-	P-	P-	P-	P3,631
Cash equivalents	20,739	-	-	-	-	20,739
Trade and other receivables:						
Trade:						
Billed electricity	14,353	1,303	393	209	1,518	17,776
Unbilled electricity	5,011	-	-	-	-	5,011
Current portion of installment contracts receivables	1,385	525	46	227	-	2,183
Service contracts and others	848	95	48	162	172	1,325
Nontrade receivables	434	118	37	415	11	1,015
Other current assets -						
Derivative assets	24	-	-	-	-	24
Other noncurrent assets:						
Unbilled receivables	3,843	-	-	-	-	3,843
AFS investments	403	-	-	-	-	403
Advance payment to suppliers	253	-	-	-	-	253
HTM	61	-	-	-	-	61
Installment contracts receivable	39	-	-	-	-	39
Derivative assets	-	-	-	-	-	-
Notes receivable	28	-	-	-	-	28
	P51,052	P2,041	P524	P1,013	P1,701	P56,331

Liquidity Risk

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

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

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

2011					
	Less than 3 Months	3-12 Months	1-5 Years	More than 5 Years	Total
<i>(Amounts in Millions)</i>					
Notes payable	P67	P-	P-	P-	P67
Trade payables and accrued expenses	27,695	743	-	-	28,438
Customers' refund	1,562	4,688	-	-	6,250
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	13	600	1,250	2,438	4,301
Fixed rate borrowings	2,074	124	6,796	9,430	18,424
Preferred stock	478	1,434	-	-	1,912
Customers' deposits	600	559	4,636	19,444	25,239
Refundable service extension costs	1,229	3,688	-	-	4,917
Total undiscounted financial liabilities	P33,718	P11,836	P12,682	P31,312	P89,548

2010					
	Less than 3 Months	3–12 Months	1–5 Years	More than 5 Years	Total
(Amounts in Millions)					
Notes payable	P149	P–	P–	P–	P149
Trade payables and accrued expenses	20,563	1,193	29	–	21,785
Customers' refund	1,787	5,344	–	–	7,131
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	929	688	1,800	–	3,417
Fixed rate borrowings	314	422	5,550	9,432	15,718
Preferred stock	551	1,653	–	–	2,204
Customers' deposits	600	600	4,800	20,840	26,840
Refundable service extension costs	258	516	3,096	175	4,045
Other noncurrent liabilities	22	142	241	–	405
Total undiscounted financial liabilities	P25,173	P10,558	P15,516	P30,447	P81,694

The maturity profile of bill deposits is not determinable since the timing of each refund is linked to the cessation of service, which is not reasonably predictable. However, *MERALCO* estimates that a portion of bill deposits (including related interest), amounting to P2,266 million, will be refunded in 2012. This is shown as part of "Trade payables and accrued expenses" account in the 2010 consolidated statement of financial position.

The 2011 schedule of maturity profile does not include the financial liabilities of *Rockwell Land*, which are reported under "Liabilities of discontinued operations" in the consolidated statement of financial position.

Capital Management

The primary objective of the *MERALCO Group'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 ensuring that returns on, and of, capital are consistent with the levels approved by its regulators for its core distribution business.

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

The *MERALCO Group* monitors capital using debt to *EBITDA* ratio, which is gross debt divided by *EBITDA*. The *MERALCO Group* considers long-term debt, redeemable preferred stock and notes payable as debt.

	2011	2010
(Amounts in Millions, except Debt to EBITDA)		
Long-term debt	P22,725	P19,152
Redeemable preferred stock	1,651	1,920
Notes payable	67	149
Debt (a)	24,443	21,221
EBITDA (b)	23,342	17,940
Debt to EBITDA ratio (a)/(b)	1.05	1.18

31. Income Taxes and Local Franchise Tax

Income Taxes

The components of deferred tax assets (liabilities) as at December 31, 2011 and 2010 are as follows:

	Note	2011	2010
(Amounts in Millions)			
Deferred tax assets:			
Provision for various claims	22	P7,126	P3,862
Unfunded pension cost and unamortized past service cost		1,873	2,786
Allowance for doubtful accounts	14	593	464
Allowance for excess of cost over net realizable value	15	148	18
Excess of effective interest rate amortization over straight-line amortization of debt issue costs		1	1
Allowance for nonrecovery of receivables		–	334
Others		332	526
		10,073	7,991

	Note	2011	2010
(Amounts in Millions)			
Deferred tax liabilities:			
Revaluation increment in utility plant and others	18	P7,831	P8,030
Depreciation method differential		1,242	1,337
Capitalized interest		755	858
Capitalized duties and taxes deducted in advance		676	708
Net book value of capitalized/realized foreign exchange losses		61	99
Others		78	239
		10,643	11,271
		(P570)	(P3,280)

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

	2011	2010
(Amounts in Millions)		
Deferred tax assets - net	P25	P42
Deferred tax liabilities - net	(595)	(3,322)
	(P570)	(P3,280)

Provision for (benefit from) income tax consists of:

	2011	2010 (As restated - see Note 6)	2009 (As restated - see Note 6)
(Amounts in Millions)			
Current	P8,454	P4,960	P2,926
Deferred	(2,515)	(937)	(595)
	P5,939	P4,023	P2,331

A reconciliation between the provision for (benefit from) income tax computed at statutory income tax rate using tax rate of 30% in 2011, 2010 and 2009, and provision for (benefit from) income tax as shown in the consolidated statements of income is as follows:

	2011	2010 (As restated - see Note 6)	2009 (As restated - see Note 6)
(Amounts in Millions)			
Income tax computed at statutory tax rate of:			
Continuing operations	P5,600	P3,995	P2,416
Discontinued operations	386	336	279
	5,986	4,331	2,695
Income tax effects of:			
Interest income subjected to lower final tax rate	(590)	(183)	(113)
Nondeductible expenses	593	79	265
Nondeductible interest expense	236	61	43
Equity in net earnings of associates and a joint venture	(20)	(85)	(73)
Nontaxable income	(10)	(63)	(54)
Others	66	180	(141)
	6,261	4,320	2,622
Less provision for income tax of discontinued operations	322	297	291
	P5,939	P4,023	P2,331

On December 18, 2009, the BIR issued Revenue Regulation, or RR No. 16-2008, which implemented the provisions of RA No. 9504 on Optional Standard Deductions or OSD. Such regulation allowed both individual and corporate taxpayers to use OSD in computing their taxable income. For corporations, they may elect a standard deduction in an amount not exceeding 40% of gross income in lieu of the itemized allowed deduction. For the years ended December 31, 2011, 2010 and 2009, none of the entities in the MERALCO Group availed of the OSD in computing taxable income, except for RSIC.

The temporary difference for which deferred tax assets have not been recognized pertains to the tax effect of net operating loss carryover amounting P115 million and P39 million as at December 31, 2011 and 2010, respectively.

LFT

Consistent with the decisions of the *ERC*, *LFT* is a recoverable charge for the account of the customers of the *DU* in the particular province or city imposing and collecting the *LFT*. It is presented as a separate line item in the customer's bill and computed as a percentage of the sum of generation, transmission, distribution services and related system loss charges.

Furthermore, the Implementing Rules and Regulations issued by the *ERC* provide that franchise taxes shall be paid only on its distribution wheeling and captive market supply revenues. At present, pending the promulgation of guidelines from the relevant government agencies, *MERALCO* is paying *LFT* based on the sum of the foregoing charges in the customers' bill.

32. Contingencies*Contingent Assets**Overpayment of Income Tax related to SC Refund*

As a result of the decision of the *SC* for *MERALCO* to refund ₱0.167 per kWh to affected customers covering the period February 1994 to May 2003, *MERALCO* overpaid income tax in the amount of ₱7,107 million for taxable years 1994 to 1998 and 2000 to 2001. Accordingly, *MERALCO* filed a claim on November 27, 2003 for the recovery of such excess income taxes paid. After examination of the books of *MERALCO* for the covered periods, the *BIR* determined that *MERALCO* had in fact overpaid income taxes in the amount of ₱6,690 million. However, the *BIR* also maintained that *MERALCO* is entitled to a refund amount of only ₱894 million, which pertains to taxable year 2001 on the ground that the period for filing a claim has prescribed.

The *BIR* then approved the refund of ₱894 million through issuance of tax credit certificates or *TCCs*, proportionate to the actual refund of claims to utility customers. The *BIR* initially issued *TCCs* amounting to ₱317 million corresponding to actual refund to customers as at August 31, 2005.

As at December 31, 2011 and 2010, the amount of unissued *TCCs* of ₱577 million out of the ₱894 million refund entitlement is presented as part of "Other noncurrent assets" account in the consolidated statement of financial position.

See Note 12 – Other Noncurrent Assets.

MERALCO filed a Petition with the Court of Tax Appeals or *CTA* assailing the denial by the *BIR* of its income tax refund claim of ₱5,796 million for the years 1994 - 1998 and 2000, arising from the *SC* decision (net of ₱894 million as approved by the *BIR* for taxable year 2001). In a decision dated December 6, 2010, the *CTA* Second Division granted *MERALCO*'s claim and ordered the *BIR* to refund or to issue tax credit certificate in favor of *MERALCO* in the amount of ₱5,796 million in proportion to the amounts that have been actually given or credited to its customers.

On December 23, 2010, a Motion for Clarification and Partial Reconsideration was filed by *MERALCO*. On December 28, 2010, a Motion for Reconsideration was filed by the *BIR*. In a *Resolution* dated April 15, 2011, the motions of *MERALCO* and the *BIR* were both denied by the *CTA*'s Second Division. The *BIR* filed a Petition for review with the *CTA* En Banc. Following the filing of *MERALCO*'s Comment to the Petition for Review and the parties' Memoranda, the case was submitted for decision by the *CTA* En Banc.

Overpayment of Income Tax Related to Change in Tax Basis

On February 4, 2008, the *SC* denied with finality a motion for reconsideration filed by the Commissioner of Internal Revenue or *CIR*, against *MERALCO*, with respect to the issue on excess income tax paid by the latter. The *SC* affirmed a *CA* decision and ordered the *CIR* to refund or issue a *TCC* in favor of *MERALCO* for ₱107 million representing overpaid income taxes for taxable years 1987 and 1988. The overpayment is in accordance with the effectivity of Executive Order No. 72, which subjected *MERALCO* to regular corporate income tax instead of 2% franchise tax based on gross receipts it was previously liable for. As at February 27, 2012, *MERALCO* is in the process of filing its application for the issuance of the *TCC*.

Application for Recovery of LFT

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

The amount of *LFT*, which *MERALCO* seeks to recover from its customers in the five provinces and 14 cities mentioned, is ₱1,581 million, plus carrying charges thereon.

Contingent Liabilities

LFT Assessments of Municipalities

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

Real Property Tax or RPT Assessments

Six Local Government Units or *LGUs*, assessed *MERALCO* for deficiency *RPTs* on certain assets of *MERALCO*. The assets include any of electric poles, wires, insulators, and transformers, collectively referred to as *TWIP*. Of these *LGUs*, one has secured a favorable decision from the *CA*. Such decision was appealed by *MERALCO* to the *SC* where it is now submitted for resolution. The cases of the other *LGUs* are pending with their respective administrative bodies or government offices.

In the event that the assessments are sustained by the *SC* and payment is warranted or appropriate, *MERALCO* will file for the recovery of any resulting real estate tax payments from customers in the relevant *LGU* through separate application with the *ERC*.

Mediation with NPC

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

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

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

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

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

The mediation resulted in the signing of a Settlement Agreement or *SA* between the parties on July 15, 2003. The *SA* was approved by the respective *BODs* of *NPC* and *MERALCO*. The net settlement amount of P14,320 million was agreed upon by *NPC* and *MERALCO* and manifested before the *ERC* through a Joint Compliance dated January 19, 2006. The implementation of the *SA* is subject to the approval of *ERC*.

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

Deferred PPA

On October 14, 2009, the *ERC* released its findings on *MERALCO*'s implementation of the collection of the approved pass-through cost under-recoveries in 2004. *ERC* directed *MERALCO* to refund P268 million of deferred *PPA* transmission line costs related to *QPPL* and deferred accounting adjustments or *DAA* incurred to customers, along with P184 million in carrying charges, or an equivalent of P0.0169 per kWh. *MERALCO* implemented the refund beginning November 2009 until September 2010. However, the *ERC* has yet to rule on *MERALCO*'s deferred *PPA* under-recoveries of P106 million. As at December 31, 2011, *MERALCO* has filed a Motion for Reconsideration, which is pending decision of the *ERC*.

Others

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

33. Significant Contracts and Commitments*NPC*

MERALCO and *NPC* have a Transition Supply Contract or *TSC*, effective the earlier of five years from November 16, 2006 up to December 25, 2011 or one year after the introduction of Open Access, should Open Access commence within the five-year contract period. Two addenda for additional contracted volumes were signed, the most recent being in 2010. The adjusted contracted volume was for a total of more than 40,000 *GWh* up to 2011.

On December 26, 2011, the *TSC* with *NPC* was extended until December 25, 2012 or three months after the implementation of *OARC*, whichever comes first.

As a result of the extension of the *TSC*, the Customer Choice Program or *CCP*, which is a joint program of *NPC* and *MERALCO* aimed at providing *NPC* time-of-use benefits to qualified customers, has also been extended to be co-terminus with the *TSC*.

FGPC and FGP

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

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

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

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

QPPL

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

In the amended *PPA* signed on February 21, 2008, the amount billable by *QPPL* included a transmission line charge reduction in lieu of a previous rebate program. The *PPA* also included an advance payment mechanism, which requires *MERALCO* to pay *QPPL* \$2.85 million per annum for 10 years beginning 2008 to offset the difference between the transmission line charge specified in the *TLA* and the *ERC*-approved transmission line charge in March 2003. *QPPL* shall return the same amount without adjustment for cost of money in equal annual payments. However, if *MERALCO* is able to dispatch *QPPL* at a plant capacity factor of no less than 86% in any particular year, *MERALCO* shall not be required to pay the \$2.85 million in that year.

See Note 17 – Other Current Assets.

TSCs with Privatized Generating Assets and IPP Contracts of NPC

From 2008 to 2009, *NPC* privatized a number of its generating assets and *IPP* contracts in favor of the successful bidders. As a result, the contracted energy volume under the original *TSC* between *MERALCO* and *NPC* was assigned by *NPC* to the respective new owners and *IPPs*. Following are the privatized plants and *IPP* contracts:

Year	Power Plant	Successor Owner/ <i>IPPs</i>	% of Total Volume
2008	Masinloc coal-fired power plant - 600 <i>MW</i>	Masinloc Power Partners Co. Ltd. or <i>Masinloc Power</i>	21.3
2009	Tiwi-Makban geothermal power plants - 289 <i>MW</i>	Aboitiz Power Renewable, Inc. or <i>Aboitiz Power</i>	8.1
	Pagbilao power plant - 735 <i>MW</i>	Therma Luzon Inc. or <i>Therma</i>	25.0
	Sual coal-fired power plant - 1,000 <i>MW</i>	San Miguel Energy Corporation or <i>SMEC</i>	8.6

Year	Power Plant	Successor Owner/IPPAs	% of Total Volume
2010	Coal-fired Calaca power plant - 600 MW	Sem-Calaca Power Corporation or <i>Sem-Calaca</i>	10.4
	Combined cycle gas turbine, natural gas-fired Ilijan power plant - 1,200 MW	South Premiere Power Corporation or <i>SPPC</i>	15.2

NPC/PSALM remains the contracting party of record for the supply of power to *MERALCO*. Payments of the contracted volume are made based on the billing instructions from *NPC/PSALM* received by *MERALCO*.

In December 2011, *MERALCO* entered into separate Power Supply Agreements or *PSAs* with *SPPC*, *Masinloc Power* and *Sem-Calaca*. The *PSAs* will be filed for approval with the *ERC*.

MMPC

MMPC operates an 8MW (designed capacity of 11MW) renewable energy generating facility, which utilizes landfill gas.

On June 11, 2009, *MMPC* began delivering energy to *MERALCO* under a two year *CSE*. The *CSE* is a "take and pay" arrangement, without a minimum energy volume. Energy is billed to *MERALCO* on an hourly basis at the *ERC*-approved *NPC TOU* rate plus certain pre-agreed cost components. Being an embedded renewable energy generator, purchases from *MMPC* are VAT zero-rated. Energy deliveries from *MMPC* are also exempt from power delivery service charge.

On July 1, 2009, the *ERC* approved the *CSE* on a provisional basis. In the event that the final rates approved by the *ERC* are lower than what *MMPC* currently charges *MERALCO*, the latter shall refund to its consumers excess payments returned by *MMPC*. *MERALCO* is awaiting final approval of the *CSE* by the *ERC*.

BEI

MERALCO signed a *CSE* with *BEI* on November 12, 2010. *BEI* owns and operates a 4MW renewable energy generation facility powered by landfill gas in San Pedro, Laguna.

The terms of the *BEI CSE* are similar to that signed with *MMPC*. Purchases from *BEI*, an embedded renewable energy generator, are VAT zero-rated and exempt from power delivery service charge. *MERALCO* filed an application for the approval of the *CSE* with the *ERC*, for the provisional implementation of the contract on December 15, 2010. The foregoing is still pending with the *ERC*.

Committed Energy Volume to be Purchased

The following are forecasted purchases/payments to *IPPs*, *FGPC*, *FGP* corresponding to the *TOP* volume provisions of the contracts. The assumptions used for the *TOP* volume include (i) fixed cost components, (ii) variable cost components, (iii) fixed cost forecasts using the U.S. and Philippine Consumer Price Index or *CPI*, and foreign exchange rate, (iv) fuel cost forecasts based on heat rates and fuel prices projected using U.S. *CPI*, among others.

Year	Minimum Energy Quantity or MEQ (In Million Kilowatt-Hours)	Equivalent Amount (In Millions)
2012	14,702	P83,490
2013	14,702	84,866
2014	14,702	86,272
2015	14,702	88,080
2016	14,603	89,454
2017-2025	133,024	877,152

Operating Lease Commitments

Rockwell Land is a lessor of commercial spaces included in the investment properties portfolio. These non-cancellable leases have remaining terms up to six years. All leases include an annual escalation to enable upward revision of the rental charge on an annual basis according to prevailing market conditions. Future minimum lease revenues follow:

	Amount (In Millions)
2012	P541
2013	103
2014	72
2015	17
2016 onwards	9
	<u>P742</u>

*Construction Contracts of Rockwell Land**One Rockwell*

In April 2008, *Rockwell Land* entered into a contract with DATEM Incorporated for the construction of the superstructure of *One Rockwell*, amounting to P2,500 million, inclusive of all taxes and related costs. As at December 31, 2011, the accumulated amount incurred was P2,120 million.

The Grove

The superstructure works related to *The Grove* project was contracted by Hilmarc's Construction Corporation or *Hilmarc*. The contract sum for the work amounted to P1,600 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 work. Superstructure works commenced in February 2010 and is currently ongoing. As at December 31, 2011, total amount incurred and paid related to this contract amounted to P669 million.

Edades Garden and Villas

In October 2010, *Rockwell Land* contracted *Hilmarc* to do substructure works related to the *Edades Garden and Villas* Project. The contract amounted to a fixed fee of P2,500 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 November 2010 and is currently ongoing. As at December 31, 2011, P168 million has been incurred and was already paid.

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

Basic and diluted earnings per share are calculated as follows:

	2011	2010	2009
	<i>(In Millions, Except per Share Data)</i>		
Net income attributable to equity holders of the Parent (a)	P13,227	P9,685	P6,005
Shares:			
Common shares at beginning of year	1,127	1,127	1,104
Weighted average common shares - issuances	–	–	4
Weighted average common shares (b)	1,127	1,127	1,108
Per Share Amounts:			
Basic and diluted earnings per share (a/b)	P11.73	P8.59	P5.42

35. Other Matters*Revised SL Caps*

On December 8, 2008, the *ERC* promulgated a lower maximum rate of system loss (technical and non-technical) that a utility can pass on to its customers. The new system loss cap shall be the lower of the actual but not to exceed 8.5% for private utilities, effective January 2010 billing, which is one percentage point lower than the 2009 system loss cap of 9.5%. The actual company use (administrative loss) shall be treated as part of the operation and maintenance expense in the next reset for utilities under *PBR*. The manner by which the utility will be rewarded for their efforts in system loss reduction shall be addressed by the *ERC* in the *PIS* under *PBR*.

As at February 27, 2012, the *ERC* has yet to act on the Petition.

Retail Competition

On February 18, 2011, the *ERC* issued an Order setting public hearings for the purpose of determining whether or not *OARC* may already be declared.

Subsequent to the conduct of hearings, in a decision dated June 6, 2011, the *ERC* ruled December 26, 2011 be the Open Access Date marking the commencement of the operation of the competitive retail electricity market in Luzon and Visayas. Commencing such date, electricity end-users with an average monthly peak demand of 1MW for the 12 months preceding December 26, 2011, as certified by the *ERC*, shall have the right to choose their own electricity suppliers.

MERALCO has formally advised the *ERC* of its firm intent to participate as a local *RES*.

Thereafter, the *ERC* released the draft "Transitory Rules for the Competitive Retail Electricity Market" in preparation for *OARC* and has conducted public consultations. Parties, including *MERALCO*, submitted their comment to the draft Rules, which were then discussed during the public consultation. The *ERC* invited the parties to give further comments, and stated that another public consultation will be conducted. *MERALCO* has submitted its additional comments and is awaiting the schedule of the next public consultation.

However, on October 24, 2011, *ERC* resolved to defer *OARC* commencement and said that any new Open Access Date will have to consider the forthcoming study and recommendations of the *DOE* Steering Committee.

Philippine Export Zone Authority or PEZA – ERC Jurisdiction

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

In support of the government's objective of providing lower cost to Ecozone locators, *MERALCO* entered into a *MOA* with *NPC* on September 17, 2007 for the provision of special Ecozone rates to high load factor *PEZA*-accredited industries. The *ERC* allowed the immediate implementation of the program.

In December 2011, the Ecozone Rate Program or *ERP* was initially extended for a period of 30 days from December 26, 2011 to January 26, 2012 under the same terms and conditions. Subsequently, as endorsed by the Department of Trade and Industry with the support of the *DOF* and *DOE*, the request of the *PEZA* for the extension of the *ERP* for one year, until December 26, 2012 or upon the implementation of *OARC*, whichever comes first, was approved by the Office of the President in January 2012.

Sucat-Araneta-Balintawak Transmission Line

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

On March 10, 2000, certain residents along Tamarind Road, Dasmariñas Village, Makati City or plaintiffs, filed a case with the Regional Trial Court – Makati Branch or *RTC-Makati* against *NPC*, enjoining *NPC* 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. Following its initial status quo Order issued on March 13, 2000, *RTC-Makati* granted on April 3, 2000 the preliminary injunction sought for by the plaintiffs. The decision was affirmed by the *SC* on March 23, 2006, which effectively reversed a decision of the *CA* to the contrary. The *RTC-Makati* subsequently issued a writ of execution based on the order of the *SC*. *MERALCO*, in its capacity as an intervenor, was constrained to file an Omnibus Motion to maintain status quo because of the significant effect of a de-energization of the Sucat-Araneta line to the public and economy. Shutdown of the 230-kV line will result in widespread and rotating brownouts within *MERALCO*'s franchise area with certain power plants unable to run at their full capacities.

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

Thereafter, the plaintiffs questioned the *RTC-Makati* order before the *CA*. As at February 27, 2012, this case remains pending for resolution in the *CA*.

Purchase of Subtransmission Assets or STAs

On November 25, 2009, *MERALCO* signed a Contract to Sell with *TransCo* for the sale and purchase of certain subtransmission assets for P86 million. On February 25, 2010, the *ERC* approved this Contract to Sell. As at February 27, 2012, the actual settlement between *MERALCO* and *TransCo* remains pending upon the request of *TransCo*.

On December 12, 2011, *MERALCO* signed various agreements for the acquisition of certain sub-transmission assets of *TransCo* within the *MERALCO* franchise area for its sole account, as well as with a consortium consisting itself, Batangas II Electric Cooperative, Inc. and First Bay Power Corporation. These contracts and agreements will be filed before the *ERC*.

Petition for Dispute Resolution

On September 9, 2008, *MERALCO* filed a Petition for Dispute Resolution with the *ERC*, against *PEMC*, *TransCo*, *NPC* and *PSALM* as a result of the congestion in the transmission system of *TransCo* arising from the outages of the San Jose-Tayabas 500kV Line 2 on June 22, 2008, and the 500kV 600 MVA Transformer Bank No. 2 of *TransCo*'s San Jose, Bulacan substation on July 11, 2008. The Petition seeks to, among others, direct *PEMC* to adopt the *NPC-TOU* rate or the new price determined through the price substitution methodology of *PEMC* as approved by the *ERC*, as basis for its billing during the period of the

congestion and direct *NPC* and *PSALM* to refund the transmission line loss components of the line rentals associated with *NPC/PSALM* bilateral transactions from the start of *WESM* operation on June 26, 2006.

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

The *ERC* issued an Order on May 4, 2011 directing *PEMC* to submit an alternative methodology for the segregation of line rental into congestion cost and line losses from the start of the *WESM*. On September 8, 2011, *MERALCO* received a copy of *PEMC*'s compliance to *ERC*'s directive and on November 11, 2011, *MERALCO* filed a counter-proposal which effectively simplifies *PEMC*'s proposal.

On December 21, 2011, *PSALM* filed its Comment on *MERALCO*'s said Motion. Then, in an Order of the *ERC* dated January 24, 2012, it directed *PEMC*, *TransCo* and *NPC* to submit their respective comments on *MERALCO*'s motion within five days from receipt. Thereafter, *MERALCO*'s Motion shall be deemed submitted for resolution. *MERALCO* is awaiting *ERC*'s action on the matter.

PSALM versus PEMC and MERALCO

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

While resolutions were initially issued by the *PEMC* directing adjustments of *WESM* settlement amounts, a series of exchanges and appeals with the *ERC* ensued. *ERC*'s decision directing the *WESM* settlement price for the 3rd and 4th billing months to be *NPC-TOU* rates prompted *PSALM* to file a Motion for Reconsideration with the *CA*, which was denied on November 6, 2009. In December 2009, *PSALM* filed a Petition for Review on Certiorari with the *SC*.

As at February 27, 2012, *PSALM*'s petition for review is pending resolution by the *SC*.

Petition for Dispute Resolution with NPC on Premium Charges

On June 2, 2009, *MERALCO* filed a Petition for Dispute Resolution against *NPC* and *PSALM* with respect to *NPC*'s imposition of premium charges for the alleged excess energy it supplied to *MERALCO* covering the billing periods May 2005 to June 2006. The premium charges amounted to P315 million during the May-June 2005 billing periods, which have been paid for by *MERALCO*, and P318 million during the November 2005, February 2006 and April-June 2006 billing periods, which is being disputed and withheld by *MERALCO*. *MERALCO* believes that there is no basis for the imposition of the premium charges.

Lifeline Subsidy

On June 21, 2011, *Republic Act No. 10150*, "An Act Extending the Implementation of the Lifeline Rate, Amending for the Purpose Section 73 of the Republic Act 9136, otherwise known as the *EPIRA* of 2001," was promulgated. The Act extended the implementation of the lifeline rate for another 10 years.

Expanded Senior Citizens Act of 2010 or ESCA

RA No. 9994, otherwise known as the Expanded Senior Citizens Act of 2010 or *ESCA*, was signed into law last February 16, 2010 mandating the grant of benefits to senior citizens.

The *ESCA* grants senior citizens whose monthly consumption does not exceed 100kWh a minimum 5% discount on the monthly electric bill, for services that are registered in their name. The law also gives a discount of at least 50% on the consumption of electricity by senior citizens centers and residential care/group homes.

On January 5, 2011, the *ERC* issued a Resolution which took effect on January 22, 2011 adopting the "Rules Implementing the Discounts to Qualified Senior Citizen End-Users and Subsidy from the Subsidizing End-Users on Electricity Consumption under Sections 4 and 5 of *RA No. 9994*". *MERALCO* implemented the discount starting the February 2011 billing.



LET THERE BE LIGHT



COMMUNITY ELECTRIFICATION

As the social development arm of the Manila Electric Company, One Meralco Foundation commits itself to give light to marginalized communities which are still deprived of the benefits of safe, reliable and efficient electricity supply.

Since 2007, over 6,000 households, community infrastructures and public schools were given the gift of light, powering not only their homes but their lives as well.



ONE MERALCO
FOUNDATION

Glossary of Terms

MERALCO'S UNBUNDLED TARIFF COMPONENTS

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

ENVIRONMENTAL CHARGE is a universal charge that accrues to an environmental fund to be used solely for watershed rehabilitation and management. Such fund is managed by the National Power Corporation (NPC) under existing arrangements and, under Section 34(d) of the Republic Act No. 9136, or the Electric Power Industry Reform Act (EPIRA), is pegged at Php0.0025 per kWh.

GENERATION CHARGE is the cost associated with Meralco's purchase of power, from its suppliers – the NPC, Independent Power Producers (IPPs) and the Wholesale Electricity Spot Market (WESM).

LIFELINE DISCOUNT/LIFELINE SUBSIDY is a socialized pricing mechanism under Section 73 of the EPIRA to benefit marginalized/low-income captive market customers. In Meralco's case, as approved by the ERC, residential customers using up to 100 kWh in a given month enjoy a Lifeline Discount to be applied to the total of the generation, transmission, system loss, distribution, supply and metering charges. The discount varies according to consumption and is funded by a Lifeline Subsidy Charge to be paid by all other customers.

LOCAL FRANCHISE TAX is levied by provinces and cities for businesses enjoying a franchise, and paid to such local government units, in accordance with the provisions of Sections 15 and 137 of the Local Government Code. This is a pass-through charge for Meralco paid and collected in accordance with BIR and ERC Regulations.

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

MISSIONARY ELECTRIFICATION CHARGE is a universal charge to fund the electrification of remote and unviable areas, as well as areas not connected to the transmission system, as mandated under Section 70 of the EPIRA.

SENIOR CITIZEN DISCOUNT/SENIOR CITIZEN SUBSIDY is a socialized pricing mechanism for senior citizens provided under Republic Act No. 8884 or the Expanded Senior Citizens Act of 2010. There are two Senior Citizens Discounts provided to end-users. The first provides

a maximum of 5% discount on the electricity bills of residential accounts registered under the name of a senior citizen which consume not more than 100 kWh a month. The second grants a 50% discount on the electricity bills of senior citizen institutions accredited by the Department of Social Welfare and Development (DSWD). The discounts are applied on the qualified customers' total generation, transmission, system loss, distribution, supply and metering charges amount, net of lifeline discount, and are funded through a subsidy to be paid by customers that are not availing of the Senior Citizen Discount or the Lifeline Discount.

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

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

TRANSMISSION CHARGE refers to the cost of delivery of electricity from generators, usually located in other provinces or in remote areas outside the distribution utility's franchise area, to the distribution system of Meralco. This is paid to the National Grid Corporation of the Philippines (NGCP), the transmission service provider.

UNIVERSAL CHARGE is a charge imposed on all electricity end-users as determined, fixed and approved by the ERC, pursuant to Section 34 of the EPIRA. It is remitted to the Power Sector Assets and Liabilities Management Corporation (PSALM), a government-owned and controlled corporation created by Republic Act No. 9136. At present, this includes the missionary electrification and environmental charges. Other possible components of the Universal Charge which are yet to be resolved by the ERC are: a) Stranded Debts and Stranded Contract Costs of the NPC, b) Stranded Contract Costs of Distribution Utilities, and c) Equalization of the taxes and royalties applied to indigenous or renewable sources of energy vis-a-vis imported fuels.

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

MERALCO'S TARIFF CATEGORIES

RESIDENTIAL AND GENERAL SERVICE A (RGSA) is the rate class applicable to residential customers for all domestic purposes such as lighting, heating, etc., in a single dwelling unit. This is also applicable to non-industrial and industrial customers with a connected load of less than five kilowatts.

GENERAL SERVICE B is the rate class applicable to non-residential customers with a connected load of five to less than 40 kilowatts.

GENERAL POWER (GP) is the rate class applicable to non-industrial and industrial customers with a minimum demand of 40 kilowatts for general power, heating and/or lighting.

GOVERNMENT HOSPITALS, METERED STREETLIGHTING SERVICE AND CHARITABLE INSTITUTIONS (GHMSCI) is the rate class applicable to government hospitals duly registered and certified by the Department of Health, metered streetlights, traffic lights, certain public parks under the National Park Development Committee and duly registered facilities of charitable institutions.

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

EMBEDDED GENERATORS WHEELING POWER TO NON-MERALCO CUSTOMERS AND/OR WESM is the rate class applicable to embedded generators connected to the distribution utility system with a minimum capacity of 40 kilowatts for wheeling of power to non-Meralco customers and/or selling to the WESM.

OTHER ELECTRICITY RATE TERMS

AUTOMATIC ADJUSTMENT OF GENERATION, TRANSMISSION AND SYSTEM LOSS CHARGES is an automatic recovery mechanism promulgated by the ERC that allows the monthly adjustment of Generation, Transmission and System Loss Charges to reflect the actual movement in generation and transmission costs and the losses per voltage level. This mechanism allows DUs to more timely recover the true cost of electricity, since changes in the generation and transmission costs are immediately reflected on customers' bills. The computation of generation, transmission and system loss charges is in accordance with the formulas prescribed in ERC Resolution No. 16, Series of 2009.

PERFORMANCE-BASED REGULATION (PBR) is an internationally accepted rate-setting methodology adopted by the ERC, pursuant to Section 43 (f) of the EPIRA to replace the Return-on-Rate Base (RORB) or Cost-Plus regulation. PBR is a forward-looking framework that aims to ensure that capital and operating expenditures are efficiently undertaken to provide timely, reliable, adequate and affordable power by the distribution utility to consumers in its franchise area. PBR entails the use of incentive mechanisms that reward or penalize the utility for exceeding or falling short of the prescribed performance standards.

REGULATORY ASSET BASE (RAB) consists of the assets employed by a regulated entity to provide efficient regulated distribution services, and upon which a utility is allowed to earn a rate of return based on a Weighted Average Cost of Capital (WACC). The RAB represents the appraised or roll-forward asset value of the utility's investment in facilities, equipment and other properties used and useful in the provision of electric service.

RETURN ON RATE BASE (RORB) is the ratio of operating income to the utility's rate base which is expressed as a percentage. Prior to the ERC's adoption of PBR, Meralco's unbundled tariffs were based on a RORB equivalent to its WACC for the year 2000, as determined by the ERC.

RULES FOR SETTING DISTRIBUTION WHEELING RATES (RDWR) is a price-cap variation of the Performance-Based Regulation as adopted by the ERC for private distribution utilities. This is an update of the Distribution Wheeling Rates Guidelines (DWRG) considering specific entry points among private distribution utilities. RDWR includes a reward and penalty mechanism called the Performance Incentive Scheme (PIS), which includes the following: a) a Price linked Incentive (S-factor) scheme which determines the rewards or penalties of DUs using a weighted performance measure, based on the performance levels achieved against a number of indices in the calendar year preceding each Regulatory Year. b) a Guaranteed Service Level (GSL) scheme which provides customers guarantees regarding responsiveness and effectiveness of DUs. If GSLs are not met, pre-determined penalties will be paid by distribution utilities directly to customers.

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

ELECTRIC INDUSTRY PARTICIPANTS refers to any person or entity engaged in the generation, transmission, distribution or supply of electricity.

DISTRIBUTION UTILITY (DU) refers to any electric cooperative, private corporation, government-owned utility or existing local government unit which has an exclusive franchise to operate a Distribution System in accordance with its franchise and the EPIRA.

ENERGY REGULATORY COMMISSION (ERC) is the independent, quasi-judicial regulatory body that was created pursuant to Section 38 of the EPIRA.

INDEPENDENT POWER PRODUCER (IPP) is an existing power-generating entity not owned by the NPC.

NATIONAL GRID CORPORATION OF THE PHILIPPINES (NGCP) is a privately-owned corporation which was awarded the concession to operate and maintain the Philippines' electricity transmission network. NGCP was granted a fifty-year franchise under Republic Act No. 9511. As the system operator of the power grid, NGCP balances the demand and supply of electricity to efficiently serve all of its customers which are generators, private distribution utilities, electric cooperatives, government-owned utilities, ecozones, industries and directly connected companies.

NATIONAL POWER CORPORATION (NPC) is the government-owned and controlled corporation created under Republic Act No. 6395, as amended.

NATIONAL TRANSMISSION CORPORATION (TransCo) is a government-owned and controlled corporation created under Section 8 of the EPIRA to which NPC transferred its transmission and sub-transmission facilities and assumed the authority and responsibility of NPC for the planning, construction and centralized operation and maintenance of its high voltage transmission facilities. Following the competitive public bidding in 2007, TransCo awarded the concession contract for the operation, maintenance, improvement and expansion of its transmission assets and the operation of any related business to the NGCP. Ownership of all transmission assets, however, remains with TransCo. As owner of the transmission assets, TransCo monitors NGCP's compliance with the terms and conditions of the Concession Agreement, divests remaining sub-transmission assets to qualified distribution utilities, and undertakes contractual consultancy and other technical services for the Philippine Economic Zone Authority.

PHILIPPINE ECONOMIC ZONE AUTHORITY (PEZA) is the Philippine government agency created under Republic Act No. 7916 tasked to promote investments, extend assistance, register, grant incentives and facilitate the business operations of investors in export-oriented manufacturing and service facilities inside selected areas throughout the country proclaimed as PEZA Special Economic Zones (ecozones).

PHILIPPINE ELECTRICITY MARKET CORPORATION (PEMC) is a non-stock and non-profit corporation constituted in November 2003 upon the initiative of the Department of Energy (DOE) with representatives from the various sectors of the electric power industry to be the governance arm of the WESM. The PEMC was likewise constituted as the autonomous group market operator (AGMO) to undertake the preparations for the establishment of the WESM and its initial operations during the interim period prior to the selection of the independent market operator (IMO). As AGMO, it acts as both the governance arm and market operator of the WESM. After the transition to the IMO, the PEMC will remain to be the governance arm of the WESM while its market operations functions will be transferred to the IMO.

POWER SECTOR ASSETS AND LIABILITIES MANAGEMENT CORPORATION (PSALM) is a government-owned and controlled corporation created under Section 49 of the EPIRA, which took ownership of all existing NPC generation assets, liabilities, IPP contracts, real estate and all other disposable assets.

PRIVATE ELECTRIC POWER OPERATORS ASSOCIATION, INC. (PEPOA) is an association of privately-owned electricity utilities franchised to operate an electric light and power distribution service in the urban areas outside of Metro Manila.

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

WHOLESALE ELECTRICITY SPOT MARKET (WESM) is the market where trading of electricity is made and was established by the DOE pursuant to Section 30 of the EPIRA.

OTHER ELECTRIC INDUSTRY TERMS

MAGNA CARTA FOR RESIDENTIAL ELECTRICITY CONSUMERS refers to the set of rules promulgated by the ERC which governs the rights and obligations of residential consumers.

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

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

TRANSITION SUPPLY CONTRACT (TSC) is a document, that contains the agreement between a generator and a distribution utility on the terms and conditions of the supply and purchase of energy including a corresponding schedule of applicable rates and consistent with Section 67 of the EPIRA.

TECHNICAL TERMS

AUTOMATIC LOAD DROPPING (ALD) is the process of automatically and deliberately removing pre-selected loads from a power system in response to an abnormal condition in order to maintain the integrity of the power system.

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

DISTRIBUTION SYSTEM refers to the system of wires and associated facilities of a franchised DU extending between: (a) the delivery points on the transmission or sub transmission system or generating plant connection and (b) the points of connection to the premises of end-users.

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

ELECTRIC POWER PLANT refers to facilities for producing electricity through electric power generation.

ENERGY is the integral of the active power with respect to time, measured in watt-hour or multiples thereof.

GIGAWATTHOUR (GWh) is the unit of electric energy equal to 1,000,000,000 watt-hours.

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

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

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

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

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

KILOWATTHOUR (kWh) is the unit of energy equal to 1,000 watt-hours.

LOAD is the entity or electrical equipment that consumes or draws electrical energy.

LOAD FACTOR is the ratio of the total energy delivered during a given period to the product of the maximum demand and the number of hours during the same period.

LUZON GRID is the high voltage backbone system of interconnected transmission lines, substations and related facilities located in the island of Luzon.

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

MANUAL LOAD DROPPING (MLD) is the process of manually and deliberately removing pre-selected Loads from a power system, in response to an abnormal condition, and in order to maintain the integrity of the power system.

POWER is the average of the instantaneous power over one period of the electrical wave, measured in watts or multiples thereof.

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

SYSTEM LOSS, in a distribution system, is the difference between the electric energy purchased and/or generated and the electric energy sold by the distributor. More specifically, it refers to technical and nontechnical losses occurring in a distribution system during the conveyance of electricity to end-users.

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

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

WATT is the amount of usable (effective) power delivered or consumed.

OTHERS

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

Investor Information

CORPORATE OFFICE

Lopez Building, Ortigas Avenue
Pasig City, Philippines 0300
Telephone Numbers: (632) 631-2222, (632) 16220

<http://www.meralco.com.ph>

TRANSFER AGENT

Securities Transfer Services, Inc.
Ground Floor, Benpres Building
Corner Exchange Road and Meralco Avenue
Pasig City, Philippines 1600
Telephone Numbers: (632) 490-0060, 1622-8881 to 82

Email: stsi@stsi.ph
stockholder.affairs.staff@meralco.com.ph
stockholder.affairs@meralco.com.ph

COMMON STOCK

The Company's common stock is listed in the Philippine Stock Exchange (Ticker symbol: MER). The declassification of the Company's common stock removed the Class "A" and Class "B" classification effective September 3, 2007. The declassification does not entail a recall, a cancellation or a replacement of certificates previously issued. All existing stock certificates, whether Class "A" or Class "B", will remain valid. Shares are available to foreign investors up to a maximum of 40 percent of the outstanding capital stock.

2011 MERALCO ANNUAL REPORT

Corporate Communications - Meralco
Concept and design: Studio 5 Designs, Inc.
Portraits and operations photography: Wig Tysmans, Albert Labrador

ACKNOWLEDGMENTS:

AIC Gold Tower Condominium
Ayala Triangle Gardens
Bank of the Philippine Islands
Megaworld Corporation



Totally Chlorine Free



Post-consumer
Recovered Fiber



9 Lives 55% Recycled Silk is a high quality 55% recycled paper with excellent environmental attributes. Its crisp white surface produces pin-sharp pictures and solid colors that stay bright. It is a perfect solution for companies who wish to demonstrate their environmental stance without compromising on quality.



MERALCO

Ortigas Avenue, Pasig City 0300 Philippines
Telephone Numbers (632) 631-2222 • (632) 16220
Fax Number (632) 632-8501 • (632) 1622-8501
www.meralco.com.ph