Coalescence

PEMC Corporate Report
January-December 2010

Philippine Electricity Market Corporation

President's Report

Melinda L. Ocampo
President

A year of renewed energy setting the stage for coalescing with power industry stakeholders towards further market development and power industry reforms.

2010 was an election year and, as with the rest of the country, PEMC welcomed a new leadership coming in with a fresh mandate and vision of a reformed power industry.

Addressing the members of the WESM and other industry participants during the Annual Meeting held on August 2010, the new Department of Energy Secretary and PEM Board Chairman, Jose Rene D. Almendras, introduced the new administration's Energy Reform Agenda (ERA). The agenda focused on the three-fold objectives to (1) Ensure energy security; (2) Achieve optimal pricing and (3) Develop sustainable energy plan. Realizing its crucial role in the achievement of the ERA objectives, PEMC incorporated in its 2010-2011 plans projects geared to support the DOE's goals.

PEMC ended 2010 with significant milestones such as the launching of the commercial operations of WESM in the Visayas. This lays the groundwork for PEMC to do its share towards the fulfillment of the industry reforms envisioned in the EPIRA.

Integration of the Visayas Grid to the WESM

DOE Sec. Jose Rene D. Almendras (far right) and PEMC Pres. Melinda L. Ocampo (center) with the PEMC Board of Directors at the Commercial Operations Launch of the WESM in the Visayas.

In what would be a fitting end to a year of renewed energy, the Department of Energy (DOE) declared integration of the Visayas grid to the WESM to commence on 26 December 2010. [1]

As with the well-attended formal launch event held on 16 December 2010 in Bacolod City, the integration of the Visayas was met with optimism by the participants, particularly in the Visayas. While the optimism may have been guarded in some, the commercial operations of the WESM is seen as a remarkable feat that promises great changes and sustained development for the WESM participants and the consumers. A significant milestone towards the realization for the Visayas of the reforms envisioned in the EPIRA, the WESM's operation in the region should lead to more efficient use of capacity, as well as provide the appropriate investment signals for more power generation capacity at the right time.

Preparations for the Visayas integration began after the start of the WESM in Luzon, although this was marked by uncertainties about the supply situation in the region and the level of preparedness of the Visayas participants. But with the great perseverance of the industry and of PEMC, commercial operations of the WESM in the Visayas effectively commenced on 26 December 2010.

Leading to the launch, PEMC spearheaded the conduct of a series of stakeholder meetings and consultations in the region to ensure that the market participants' interests with regard to market preparedness were taken into consideration and participants were kept fully informed of developments.

As part of the final preparations for the Visayas integration, PEMC implemented a full and integrated testing of all market systems and trial operations from 15 July 2010 until commencement date. The Trial Operations Program (TOP) in the Visayas served as a dry run and a thorough testing of the WESM Market Management System (MMS). The trials enabled participants to gain familiarity and experience in using the system and to enhance their knowledge of the market rules, protocols and procedures prior to the start of commercial operations. Moreover, the TOP was aimed at encouraging early involvement of the Trading Participants in the operation of the Visayas WESM.

Concurrently, PEMC continued the processing of applications for WESM registration as well as the training of trading participants. Furthermore, PEMC and the National Grid Corporation of the Philippines (NGCP), which serves as the System Operator as well as Metering Services, worked closely in establishing and attaining mutual milestones. It was vital that interfaces with the System Operator's Energy Management System (EMS) were effectively completed on time to enable the efficient operation of the spot market. Likewise, the WESM-compliant revenue metering facilities also needed to be put in place.

PEMC also initiated the amendment of existing market methodologies and protocols to adapt these to the conditions in the Visayas and to facilitate the transition to the integration of the grid to the WESM. In particular, PEMC introduced amendments to establish the rules and procedures for the regional application of the Price Substitution Methodology, the Administered Price Determination Methodology and the relevant criteria and procedures on declaration of pricing errors. These amendments were aimed at, among other things, ensuring smooth integration of the Visayas grid into the WESM.

[1] *DOE declared the commencement of the WESM in the Visayas through Department Circular Number DC 2010-11-0012 entitled "Declaring the Commercial Operation of the Wholesale Electricity Spot Market (WESM) in the Visayas Grid and its integration with the Luzon Grid."*

Strengthening of Market Governance

WESM Compliance Officers. In a move to strengthen the governance of the WESM, the DOE set out to institutionalize the WESM Compliance Officer (WCO). An amendment to the WESM Rules was introduced requiring all WESM Members, the Market Operator and the System Operator and other WESM service providers to designate a WESM Compliance Officer.

PEMC embarked on a campaign to encourage designation by WESM Members of their respective WCOs. To launch the projects and activities of the WESM for the WCOs, PEMC convened the appointed WCOs on 03 December 2010 for the 1st WESM Compliance Officers' General Assembly held at the PEMC Office in Ortigas Center, Pasig City. The event was likewise attended by representatives of the DOE and the Energy Regulatory Commission (ERC).

PEMC President Melinda L. Ocampo welcomed the attendees representing various WESM Members in Luzon and reminded the WCOs of their important role in fostering a culture of compliance in the WESM and building a foundation of strong governance for the WESM. In her welcome remarks, President Ocampo emphasized the need for partnership between the WCOs and PEMC in institutionalizing the compliance program in each of the respective WESM participants' organizations for a more competitive and transparent market.

Attendees to the General Assembly were given an introduction to the Philippine Electricity Market Corporation, particularly the relevant units and groups within PEMC, and the units' respective contributions in the governance and operations in WESM, as well as an overview of the roles of the Enforcement and Compliance Office (ECO), Market Assessment Group (MAG), Market Surveillance Committee (MSC) and other governance committees in governance and compliance in the WESM. WESM's Enforcement and Compliance Officer Ms. Sheila P. Ingco presented to the WCOs some practical suggestions on how to properly manage their respective organization's compliance to the WESM Rules. These, among other things, include elements of an efficient internal ethics and compliance program, as well as perspectives on how to become an effective and efficient WCO. The DOE Electricity Power Industry Management Bureau's Director Mylene C. Capongcol delivered an inspirational message accentuating the essential value of the WCOs as the industry's partners in WESM Governance. Director Capongcol expounded on the critical role the WCOs play in promoting a culture of compliance founded on a strong ethical base in the WESM and the entire power industry.

Participants to the General Assembly were each provided with a Compliance Kit containing useful materials to assist the WCOs in their function of managing compliance within their respective organizations.

PEMC is currently in the process of developing a program for the WCOs to encourage their greater individual involvement in the promotion of a culture of compliance in the WESM. WESM Trainings for WCOs are also scheduled for 2011.

Strengthening of WESM Membership

PEMC undertook efforts to enforce the requirement for mandatory registration of all entities connected to the grid, particularly those that have long been served through the Default Wholesale Supply (DWS) arrangement.

Enforcement of mandatory WESM registration became particularly important in view of the termination of the Default Wholesale Supply arrangement of the National Power Corporation (NPC) and the Power Sector Assets and Liabilities Management Corporation (PSALM). Instituted by the DOE in 2006 at the commencement of the WESM commercial operations in Luzon, the DWS was intended as an interim mechanism to facilitate transition and participation of the distribution utilities and bulk grid customers to the competitive trading environment of the WESM.

With the privatization of the generation assets of the NPC and the appointment of IPP Administrators by PSALM, the capacity to serve as DWS has significantly diminished. This prompted the termination by the DOE of the DWS arrangement pursuant to Department Circular No. DC2010-05-0006 entitled "Terminating the Default Wholesale Supplier Arrangement for the Philippine Wholesale Electricity Spot Market (WESM) and Declaring a Disconnection Policy."

In tandem with this, the DOE also issued the rules and procedures to implement the disconnection policy through the Department Circular DC2010-08-0010 entitled Prescribing the Implementing Rules and Procedures for Department Circular DC2010-05-0006 entitled "Terminating the Default Wholesale Supplier Arrangement for the Philippine Wholesale Electricity Spot Market (WESM) and Declaring a Disconnection Policy."

PEMC participated in the series of consultations conducted by the DOE for the formulation and dissemination of these policies. Consultations were held by the DOE in various venues in Luzon, Visayas and Mindanao, where PEMC contributed its efforts in addressing and resolving the various issues raised by the industry participants, particularly in respect to their participation in the WESM.

PEMC's efforts to strengthen membership in the WESM went beyond simply requiring compliance with the registration requirements. To prepare the industry participants for their participation in the WESM, PEMC continued to conduct training on the basic WESM concepts and processes. As of December 2010, PEMC completed 93 training sessions and has reached some 137 industry participants, both in Luzon and the Visayas.

Contributions to Market Development

Rules Changes Initiated by PEMC. PEMC has taken various initiatives to enhance existing pricing and settlement methodologies, including amendments intended to address the issues relating to the integration of the Visayas.

PEMC obtained provisional approval from the ERC of revisions to the Price Substitution Methodology (PSM Manual) and the Administered Price Determination Methodology (APDM). These revisions include the guidelines and procedures for regional application (i.e., Luzon or Visayas) of the PSM or the APDM where occurrences of network congestion or intervention occur in one region only. With regional application, the price adjustment mechanism is applied only in the region where the cause of adjustment occurs and the prices of the non-affected region are preserved. Thus, normal market prices are applied to the non-affected region even if the non-affected region imports from the affected region. Users pay for quantities imported at prices based on the reference node of the non-affected region.

To address the recurrence of pricing errors due to imposition of contingency limitations by the System Operator, PEMC proposed and obtained approval for an amendment to exclude the System Operator contingency list from among the conditions to be considered in the ex-post market runs. This is consistent with the WESM Rules, which require that the determination of the ex-post nodal energy prices take into consideration actual system conditions. The amendments were introduced on the WESM Manual on Procedure for Determining Ex-Post (RTX) Nodal Energy Prices and the WESM Dispatch Protocol.

To improve market transparency where participants are informed of market operator processes for declaration of pricing errors and conduct of market re-runs, PEMC formulated a new market manual, the WESM Manual on the Criteria and Guidelines for Issuance of Pricing Error Notice and Conduct of Market Re-Run (PEN Manual). The PEN Manual also introduced the guidelines for the regional application of rules on declaration of pricing errors and conduct of market re-run.

A related enhancement is the amendment to the PSM Manual to clarify the guidelines for determining substitute prices where there are simultaneous occurrence in one market run or one market trading interval of a pricing error due network congestion (which calls for price substitution under the PSM) and pricing error due to other causes.

To consolidate existing business processes on registration of market participants and related processes and to provide for guidelines and procedures for the implementation of the disconnection policy promulgated by the DOE, PEMC submitted to the Rules Change Committee the proposed WESM Manual on Registration, Suspension and De-Registration Criteria and Procedures.

Renewable Energy Market. PEMC was an active participant in current efforts towards the implementation of the National Renewable Energy Law. It is represented in the National Renewable Energy Board (NREB), the Technical Working Group and in the various NREB committees. As such, it has participated in all consultations and discussions conducted by the NREB and the DOE. As its contribution, the PEMC submitted a proposal on the methodology for the collection and disbursement of the Feed-in Tariff (FiT). Internally, a technical working group was created, composed of PEMC officers and staff, to formulate a conceptual design for the implementation of the RE registrar and the RE Market under the WESM, and to provide technical support to PEMC's participation in the implementation of the RE law.

Enhancement of Operational Efficiency

Wholesale Billing and Settlements System. PEMC developed the Wholesale Billing and Settlements System (WBSS), which is an infrastructure that will support the billing and settlements processes in the WESM. As the adage goes, necessity is the mother of invention. The in-house development of the WBSS was prompted by the limitations of the settlement module of the MMS, which has been rendered increasingly ineffectual with the changes in law, market rules and manuals, as well as new regulatory directives that have had an impact on the pricing and settlement methodologies in the WESM. These include changes in the value added tax regulations, the introduction of the Must-Run Unit compensation methodology, the Price Substitution Methodology and the new Rules on Distribution of the Net Settlement Surplus.

The WBSS is an integrated customized application for settlement and metering information management, calculation and data reporting that covers the core function of the WESM metering, settlement and billing process. It consists of modules on data management, metering and settlement calculations, issuance of billing information and a new interface for trading participants to declare Bilateral Contract Quantities (BCQ) and view metering and settlement results.

Development of the system was divided into two phases. The first phase was mainly for the core metering and settlement functionalities, while the second phase covers new regulatory compliances, such as the application of the Price Substitution Methodology, Net Settlement Surplus Allocation and compensation for Must-Run Units. Both phases were successfully completed in the last quarter of 2010. While still a work in progress, the WBSS should enable PEMC to achieve its goal of ensuring the timeliness in the issuance of and the accuracy of the WESM settlement statements. Further enhancements to the WBSS are in the pipeline and these include settlement calculation changes brought about by the implementation of the Regional Application of the Price Substitution Methodology and the Administered Price Determination Methodology, as well as new software requirements for prudential monitoring and accounts management.

Information Security Management System (ISMS). Information management is a key element of PEMC's performance as the Market Operator of the WESM. The PEMC initiated efforts to establish and implement an Information Security Management System to be certified as compliant to the ISO 27001:2005 standards. Leading PEMC's efforts is an ISMS Committee and ISMS Core Team created on 23 July 2010 from among the PEMC management and staff members. The Committee and the Core Team are in charge of overseeing the implementation and pre-certification audit activities of the ISMS.

Part of the ISMS implementation is to establish roles and responsibilities for information security. The ISMS Committee determined the need to augment the ISMS organization by appointing a Management Representative and creating two new teams – the ISMS Internal Auditor Team and the Document Controller Team. They shall perform significant roles to effectively attain the objectives of the Corporation to obtain an ISO27001:2005 certification and maintain compliance with its standards.

Information and Communications Technology (ICT) Change management processes. PEMC has defined and established the standards and guidelines for any ICT change management requirement through the PEMC IT Steering Committee. The committee, composed of PEMC management personnel, was created on 11 June 2010 to ensure that changes to ICT are organized, managed and implemented in a way that minimizes risk and impact to the WESM operations.

The ICT Change Management Process (ICMP) ensures that standardized methods and procedures are used for efficient handling of all changes. Through this process, the PEMC Management reviews and approves all change requests in relation to predetermined standards, plans or objectives in order to determine whether such proposals or concepts are in line with the company's overall business strategy.

Continued International Linkages

Association of Power Exchanges (APEx). *PEMC has been an APEx member since July 2007. The APEx is an international organization composed of electric power markets across the globe. It fosters free communication of ideas and practices geared towards information and experience-sharing among market operators essential to the growth and development of their respective markets. It holds two conferences for its members every year – the APEx Annual Conference, usually held around the third or fourth quarter; and the APEx Asia-Pacific Annual Conference, held sometime in the first quarter.*

PEMC actively participated in the conferences held in 2010 as it continues to maintain linkages with various market operators in other markets.

3rd Annual APEx Asia-Pacific Regional Meeting – Perth, Australia. The Independent Market Operator (IMO) of Western Australia hosted the 3rd Annual APEx Asia-Pacific Regional Meeting in Perth, Australia from 15-17 March 2010. Held annually, PEMC hosted last year's meeting, while the Energy Market Company Pte Ltd (EMC) of Singapore kicked off this now much-anticipated event in 2008. This year, delegates from the Australian Energy Market Operator (AEMO), Energy Market Authority (EMA) and EMC Singapore, Korea Power Exchange (KPX), New Zealand Exchange Limited (NZX), PEMC, Power Exchange India Limited (PXIL) and Transpower NZ Ltd New Zealand came together to learn from each other's experiences and new developments in the markets of the region.

APEx 2010 Conference – Dublin, Ireland. Delegates from PEMC participated in the APEx 2010 Conference hosted by the Single Electricity Market Operator (SEM-O) of Ireland in the City of Dublin, Republic of Ireland from 17-19 October 2010.

A wide variety of topics ranging from market trends and expansions to other geographic regions, return to cost-based pricing, coping with the El Niño phenomenon, integration of wind energy as a solution to the effects of climate change, inter-regional dispatching and pricing, effects and solutions to fuel supply problems, regulations, emerging markets, potential demand response, smart grids, smart meter and electric cars were presented and vigorously discussed over the three-day event that was opened with a gala night and made colorful by a side trip to the Guinness Beer Storehouse.

PEMC's Senen D. Fenemeno, Assistant Manager of the Corporate Planning and Communications Department, had his share of the limelight when he presented the plan of expanding the WESM market operation to the Visayas region.

22nd EISG Meeting in Cebu, Philippines

23rd Spring EISG Meeting in New Orleans, Louisiana, USA

22nd EISG Meeting – Cebu, Philippines. PEMC hosted the 22nd EISG Meeting which was held at Shangri-La's Mactan Island Resort & Spa in Cebu from 27-28 September 2010.

Pres. Melinda L. Ocampo welcomed the delegates from the other member countries. In attendance were representatives from the Alberta Market Surveillance Administrator (MSA), Australia Energy Regulator (AER), IMO Western Australia, Korea Power Exchange (KPX), New England ISO, Ontario Independent Electricity System Operator (IESO), Singapore Energy Market Company (EMC), Philippine Energy Regulatory Commission (ERC), and the Philippine Department of Energy (DOE). The Public Utility Commission of Texas (PUCT) and Southwest Power Pool (SPP) also attended via teleconference.

Aside from market updates about their respective jurisdictions, the participants also presented and discussed the implementation and monitoring of renewable energy trading, compliance procedures and information gathering powers, mitigating measures to address issues arising from the physical limitations of the grid and other case studies. Presentations on the Philippine electricity market and the offer behavior for the Alberta market were also discussed in detail.

Other member-organizations of the EISG are California Independent System Operator (CAISO), Electricity Commission of New Zealand (ECNZ), Japan Electric Power Exchange (JPX) and Midwest ISO (MISO).

23rd Spring EISG Meeting – New Orleans, Lousiana, USA. PEMC delegates attended the 23rd Spring EISG Meeting hosted by the Market Monitoring Unit of the Southwest Power Pool (SPP) in New Orleans, Louisiana, USA from 10-12 April 2011. Also in attendance were representatives of the AER, CAISO, Western Australia Economic Regulation Authority (ERA), Ontario IESO, Alberta MSA, Monitoring Analytics LLC (the independent market monitor for PJM), New York Independent System Operator (NYISO), New Zealand Electricity Authority, Potomac Economics, Public Utility Commission of Texas, Superintendencia de Servicios Publicos Domiciliarios of Colombia, the Philippine ERC, and the Philippine DOE.

The EISG meeting concluded with a visit to the Tulane Energy Institute's Trading Center in Tulane University. Equipped with state-of-the-art technologies, the Center offers a hands-on real-world trading experience.

Following the EISG meeting, the PEMC and DOE delegates held a coordination meeting with the SPP at their office in Little Rock, Arkansas on 14 April 2011 where various topics were discussed, including SPP's structure and organization, role of market monitoring and design and programs being undertaken for the implementation of SPP's new Integrated Marketplace, which is expected to be in place in March 2014. This new market design will introduce a Day-Ahead Market with Transmission Congestion Rights (TCR), a Reliability Unit Commitment process and a Real-Time Balancing Market .

Energy Intermarket Surveillance Group (EISG). *The EISG is an international organization of wholesale electricity market monitors, whose membership is restricted to member organizations or market monitors that have primary responsibility for surveillance of the efficiency and competitiveness of wholesale electricity markets, and that observe an independent and arm's-length relationship with market participants and the market and system operator. It is composed of 19 member organizations, including the Market Assessment Group (MAG) of PEMC, the Philippine Energy Regulatory Commission (ERC) and the Philippine Department of Energy (DOE), which became a member on 23 July 2010. PEMC has been an EISG member since March 2006.*

The EISG holds bi-annual meetings hosted by its various members. The meetings are a venue where member-organizations come together to discuss techniques and issues, among others, related to their responsibilities as independent market monitors of wholesale electricity markets.

Zigfred Nino C. Viray (left) and Victor Joel E. Francisco (right) with Dr. Toshikazu Ohkubo (IEEE-TENCON Power and Energy Chair) at the IEEE Technical Conference 2010 in Fukuoka, Japan

IEEE Technical Conference 2010 – Fukuoka, Japan. The Philippine WESM has joined the ranks of world-class electricity markets to be catalogued in the world's largest and highly cited publications, conferences and technology standards – the Institute of Electrical and Electronics Engineers (IEEE).

On November 2010, two PEMC engineers, Mr. Zigfred Niño C. Viray (Trading Operations Department) and Mr. Victor Joel E. Francisco (Corporate Planning and Communications Department) successfully presented their individual technical research papers at the IEEE Technical Conference (TENCON) held at the Fukuoka International Convention Center, Fukuoka City, Japan after undergoing peer-review by international academics and professionals who ensure that only original and innovative work are accepted and published.

Mr. Viray's research on "Integrated Energy and Reserved Electricity Market Analysis Using Probabilistic Optimal Power Flow" and Mr. Francisco's research on "Strategic Bidding and Scheduling in Reserve Co-optimized Based Electricity Spot Markets" are based on the Philippine WESM design. These technical papers, developed during their graduate studies at University of the Philippines-Diliman, implement a Security Constrained Economic Dispatch (SCED) based on the Market Dispatch Optimization Model (MDOM) design of the WESM Price Determination Methodology (PDM).

These technical research papers are now accessible to academics and professionals around the world at http://ieeexplore.ieee.org.

Integrated Energy and Reserve Electricity Market Analysis using Probabilistic Optimal Power Flow by Zigfred Niño C. Viray. *In this study, a probabilistic optimal power flow approach is used to analyze an energy and reserve co-optimized electricity market using the Philippine Wholesale Electricity Spot Market model. The probabilistic optimal power flow problem is solved using the Point Estimate Method, which is shown to be faster and more efficient than the traditional resource-heavy and time consuming Monte Carlo Simulation method. Simulation of test cases using various market set-ups are performed to evaluate the performance and accuracy of the Point Estimate Method as applied to the probabilistic optimal power flow problem. The resulting locational marginal prices, generator energy schedules, zonal reserve prices and generator reserve schedules are then compared with the results obtained using the Monte Carlo Simulation method. Analyses of the results show that the Point Estimate Method significantly reduces simulation time while maintaining accuracy.*

Strategic Bidding and Scheduling in Reserve Co-optimized Based Electricity Spot Markets by Victor Joel E. Francisco. *In electricity spot markets, revenue of independent power producers (IPPs) is dependent on successful bidding strategies. This research establishes a model for strategic bidding and short-term generation scheduling in reserve co-optimized markets like the Philippine Wholesale Electricity Spot Market. The model, which is applicable to independent power producers, is based on the combination of security constrained economic dispatch and a probabilistic bidding model. The security constrained economic dispatch models fundamental price drivers in the market, and takes into account transmission network parameters, marginal loss factors and reserve co-optimization to solve schedules and nodal prices for energy and reserve. The bidding model then determines optimum bid prices for each trading interval by maximizing the probability of a bid being cleared while at the same time capitalizing on positive returns from the market. A simulation tool is developed to implement the strategic bidding model where strategies are derived for various scenarios. The test system includes an independent power producer with corresponding energy and reserve offers for electricity market trading. Several bidding strategies derived from the model are then presented and discussed.*

Future Directions

For 2011, PEMC has chosen the theme "Coalescence" to signify the coming together of all the major players to work as one body to supply efficient, affordable and reliable electricity to influence the development and growth in the country. This coalescence of the power industry is made possible by the existence of the WESM, which serves as a venue – a melting pot – of generation, transmission and distribution. The harmonious relationships between these entities and governing bodies act as a guiding light, which drives the industry forward.

Retail Competition and Open Access. The final conditions for the declaration of open access and retail competition have been met, and the opening of the retail electricity supply market is already imminent. PEMC looks forward to expanded participation in the WESM, as well as to possibly playing a crucial role in the implementation and operations of the retail electricity market.

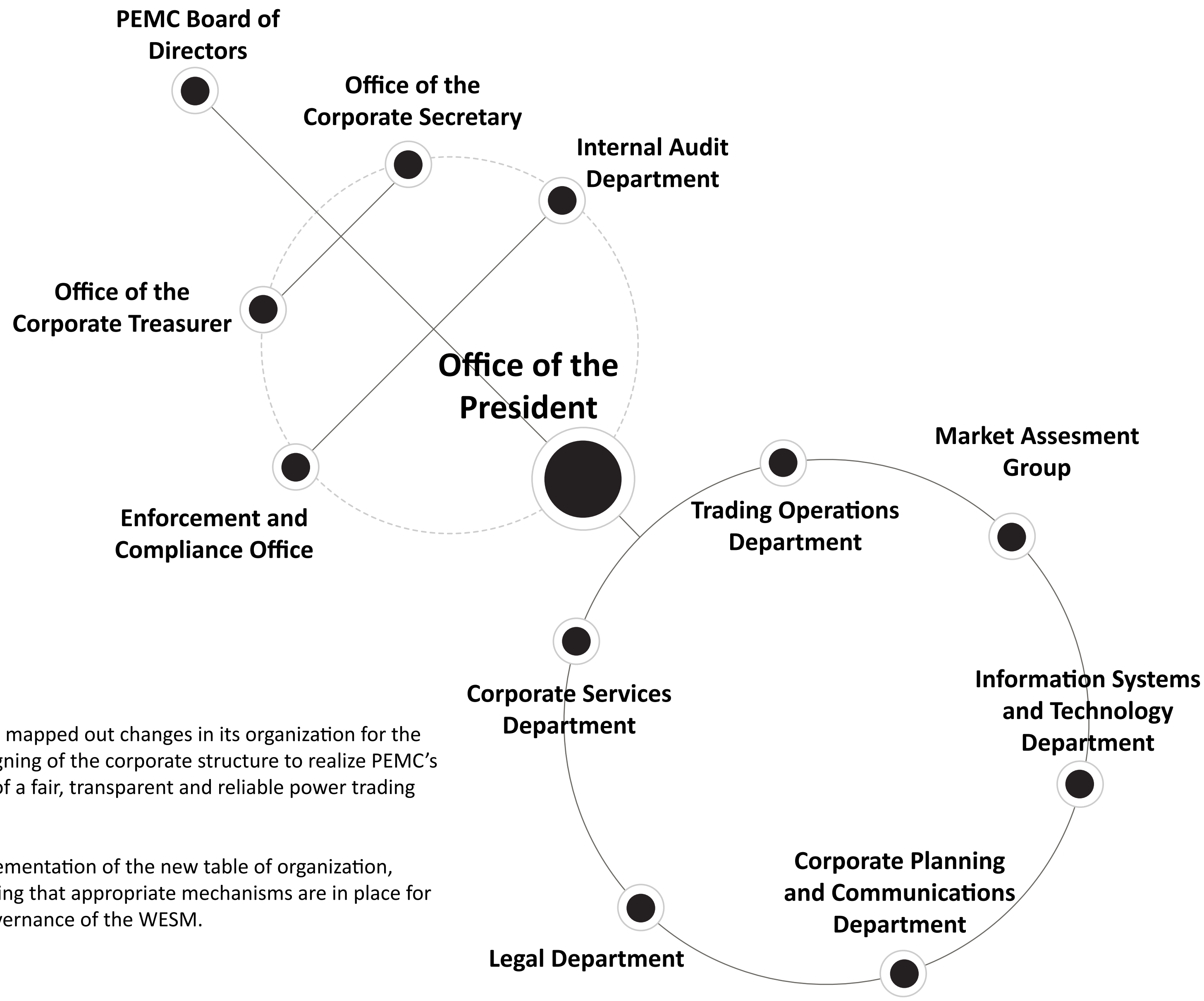
Renewable Energy Market. PEMC expects to again blaze a new trail as it works for the establishment of the Renewable Energy Market under the WESM through the auspices of the DOE.

Reserve Market. After having successfully launched the integration of the Visayas into the WESM, PEMC looks forward to expanding the operations of the spot market to include the trading of reserves. Tradable reserves include regulating, contingency and dispatchable reserves. In a recent announcement, the DOE has directed PEMC to commence trading of reserves by June 2012. Towards this end, PEMC is currently working on its compliance with the directives of the ERC in relation to the approval of the pricing and cost recovery methodology for trading of reserves.

Transition to Independent Market Operator. Eventual transfer of the market operator functions to an Independent Market Operator as required under the EPIRA is anticipated to occur in the near future.

Development of a New Market Management System. Hardware obsolescence and the need to integrate enhancements to address regulatory and rule changes and auditor recommendations prompted the approval by the PEM Board of the acquisition and development of a new Market Management System. The project is expected to commence once approval of the market fees to defray project cost is obtained.

Organization



In 2010, PEMC mapped out changes in its organization for the purpose of aligning of the corporate structure to realize PEMC's key objective of a fair, transparent and reliable power trading environment.

With the implementation of the new table of organization, PEMC is ensuring that appropriate mechanisms are in place for the proper governance of the WESM.

Executive Committee

From left to right: Maria Nerissa A. Cordoba, Claudette G. Ubaldo, Melinda L. Ocampo, Criselda S. Martin-Funelas, Sheila P. Ingco

From left to right: Chrysanthus S. Heruela, Medardo T. Nuñez, Carlito S. Claudio, Robinson P. Descanzo, Jesusito H. Sulit

Officers

Seated from left to right: Marissa P. Gandia, Caryl Miriam Y. Lopez, Claudette G. Ubaldo, Maria Nerissa A. Cordoba, Melinda L. Ocampo, Sheila P. Ingco, Criselda S. Martin-Funelas, Rachel Angela P. Anosan, Celina R. Encarnacion

Standing from left to right: Patrick S. Fernandez, Jesusito H. Sulit, Medardo T. Nuñez, Edwin N. Mosa, Isidro E. Cacho Jr., Carlito C. Claudio, Millan H. Libongco, Chrysanthus S. Heruela, Robinson P. Descanzo

Office of the President

Melinda L. Ocampo, President

The Office of the President is responsible for the execution and implementation of plans, programs, policies and procedures approved by the PEMC Board, and the overall management, operation and administration of PEMC and its integral units.

Office of the Corporate Secretary

Atty. Claudette G. Ubaldo, Corporate Secretary

The Office of the Corporate Secretary manages the preparation of all PEM Board and general membership meetings; including dissemination of notices and agenda as specified in the PEMC by-laws.

Enforcement and Compliance Office

Sheila P. Ingco, Vice President

The Enforcement and Compliance Office is responsible for the conduct of investigations of possible breaches of WESM Rules and WESM Manuals as directed by the PEM Board. It leads in fostering a culture of compliance in the WESM.

Internal Audit

Maria Nerissa A. Cordoba, Vice President

The Internal Audit Department is responsible for the audit of the company’s financial, operational and support functions and processes to ensure the adequacy of internal control systems, reliability and integrity of data, compliance with policies, safeguarding of assets, economical and efficient use of resources and implementation of resolutions and recommendations.

Legal

Atty. Criselda S. Martin-Funelas, Vice President

The Legal Department provides overall legal assistance to various PEMC internal business units and stakeholders.

Corporate Planning and Communications

Robinson P. Descanzo, Vice President

The Corporate Planning and Communications Department develops, manages and monitors the overall business and annual operational plans of the corporation, ensuring synergy across the corporation's performance measures and alignment of corporate goals and activities with regulatory compliance and government agency policies. It also manages the overall training and communications plan of PEMC.

Information Systems and Technology

Carlito C. Claudio, Vice President

The Information Systems and Technology Department is responsible for the development and management of the overall IS/IT business goals and objectives and determining the appropriate strategies both for MMS IS/IT Infrastructure-related operations and the corporate office.

Market Assessment

Chrysanthus S. Heruela, Vice President

The Market Assessment Group is responsible for the monitoring and assessment of performance of the WESM and the activities of the WESM participants, Market Operator and System Operator with the end view of ensuring the effective functioning and overall efficiency of the WESM. It also serves as the primary support unit of the various WESM governance committees – Market Surveillance, Technical, Dispute Resolution, PEM Audit and Rules Change Committee.

Corporate Services

Medardo T. Nuñez, Vice President

The Corporate Services Department is responsible for the development of policies. It provides administrative support and guidance, and implements programs at the corporate level in the areas of Finance, Human Resources and Administration and Billing and Settlement, ensuring consistency of implementation across the different units in the organization.

Office of the Corporate Treasurer

Medardo T. Nuñez, Corporate Treasurer

The Office of the Corporate Treasurer serves as the custodian of company funds and manages forecasting future needs for funding and seeking the best alternatives for obtaining it.

Trading Operations

Jesusito H. Sulit, Vice President

The Trading Operations Department manages, directs and coordinates real-time operation of the WESM 24 hours a day. It is responsible for the daily trading operations, development of market operating systems, procedures and business processes, market documentation, market report publication, participant and client support, market forecast and projections, dispatch scheduling and pricing, analysis of market outcome, facilitation of market re-run and interface with the system operator.

Digital Graphic Design Contest Winners

Seated from left to right: Orlando C. Ninon, Gladys Evette G. Nebab-Zamora, Ma. Victoria B. Que, Jocelyn Q. Sabile
Standing from left to right: Bienvenido C. Mendoza Jr., Pricillano Jesus G. dela Cruz Jr., Roel B. Calano
Not in photo: Resty S. Hong, Edward I. Olmedo, Claudette G. Ubaldo

Credits are due to Ms. Ma. Victoria B. Que from PEMC's Information Systems and Technology Department for the design and theme of this year's WESM Market Report and PEMC Corporate Report.

Vicky's entry entitled "Coalescence" won over several entries in PEMC's 2010 Digital Graphic Design Contest. This contest, which PEMC intends to hold annually, served as a venue and opportunity for the PEMC employees to contribute their ideas and display their artistic talents in coming up with a cover design for the PEMC and WESM annual reports and other collaterals. The contest aimed to promote employee awareness and involvement in company projects, like the publication of the annual report. It also allowed them to contribute not only on the technical matters of the organization, but also in the area of design and art.

PEMC also congratulates the finalists, whose works will be featured in the 2012 PEMC Calendar:

- "The Rebirth" by Roel B. Calano, Corporate Services Dept. – Billing and Settlement
- "Empowered" and "Illumination" by Pricillano Jesus G. de la Cruz Jr., Information Systems and Technology Dept.
- "Connecting People through the WESM Way" by Resty S. Hong, Information Systems and Technology Dept.
- "Drop of Light" by Bienvenido C. Mendoza Jr., Market Assessment Group
- "Making it Happen" and "One Grid, One Market" by Orlando C. Ninon, Information Systems and Technology Dept.
- "One WESM" by Gladys Evette G. Nebab-Zamora, Legal Dept.
- "Energy in Motion" by Edward I. Olmedo, Trading Operations Dept.
- "Dawn of the New Era" by Ma. Victoria B. Que, Information Systems and Technology Dept.
- "Ray of Light" by Jocelyn Q. Sabile, Market Assessment Group
- "Gearing Up" by Claudette G. Ubaldo, Office of the Corporate Secretary

Audited Financial Statements

Punongbayan & Araullo

Report of Independent Auditors

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The Board of Directors
Philippine Electricity Market Corporation
(A Nonstock, Nonprofit Corporation)
9th Floor, Robinsons Equitable Tower
ADB Avenue, Ortigas Center, Pasig City

Report on the Financial Statements

We have audited the accompanying financial statements of Philippine Electricity Market Corporation, which comprise the statement of financial position as at December 31, 2010, and the statement of comprehensive income, statement of changes in fund balance and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Punongbayan & Araullo

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Philippine Electricity Market Corporation as at December 31, 2010, and of its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

We have also reviewed the adjustments described in Note 18 that were applied to restate the 2009 and 2008 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

Other Matter

The financial statements of Philippine Electricity Market Corporation as of and for the years ended December 31, 2009 and 2008 were audited by other auditors whose report, dated March 25, 2010, expressed an unqualified opinion on those statements prior to restatement.

Punongbayan & Araullo

Report on Other Legal and Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information for the year ended December 31, 2010 required by the Bureau of Internal Revenue on taxes, duties and license fees disclosed in Note 23 to the financial statements is presented for purposes of additional analysis and is not a required part of the basic financial statements prepared in accordance with Philippine Financial Reporting Standards. Such supplementary information is the responsibility of management. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PUNONGBAYAN & ARAULLO

By: Benjamin P. Valdez
Partner

CPA Reg. No. 0028485
TIN 136-619-880
PTR No. 2641799, January 3, 2011, Makati City
Partner's SEC Accreditation No. 009-AR-2 (until Mar. 1, 2012)
BIR AN 08-002511-11-2008 (until Nov. 24, 2011)
Firm's BOA/PRC Cert. of Reg. No. 0002 (until Dec. 31, 2012)
Firm's SEC Accreditation No. 0002-FR-2 (until Feb. 1, 2012)

March 31, 2011

PHILIPPINE ELECTRICITY MARKET CORPORATION
(A Nonstock, Nonprofit Corporation)
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2010
(With Comparative Figures for 2009 and 2008)
(Amounts in Philippine Pesos)

	Notes	2010	2009 (As Restated - See Note 18)	2008 (As Restated - See Note 18)
A S S E T S				
CURRENT ASSETS				
Cash and cash equivalents	5	**P 722,737,512**	P 402,671,968	P 170,665,208
Funds held for WESM trading participants	6	**395,202,030**	260,107,232	2,425,150,709
Market fees and other receivables	7	**84,078,923**	128,527,717	91,753,546
Prepayments and other current assets	8	**19,207,124**	10,594,885	13,534,052
Total Current Assets		**1,221,225,589**	801,901,802	2,701,103,515
NON-CURRENT ASSETS				
Property and equipment - net	9	**53,151,940**	56,963,207	71,340,568
Intangible assets - net	10	**349,868,345**	346,701,741	415,857,786
Prepaid income taxes	19	**8,374,250**	8,374,250	3,311,126
Total Non-current Assets		**411,394,535**	412,039,198	490,509,480
TOTAL ASSETS		**P 1,632,620,124**	P 1,213,941,000	P 3,191,612,995
LIABILITIES AND FUND BALANCE (DEFICIENCY)				
CURRENT LIABILITIES				
Accounts and other payables	11	**P 64,799,604**	P 71,477,679	P 70,445,494
Interest-bearing loans and borrowings	12	**206,653,981**	120,531,453	107,955,550
Due to WESM trading participants	6	**395,202,030**	260,107,232	2,425,150,709
Total Current Liabilities		**666,655,615**	452,116,364	2,603,551,753
NON-CURRENT LIABILITIES				
Interest-bearing loans and borrowings	12	**728,557,962**	709,595,392	830,126,845
Retirement benefit obligation	15	**16,652,603**	41,308,849	27,766,600
Total Non-current Liabilities		**745,210,565**	750,904,241	857,893,445
Total Liabilities		**1,411,866,180**	1,203,020,605	3,461,445,198
FUND BALANCE (DEFICIENCY)	18	**220,753,944**	10,920,395	(269,832,203)
TOTAL LIABILITIES AND FUND BALANCE (DEFICIENCY)		**P 1,632,620,124**	P 1,213,941,000	P 3,191,612,995

See Notes to Financial Statements.

PHILIPPINE ELECTRICITY MARKET CORPORATION
(A Nonstock, Nonprofit Corporation)
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Comparative Figures for 2009)
(Amounts in Philippine Pesos)

	Notes	2010	2009 (As Restated - See Note 18)
REVENUES			
Market fees	13	**P 769,757,648**	P 740,660,035
Interest	5	**16,951,656**	7,629,441
Others	14	**10,721,535**	18,974,588
		797,430,839	767,264,064
EXPENSES			
Salaries and employee benefits	15	**207,080,649**	185,301,337
Depreciation and amortization	9, 10	**140,595,676**	115,931,736
Interest	12	**64,278,653**	35,214,317
Outside services		**41,497,678**	29,610,368
Rental	19	**23,490,521**	19,770,073
Honorarium and allowances		**23,284,000**	16,782,882
Repairs and maintenance		**21,391,087**	18,599,306
Utilities		**17,089,022**	18,106,229
Transportation and travel		**14,590,282**	15,518,023
Supplies		**9,241,012**	6,955,456
Miscellaneous	16	**25,058,710**	24,721,739
		587,597,290	486,511,466
EXCESS OF REVENUES OVER EXPENSES		**209,833,549**	280,752,598
OTHER COMPREHENSIVE INCOME		**-**	-
TOTAL COMPREHENSIVE INCOME		**P 209,833,549**	P 280,752,598

See Notes to Financial Statements.

PHILIPPINE ELECTRICITY MARKET CORPORATION
(A Nonstock, Nonprofit Corporation)
STATEMENT OF CHANGES IN FUND BALANCE
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Comparative Figures for 2009)
(Amounts in Philippine Pesos)

	Notes	2010	2009 (As Restated - See Note 18)
CONTRIBUTED CAPITAL	3	**P 10,000**	P 10,000
ACCUMULATED EXCESS (DEFICIENCY) OF REVENUES OVER (AGAINST) EXPENSES			
Balance at beginning of year, as restated	18	**10,910,395**	(269,842,203)
Excess of revenues over expenses during the year		**209,833,549**	280,752,598
Balance at end of year		**220,743,944**	10,910,395
TOTAL FUND BALANCE		**P 220,753,944**	P 10,920,395

See Notes to Financial Statements.

PHILIPPINE ELECTRICITY MARKET CORPORATION
(A Nonstock, Nonprofit Corporation)
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Comparative Figures for 2009)
(Amounts in Philippine Pesos)

	Notes	2010	2009 (As Restated - See Note 18)
CASH FLOWS FROM OPERATING ACTIVITIES			
Excess of revenues over expenses		P 209,833,549	P 280,752,598
Adjustments for:			
Depreciation and amortization	9, 10	140,595,676	115,931,736
Interest expense	12	64,278,653	35,214,317
Interest income	5	(16,951,656)	(7,629,441)
Noncash expenses included in interest-bearing loans and borrowings		5,505,593	-
Excess of revenues over expenses before working capital changes		403,261,815	424,269,210
Decrease (increase) in funds held for WESM trading participants		(135,094,798)	2,165,043,477
Decrease (increase) in market fees and other receivables		46,235,803	(36,371,399)
Decrease (increase) in prepayments and other current assets		(8,612,239)	2,939,167
Decrease (increase) in prepaid income taxes		-	(5,063,124)
Increase (decrease) in accounts and other payables		(5,354,191)	2,208,438
Increase (decrease) in due to WESM trading participants		135,094,798	(2,165,043,477)
Increase (decrease) in retirement benefit obligation		(24,656,246)	13,542,249
Net Cash From Operating Activities		410,874,942	401,524,541
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisitions of property and equipment - net	9	(31,264,742)	(21,469,604)
Interest received	5	15,164,647	7,226,669
Acquisitions of intangible asset	10	(2,331,422)	(10,928,726)
Net Cash Used in Investing Activities		(18,431,517)	(25,171,661)
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of interest-bearing loans and borrowings		(58,599,461)	(107,955,550)
Interest paid		(13,778,420)	(36,390,570)
Net Cash Used in Financing Activities		(72,377,881)	(144,346,120)
NET INCREASE IN CASH AND CASH EQUIVALENTS		320,065,544	232,006,760
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		402,671,968	170,665,208
CASH AND CASH EQUIVALENTS AT END OF YEAR		P 722,737,512	P 402,671,968

Supplemental Information on Noncash Operating, Investing and Financing Activities

1) In 2010, additional costs charged as part of intangible asset amounting to P106.4 million and as outright expenses amounting to P47.2 million were included as part of the Company's interest-bearing loans and borrowings (see Notes 10, 12 and 17). Outright expenses include professional fees and interest expense amounting to P5.5 million and P41.7 million, respectively.

2) Accrued interest income amounting to P2.2 million and P0.4 million were included in revenues for the years ended December 31, 2010 and 2009, respectively (see Note 7).

3) As of December 31, 2010, 2009 and 2008, accrued interest expense amounted to P1.5 million, P2.8 million and P4.0 million, respectively (see Note 11). Also, the interest related to the quarterly loan payments of the loan from Transco was not remitted (see Note 12).

See Notes to Financial Statements.

PHILIPPINE ELECTRICITY MARKET CORPORATION
(A Nonstock, Nonprofit Corporation)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2010
(With Comparative Figures for 2009 and 2008)
(Amounts in Philippine Pesos)

1. CORPORATE MATTERS

1.01 Incorporation and Operations

Philippine Electricity Market Corporation (the Company) is a nonstock, nonprofit corporation registered with the Philippine Securities and Exchange Commission on November 18, 2003. The Company's registered office, which is also its principal place of business, is located at the 9th Floor, Robinsons Equitable Tower, ADB Avenue, Ortigas Center, Pasig City.

The Company was created by the Department of Energy (DOE) as mandated by Section 30 of Republic Act (R.A.) No. 9136, the *Electric Power Industry Reform Act* or *EPIRA* (see Note 1.02) which directs the DOE to form a market operator which shall be an autonomous group and shall undertake the preparatory work and initial operation of the Wholesale Electricity Spot Market (WESM). The WESM is the market where trading of electricity is made. All the Company's costs of administering and operating the WESM is expected to be fully funded through the market fees collected from the WESM trading participants (see Note 13). Currently, the Company acts as the market operator and governing body of the WESM. It oversees the transaction billing and settlement procedures of the WESM in accordance with the WESM Rules (see Note 1.02). Transactions between the WESM trading participants are not reflected in the Company's financial statements because such transactions are those of the trading participants with the Company acting simply as a pass-through entity (see Note 2). However, cash received and held by the Company for the WESM trading participants are recorded as Funds Held for WESM Trading Participants with a corresponding credit to Due to WESM Trading Participants account in the Company's statement of financial position (see Note 6).

Pursuant to the DOE's Department Circular No. 2006-06-008 issued on June 21, 2006 in accordance with the EPIRA, WESM's commercial operations in Luzon were formally launched on June 26, 2006. In October 2005, the WESM Trial Operations Program (the Program) for the Visayas began while the final phase, the Live Dispatch Operations Program, officially began in February 2008. In the course of the Program, however, the DOE identified various issues pertaining to the operations of the WESM as well as certain gaps in the WESM Rules that needed to be addressed before commercial operations of the WESM extended to the Visayas grid. Trial operations were temporarily suspended in May 2009. Prior to integration of WESM Visayas to the Luzon Grid, Limited Live Dispatch Operation for WESM Visayas was again undertaken on September 20-29, 2010 and, finally, on December 26, 2010, the commercial operations of the WESM in the Visayas started (see also Note 22.04).

1.02 EPIRA

R.A. No. 9136, the EPIRA, which became effective in 2002, and the related Implementing Rules and Regulations provide for significant changes in the power sector, which include, among others:

i. the unbundling of the generation, transmission, distribution and supply and other disposable assets of Electric Power Industry Participant, including its contracts with independent power producers and electricity rates;

ii. creation of a WESM within one year; and,

iii. implementation of an open and nondiscriminatory access to transmission and distribution systems.

With respect to the creation of the WESM, the EPIRA mandated the DOE to formulate the rules that will govern the market (WESM Rules) jointly with the WESM trading participants and to create a market operator. In the implementation of this mandate, the WESM Rules were promulgated on June 28, 2002 and the Company was incorporated in November 2003 to act as the market operator as well as the governing body for the WESM.

1.03 Board of Directors and the Independent Market Operator

The powers and functions of the Company are exercised by its Board of Directors (BOD) whose members, currently, are the same individuals who sit as members of the Philippine Electricity Market Board or PEM Board. The sectors of the electric power industry are equitably represented in the PEM Board; i.e., the market operator, system operator, independent members and other WESM participants. The WESM trading participants include generation companies, distribution utilities (including electric cooperatives), bulk customers and suppliers or aggregators. The Company's primary purpose is to manage, govern and administer an efficient, competitive, transparent and reliable market for the wholesale and purchase of electricity and ancillary services in the Philippines in accordance with the EPIRA and the rules promulgated to govern the operation of the WESM, including their respective amendments and such other laws, rules and regulations which may be enacted hereafter that shall govern the WESM.

Section 30 of the EPIRA and Provision 10.2 of the WESM Rules mandate that the Company undertake the initial operations of the WESM, and one year from implementation of the WESM (the Interim Period), an Independent Market Operator (IMO) shall be formed and the functions, assets and liabilities of the Company shall be transferred to the IMO upon the joint endorsement of the DOE and the WESM trading participants. As of December 31, 2010, the IMO has not yet been formed or designated by the DOE and the WESM trading participants as there are still policy issues raised by the DOE that have to be addressed before transition to the IMO can be implemented. The DOE has engaged the services of consultants to study the possible structure and manner of selection or appointment of the IMO.

Consistent with the above provision of the EPIRA, the Company's by-laws provide for expiration of the Interim Period one year from commencement date of the WESM operations. As the IMO has not yet been formed, the PEM BOD remains as the Interim Board with its members appointed by the Secretary of the DOE, until such time that the IMO has been finally designated.

1.04 Approval of the Financial Statements

The financial statements of the Company as of and for the year ended December 31, 2010 (including the comparatives as restated for the years ended December 31, 2009 and 2008) were authorized for issue by the Company's President on March 31, 2011.

2. WESM TRADING OPERATIONS

As market operator of the WESM, the Company oversees the transaction billing and settlement procedures of the market in accordance with the WESM Rules. Under the WESM settlement process described in Section 3.14.6 and Section 3.14.7 of the WESM Rules, each WESM member shall pay to the market operator in cleared funds the settlement amount (if any) stated to be payable to the market operator as reflected in the WESM member's final statement, regardless whether the amount is disputed or not. The market operator shall then pay to each WESM member in cleared funds the settlement amount (if any) stated to be payable to that WESM member in the latter's final statement.

In accordance with Section 3.14.8.2 of the WESM Rules, disputes in respect of final statements or the supporting data shall be raised within 12 months of the relevant billing period.

2.01 Prudential Fund

The WESM prudential fund pertains to security deposits submitted by trading participants to secure payment of obligations upon due date. As prescribed in Section 3.15 of the WESM Rules, the Company shall assess a prudential security requirement from trading participants to ensure settlement of their obligations. The security shall amount to no less than the potential maximum liability that may be incurred by the participant in the market until such time that it is suspended from participation in the spot market. The Company will draw on the prudential security deposit if the settlement amount of the trading participant to the Company is not fully remitted within the timetable as set in Section 3.14 of the WESM Rules. In the event of a drawdown, the participant shall deliver a valid security of such amount as would bring its prudential security deposit back to the required level.

In 2008, majority of the newly registered WESM trading participants delivered Letters of Credit serving as their prudential security requirement. Subsequent to 2008, newly registered participants are required to maintain their prudential requirements with the Company.

2.02 Net Settlement Surplus

The WESM Rules define net settlement surplus (NSS) as that surplus remaining after all market transactions have been accounted for and is assumed to be attributable to economic rentals arising from other binding constraints. The NSS is the difference between the collections from the customers and payments to the generators. Under clause 3.13.16.2 of the WESM Rules, the NSS may be: (i) retained by the market operator to fund deficit settlement as a result of transactions required in clause 3.13.14 of the WESM Rules; (ii) flowed back to the trading participants in accordance with the procedures to be developed and approved by the PEM Board; and, (iii) used by the market operator to establish and support the market for Financial Transmission Rights subject to the approval of the PEM Board. Pursuant to the WESM Rules, the PEM Board approved the WESM Manual on Management of NSS which provides for the formula and procedures for the allocation and flowback of the NSS to the participants. As approved, the NSS is allocated to WESM customer participants on a monthly basis in proportion to their respective WESM trading amounts for each billing month. The Company, however, is allowed to retain 10% of the NSS generated to fund any settlement adjustments, if any. Any excess amount will likewise be returned to the participants together with the interest earned from the account.

On March 13, 2009, Energy Regulatory Commission (ERC) Resolution No. 06, Series of 2009 (the Resolution) regarding the rules for the Distribution of NSS was passed. The Resolution directed that the NSS allocation of each participant, less the allowable retention amount, shall be returned through automatic deduction from their WESM trading amounts. The Resolution also directed that the retention amount should be equivalent to 10% of the NSS for the previous three months. Based on Section 8.1 of the Resolution, should PEMC be unable to return the amount of the NSS due to be returned to WESM recipients and/or the interest incurred in the retained 10% during the specified period under the Rules, the retained amount will be imposed an interest at the rate of the prevailing 91-day T-bill rate plus 300 basis points. The rules under the Resolution shall be implemented in Luzon and will take effect 15 days following its publication in a newspaper of general circulation and will continue until otherwise directed by the ERC.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized in the succeeding sections. The policies have been consistently applied to all the years presented, unless otherwise stated.

3.01 Basis of Preparation of Financial Statements

(a) Statement of Compliance with Philippine Financial Reporting Standards

The financial statements of the Company have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are adopted by the Financial Reporting Standards Council (FRSC) from the pronouncements issued by the International Accounting Standards Board.

The financial statements have been prepared using the measurement bases specified by PFRS for each type of asset, liability, revenues and expense. The measurement bases are more fully described in the accounting policies that follow.

(b) *Presentation of Financial Statements*

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1 (Revised 2007), *Presentation of Financial Statements*. The Company presents all items of revenues and expenses in a single statement of comprehensive income. Two comparative periods are presented for the statement of financial position when the Company applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements, or reclassifies items in the financial statements. In 2010, the Company made a retrospective restatement of certain items in its financial statements as discussed in Note 18, hence, a third statement of financial position is presented.

(c) *Functional and Presentation Currency*

These financial statements are presented in Philippine pesos, the Company's functional and presentation currency, and all values represent absolute amounts except when otherwise indicated.

Items included in the financial statements of the Company are measured using its functional currency. Functional currency is the currency of the primary economic environment in which the Company operates.

3.02 Adoption of New Interpretations, Revisions and Amendments to PFRS

(a) *Effective in 2010 that are Relevant to the Company*

Among the amendments, revisions and interpretations to existing standards effective in 2010, only the *Improvements to PFRS 2009* are relevant to the Company. Most of these improvements became effective for annual periods beginning on or after July 1, 2009 or January 1, 2010 but only the following were identified to be applicable to the Company's financial statements:

- PAS 7 (Amendment), *Statement of Cash Flows*. The amendment clarifies that only an expenditure that results in a recognized asset can be classified as a cash flow from investing activities. Under its current policies, only recognized assets are classified by the Company as cash flow from investing activities.

- PAS 18 (Amendment), *Revenue*. The amendment provides guidance on determining whether an entity is acting as a principal or as an agent. Presently, the Company is the principal in all of its business undertakings although it is only responsible for the administration of the WESM.

Both improvements did not have any impact on the Company's financial statements.

(b) *Effective in 2010 that are not Relevant to the Company*

The following revisions, amendments and interpretations to published standards are mandatory for accounting periods beginning on or after January 1, 2010 but are not relevant to the Company's operations:

PAS 27 (Revised 2008)	:	Consolidated and Separate Financial Statements
PAS 39 (Amendment)	:	Financial Instruments: Recognition and Measurement – Eligible Hedged Items
PFRS 1 (Amendment)	:	Additional Exemptions for First-time Adopters
PFRS 2 (Amendment)	:	Share-based Payment
PFRS 3 (Revised 2008)	:	Business Combinations
Philippine Interpretations International Financial Reporting Interpretations Committee (IFRIC) 9	:	Embedded Derivatives – Amendments to IFRIC 9 and PAS 39
IFRIC 17	:	Distribution of Non-cash Assets to Owners
IFRIC 18	:	Transfers of Assets from Customers

(c) *Effective Subsequent to 2010*

There are new PFRS, revisions, amendments, annual improvements and interpretations to existing standards that are effective for periods subsequent to 2010. Management has initially determined the following pronouncements, which the Company will apply in accordance with their transitional provisions, to be relevant to its financial statements:

(i) PAS 24 (Revised), *Related Party Disclosures* (effective from January 1, 2011). Earlier application of the standard, in whole or in part, is permitted but the Company opted not to early adopt the standard. The revised standard clarifies and simplifies the definition of a related party and removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities. The Company is currently reviewing the impact of the standard on its related party disclosures in time for its adoption of the revised standard in 2011.

(ii) Philippine Interpretation IFRIC 14, *Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14* (effective from January 1, 2011). This interpretation addresses unintended consequences that can arise from the previous requirements when an entity prepays future contributions into a defined benefit pension plan. It sets out guidance on when an entity recognizes an asset in relation to a PAS 19, *Employee Benefits*, surplus for defined benefit plans that are subject to a minimum funding requirement. Management does not expect that its future adoption of the amendment will have a material effect on its financial statements because it does not usually make substantial advance contributions to its retirement fund.

(iii) PFRS 9, *Financial Instruments* (effective from January 1, 2013). PAS 39 will be replaced by PFRS 9 in its entirety which is being issued in phases. The main phases are (with a separate project dealing with derecognition):

- Phase 1: Classification and Measurement
- Phase 2: Impairment Methodology
- Phase 3: Hedge Accounting

To date, the chapters dealing with recognition, classification, measurement and derecognition of financial assets and liabilities have been issued. These chapters are effective for annual periods beginning January 1, 2013. Other chapters dealing with impairment methodology and hedge accounting are still being finalized.

Management is yet to assess the impact that this amendment is likely to have on the financial statements of the Company. However, it does not expect to implement the amendments until all chapters of PFRS 9 have been published at which time the Company expects it can comprehensively assess the impact of the revised standard.

(iv) 2010 Annual Improvements to PFRS. The FRSC has adopted the *Improvements to PFRS 2010* (the 2010 Improvements). Most of these amendments became effective for annual periods beginning on or after July 1, 2010, or January 1, 2011. The 2010 Improvements amend certain provisions of PFRS 3 (Revised 2008), clarify presentation of the reconciliation of each of the components of other comprehensive income and clarify certain disclosure requirements for financial instruments. The Company's preliminary assessments indicate that the 2010 Improvements, especially PFRS 3 which is not relevant to the Company, will not have a material impact on its financial statements.

3.03 Financial Assets

Financial assets are recognized when the Company becomes a party to the contractual terms of the financial instrument. Financial assets other than those designated and effective as hedging instruments are classified into the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired.

Regular purchases and sales of financial assets are recognized on their trade date. All financial assets that are not classified as at fair value through profit or loss are initially recognized at fair value plus any directly attributable transaction costs. Financial assets carried at fair value through profit or loss are initially recorded at fair value and transaction costs related to it are recognized in the statement of comprehensive income.

All of the Company's financial assets are currently categorized as loans and receivables. These are presented as Cash and Cash Equivalents, Funds Held for WESM Trading Participants, Market Fees and Other Receivables, and as part of Prepayments and Other Current Assets (only the item that pertains to the guaranty deposit included in the account) in the statement of financial position. Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods or services directly to a debtor with no intention of trading the receivables. They are included in current assets, except for maturities greater than 12 months after the reporting period which are classified as non-current assets.

Loans and receivables are subsequently measured at amortized cost using the effective interest method, less impairment loss, if any. Any change in their value is recognized in the statement of comprehensive income. Impairment loss is provided when there is objective evidence that the Company will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the impairment loss is determined as the difference between the assets' carrying amount and the present value of estimated cash flows.

All revenues and expenses, including impairment losses, relating to financial assets that are recognized in the statement of comprehensive income are presented as part of Interest Income and Interest Expense in the statement of comprehensive income.

Non-compounding interest and other cash flows resulting from holding financial assets are recognized in the statement of comprehensive income when earned, regardless of how the related carrying amount of financial assets is measured.

Derecognition of financial assets occurs when the rights to receive cash flows from the financial instruments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred.

3.04 Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and any impairment in value.

The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred.

Depreciation is computed on the straight-line basis over the estimated useful lives of the assets as follows:

Transportation equipment	5 years
Office equipment	3-5 years
System equipment	3-5 years
Furniture and fixtures	3 years

Leasehold improvements are amortized over five years regardless of the term of the lease (see Note 4.01).

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 3.11).

The residual values and estimated useful lives of property and equipment are reviewed, and adjusted if appropriate, at the end of each reporting period.

An item of property and equipment, including the related accumulated depreciation and any impairment losses, is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the statement of comprehensive income in the year the item is derecognized.

3.05 Intangible Assets

Intangible assets represent the Company's Market Management System (MMS) which is the enabler of the WESM. It is an infrastructure with various hardware, software and interfaces that is made up of several highly advanced applications for market interface, market application, settlement, accounting and metering that supports WESM's Day-ahead Market, Week-ahead Market Economic Dispatch for Real-time Market, Locational Marginal Pricing and Billings and Settlement (see Note 10).

The asset is accounted for under the cost model. The cost of the asset is the amount of cash or cash equivalents paid or the fair value of the other considerations given up to acquire or develop the MMS. It also includes borrowing costs incurred at the time of its development. Capitalized costs are amortized on a straight-line basis over eight years, the estimated useful life of the asset. It also is subject to impairment testing as described in Note 3.11.

3.06 Financial Liabilities

Financial liabilities of the Company include accounts and other payables [except the output value-added tax (VAT) component], interest-bearing loans and borrowings, and due to WESM trading participants. These are measured at amortized cost using the effective interest rate method.

Financial liabilities are recognized when the Company becomes a party to the contractual terms of the instrument. All finance-related charges are recognized as Interest under the caption Expenses in the statement of comprehensive income.

Accounts payables are initially recognized at their fair value and subsequently measured at amortized cost.

Interest-bearing loans and borrowings are raised for support of long-term funding of operations. They are recognized at proceeds received, net of direct issue costs.

Financial liabilities are derecognized from the statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration.

3.07 Provisions and Contingencies

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the end of the reporting period, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. When time value of money is material, long-term provisions are discounted to their present values using a pretax rate that reflects market assessments and the risks specific to the obligation. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the financial statements. Similarly, possible inflows of economic benefits to the Company that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the financial statements. On the other hand, any reimbursement that the Company can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset not exceeding the amount of the related provision.

3.08 Revenue and Expense Recognition

Revenue comprises revenue from the rendering of services measured by reference to the fair value of consideration received or receivable by the Company for services rendered, excluding VAT.

Revenue is recognized to the extent that it can be reliably measured; it is probable that the economic benefits will flow to the Company; and the costs incurred or to be incurred can be measured reliably. In addition, the following specific recognition criteria must also be met before revenue is recognized:

(a) *Market fees* – These include transaction fees and registration fees. Market transaction fees are recognized when services are rendered and are based on market fee filings as approved by the ERC. On the other hand, market registration fees consist of fixed and variable fees. Fixed market registration fees are recognized on a straight-line basis over the year and are based on rates approved by the ERC. Variable market registration fees are recognized when related services are rendered.

(b) *Interest income* – This is recognized as the interest accrues taking into account the effective yield on the asset.

Expenses are recognized in the statement of comprehensive income upon utilization of services or at the date they are incurred. All finance costs are reported in the statement of comprehensive income, except capitalized borrowing costs which are included as part of the cost of the related qualifying asset (see Note 3.13), on an accrual basis.

3.09 Leases – Company as Lessee

Leases which do not transfer to the Company substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as expense in the statement of comprehensive income on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

The Company determines whether an arrangement is, or contains, a lease based on the substance of the arrangement. It makes an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

3.10 Foreign Currency Transactions

The accounting records of the Company are maintained in Philippine pesos. Foreign currency transactions during the year are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates.

Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of comprehensive income.

3.11 Impairment of Non-financial Assets

The Company's property and equipment and intangible assets are subject to impairment testing. Intangible assets with an indefinite useful life or those not yet available for use are tested for impairment at least annually. All other individual assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). As a result, assets are tested for impairment either individually or at the cash-generating unit level.

Impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell, and value in use, based on an internal evaluation of discounted cash flow. Impairment loss is charged pro-rata to other assets in the cash-generating unit.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist and the carrying amount of the asset is adjusted to the recoverable amount resulting in the reversal of the impairment loss.

3.12 Employee Benefits

(a) Post-employment Benefits

Post-employment benefits are provided to employees through a defined benefit plan.

A defined benefit plan is a post-employment plan that defines an amount of post-employment benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of post-employment plan remains with the Company, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Company's post-employment defined benefit pension plan covers all regular full-time employees. The pension plan is tax-qualified, noncontributory and administered by a trustee.

The liability recognized in the statement of financial position for post-employment defined benefit pension plans is the present value of the defined benefit obligation (DBO) at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The DBO is calculated annually by independent actuaries using the projected unit credit method. The present value of the DBO is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related post-employment liability.

Actuarial gains and losses are not recognized unless the total unrecognized gain or loss exceeds 10% of the greater of the obligation and related plan assets. The amount exceeding this 10% corridor is recognized in the statement of comprehensive income over the employees' expected average remaining working lives. Actuarial gains and losses within the 10% corridor are disclosed separately. Past service costs are recognized immediately in the statement of comprehensive income, unless the changes to the post-employment plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight-line basis over the vesting period.

(b) Termination Benefits

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to either: (a) terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or (b) providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the reporting period are discounted to present value.

(c) Compensated Absences

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of the reporting period. They are included in Accounts and Other Payables account in the statement of financial position at the undiscounted amount that the Company expects to pay as a result of the unused entitlement.

3.13 Borrowing Costs

Borrowing costs are recognized as expense in the period in which they are incurred, except to the extent that they are capitalized. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e., an asset that takes a substantial period of time to get ready for its intended use or sale) are capitalized as part of cost of such asset. The capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization ceases when substantially all such activities are complete.

3.14 Related Party Transactions

Related party transactions are transfers of resources, services or obligations between the Company and its related parties, regardless of whether a price is charged.

Parties are considered to be related if one party has the ability to control the other party or if one party can exercise significant influence over the other party in making financial and operating decisions. These include: (a) individuals owning, directly or indirectly through one or more intermediaries, control or are controlled by, or under common control with the Company; (b) associates; and, (c) individuals owning, directly or indirectly, an interest in the voting power of the Company that gives them significant influence over the Company and close members of the family of any such individual.

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely on the legal form.

3.15 Fund Balance (Deficiency)

Fund balance or deficiency (as the case may be) includes the initial contributions made by the incorporators of the Company and the accumulated excess or deficiency of revenues over or against expenses from current and prior periods as reported in the statement of comprehensive income.

4. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The Company's financial statements prepared in accordance with PFRS require management to make judgments and estimates that affect amounts reported in the financial statements and related notes. Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may ultimately differ from these estimates.

4.01 Critical Management Judgments in Applying Accounting Policies

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

(a) Classification of the MMS

The MMS incorporates both intangible and tangible elements, and management has determined that the software component of the asset is more prominent than its hardware component. Accordingly, MMS is classified and presented as Intangible Assets in the statement of financial position.

(b) *Amortization of Intangible Assets*

In 2010, significant judgment was applied by management in deciding whether to amortize the cost of the MMS, which is presented as Intangible Assets in the statements of financial position, or not and whether such amortization should be retroactively or prospectively done. In prior years, the Company did not amortize the cost of the MMS because management believed that since the cost of the MMS is still provisional, the amortization should be deferred until such time the amount becomes final. Based on re-evaluation by management, it concluded that although the amount is provisional, this does not preclude management from recognizing amortization of the asset based on such provisional amount and that the treatment in prior years resulted in the absence of periodic amortization for the asset which amortization should have instead been recognized from the time the asset was used starting middle of 2006. Accordingly, in 2010, management made prior period adjustments to restate the accounts affected by the non-recognition of amortization of the MMS (see Note 18).

(c) *Recognition of Funds Held for WESM Trading Participants and Due to WESM Trading Participants*

As mentioned in Notes 6 and 18, the Company recognized the cash received and the related obligation (i.e., to remit such cash to the WESM trading participants) arising from transactions in the WESM of the WESM trading participants in its financial statements which were not previously recognized in prior years. Management believes that the Company's obligation to remit these collections to the WESM trading participants should be given accounting recognition. Accordingly, it restated its financial statements to recognize such funds held for the WESM trading participants and the obligation to remit the same.

(d) *Exemption from Income Taxation*

As discussed in Note 19.03, management took a position that the Company, being a nonstock, nonprofit corporation, is exempt from income tax and as such, pending approval by the Bureau of Internal Revenue (BIR) of its application for a tax ruling on its exemption from income tax, it did not recognize any income tax on the excess of its revenues over expenses. Any unfavorable outcome of the pending application for a tax ruling may result in a significant tax obligation. Management, however, believes that there is basis for a favorable ruling from the BIR.

(e) *Leasehold Improvements*

The Company's leasehold improvements are amortized over five years, which is the estimated useful life of the asset, regardless of the term of the lease because management believes that it is probable that the Company will maintain and continue to renew its lease of the building space where it holds offices and conducts its activities over a period of time that extend beyond five years. A decision by management not to renew its lease agreement will result in a significant amount of expense to be recognized in the statement of comprehensive income in the period such decision is made.

(f) Provisions and Contingencies

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition and disclosure of provision and disclosure of contingencies are discussed in Note 3.07 and relevant disclosure on present commitments and contingencies are presented in Note 19.

4.02 Key Sources of Estimation Uncertainty

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

(a) Useful Lives of Property and Equipment and Intangible Assets

The Company estimates the useful lives of property and equipment and intangible assets based on the period over which the assets are expected to be available for use. The estimated useful lives of property and equipment and intangible assets are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence or other limits on the use of the assets. The carrying amounts of property and equipment and intangible assets are analyzed in Notes 9 and 10, respectively. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above. There is no change in estimated useful lives of property and equipment or intangible assets during the year.

(b) Allowance for Impairment of Market Fees and Other Receivables

An allowance for impairment of market fees and other receivables is provided where objective evidence of impairment exists. The Company evaluates these accounts based on available facts and circumstances, including, but not limited to, the standing and length of membership of the trading participant in the WESM, the trading participant's current credit status, average age of accounts, collection experience and historical loss experience.

Based on management's assessment, no impairment losses on Market Fees and Other Receivables were recognized in 2010 and 2009.

(c) *Impairment of Non-financial Assets*

PFRS requires that an impairment review be performed when certain impairment indicators are present. The Company's policy on estimating the impairment of non-financial assets is discussed in detail in Note 3.11. Though management believes that the assumptions used in the estimation of fair values reflected in the financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

There are no impairment losses recognized on the Company's non-financial assets in 2010 and 2009.

(d) *Post-employment Benefit*

The determination of the Company's obligation and cost of post-employment benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 15.02 and include, among others, discount rates, expected rate of return on plan assets and salary increase rate. In accordance with PFRS, actual results that differ from the assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods.

The retirement benefit obligation amounted to P16.7 million, P41.3 million and P27.8 million as of December 31, 2010, 2009 and 2008, respectively. Also, the unrecognized actuarial losses amounted to P18.8 million in 2010 and unrecognized actuarial gains amounted to P11.3 million in 2009 and P16.5 million in 2008 (see Note 15.02).

5. CASH AND CASH EQUIVALENTS

Details of the Cash and Cash Equivalents account follow:

	2010	2009	2008
Cash on hand and in banks	**P 9,379,996**	P 21,321,090	P 47,235,037
Short-term placements	**713,357,516**	381,350,878	123,430,171
	P 722,737,512	P 402,671,968	P 170,665,208

Cash in banks generally earn interest at rates based on daily bank deposit rates. Short-term placements are made for varying periods of up to three months and earn effective interest ranging from 3.50% to 4.50% in 2010, 2.25% to 5.25% in 2009 and 3.00 % to 6.00% in 2008.

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6. FUNDS HELD FOR WESM TRADING PARTICIPANTS

This account pertains to cash collected by the Company from the market settlements in the WESM which are effectively, being held for the WESM trading participants and subsequently remitted to whom these are due within two to three months from the date of market settlements, except for appropriate retentions and prudential security deposits. These funds are deposited in bank accounts in the name of the Company and whose signatories are officers of the Company. Accordingly, the Company recognized the corresponding asset and the obligation to the WESM participants to whom these are due. The related obligation is presented as Due to WESM Trading Participants in the statements of financial position.

As discussed in Note 1, the WESM started its operations in June 2006 and since then, the NSS started to accumulate. However, the rules on the distribution of the NSS were set only on March 13 2009, under ERC Resolution No. 06, Series of 2009. As a result, the Company only started in 2009 the distribution of the accumulated amount of NSS in prior years. As of December 31, 2010, 2009 and 2008, NSS amounting to P95.9 million, P164.7 million and P2,132.4 million, respectively, are presented as part of Due to WESM Trading Participants. Also, prudential security deposits amounting to P142.8 million, P53.7 million and P12.7 million are presented as part of this account as of those dates.

Funds Held for WESM Trading Participants account also includes the related interest income from banks where the cash are deposited. The intent is also subsequently remitted to the WESM trading participants. As such, the interest income is likewise recorded as Due to WESM Trading Participants and does not flow through the Company's results of operations.

In prior years, funds held for WESM trading participants and the corresponding obligation have not been recognized by the Company in its financial statements
(see Notes 4.01 and 18).

7. MARKET FEES AND OTHER RECEIVABLES

This account is composed of the following receivables:

	Note	**2010**	2009	2008
Market fees	17.01	**P 79,345,449**	P 125,723,376	P 90,926,819
Interest		**2,189,781**	402,772	-
Others		**2,543,693**	2,401,569	826,727
		P 84,078,923	P 128,527,717	P 91,753,546

Market fees receivables pertain to the amounts due to the Company from the imposition of market fees on the generation companies (see Note 13). As provided under Section 3.14.6 of the WESM Rules, these market fees receivables are noninterest-bearing and generally have 30-day terms.

All of the Company's market fees and other receivables have been reviewed for indications of impairment. These accounts are deemed to be fully collectible, hence, no allowance for impairment was provided by the Company.

8. PREPAYMENTS AND OTHER CURRENT ASSETS

This account consists of the following as of December 31:

	2010	2009	2008
Guaranty deposits	**P 6,168,166**	P 4,552,480	P 3,808,197
Prepaid rent	**4,068,673**	3,043,420	3,209,419
Expanded withholding tax receivable	**2,734,096**	-	-
Withholding VAT	**2,599,772**	-	-
Prepaid maintenance	**1,773,968**	1,341,063	603,208
Prepaid insurance	**1,167,704**	902,392	1,117,728
Input VAT – net	**-**	-	4,270,903
Others	**694,745**	755,530	524,597
	P 19,207,124	P 10,594,885	P 13,534,052

Guaranty deposits and prepaid rent are related to various cancelable and non-cancelable operating leases entered into by the Company for its offices.

9. PROPERTY AND EQUIPMENT

The gross carrying amounts and the accumulated depreciation and amortization of property and equipment at the beginning and end of 2010, 2009 and 2008, are shown below.

	Office Equipment	System Equipment	Leasehold Improvements	Transportation Equipment	Furniture and Fixtures	Total
December 31, 2010						
Cost	P 86,741,513	P 50,888,986	P 48,901,925	P 14,976,105	P 11,328,300	P 212,836,829
Accumulated depreciation and amortization	(72,140,122)	(25,838,554)	(41,956,012)	(8,794,004)	(10,956,197)	(159,684,889)
Net carrying amount	**P 14,601,391**	**P 25,050,432**	**P 6,945,913**	**P 6,182,101**	**P 372,103**	**P 53,151,940**
December 31, 2009						
Cost	P 81,715,76	P 32,425,167	P 45,350,880	P 10,984,142	P 11,173,122	P 181,649,071
Accumulated depreciation and amortization	(59,259,314)	(13,755,600)	(35,024,348)	(6,624,915)	(10,021,687)	(124,685,864)
Net carrying amount	P 22,456,446	P 18,669,567	P 10,326,532	P 4,359,227	P 1,151,435	P 56,963,207
December 31, 2008						
Cost	P 66,578,290	P 27,660,065	P 45,350,880	P 9,644,856	P 10,978,102	P 160,212,193
Accumulated depreciation and amortization	(45,941,795)	(4,187,936)	(25,951,688)	(4,626,492)	(8,163,714)	(88,871,625)
Net carrying amount	P 20,636,495	P 23,472,129	P 19,399,192	P 5,018,364	P 2,814,388	P 71,340,568
January 1, 2008						
Cost	P 74,337,890	P -	P 45,268,737	P 8,618,070	P 10,613,397	P 138,838,094
Accumulated depreciation and amortization	(35,542,614)	(-)	(16,884,250)	(2,731,926)	(4,612,108)	(59,770,898)
Net carrying amount	P 38,795,276	P -	P 28,384,487	P 5,886,144	P 6,001,289	P 79,067,196

Fully depreciated property and equipment with total cost of P88.9 million are still being used as of December 31, 2010 and have not yet been derecognized.

A reconciliation of the carrying amounts of property and equipment at the beginning and end of 2010, 2009 and 2008 is shown below.

	Office Equipment	System Equipment	Leasehold Improvements	Transportation Equipment	Furniture and Fixtures	Total
Balance at January 1, 2010, net of accumulated depreciation and amortization	P 22,456,446	P 18,669,567	P 10,326,532	P 4,359,227	P 1,151,435	P 56,963,207
Additions	5,112,360	18,463,819	3,551,045	3,991,963	155,178	31,274,365
Disposals	(9,623)	-	-	-	-	(9,623)
Depreciation and amortization charges for the year	(12,957,792)	(12,082,954)	(6,931,664)	(2,169,089)	(934,510)	(35,076,009)
Balance at December 31, 2010, net of accumulated depreciation and amortization	**P 14,061,391**	**P 25,050,432**	**P 6,945,913**	**P 6,182,101**	**P 372,103**	**P 53,151,940**
Balance at January 1, 2009, net of accumulated depreciation and amortization	P 20,636,495	P 23,472,129	P 19,399,192	P 5,018,364	P 2,814,388	P 71,340,568
Additions	15,137,470	4,765,102	-	1,339,286	292,922	21,534,780
Disposals	-	-	-	-	(65,176)	(65,176)
Depreciation and amortization charges for the year	(13,317,519)	(9,567,664)	(9,072,660)	(1,998,423)	(1,890,699)	(35,846,965)
Balance at December 31, 2009, net of accumulated depreciation and amortization	P 22,456,446	P 18,669,567	P 10,326,532	P 4,359,227	P 1,151,435	P 56,963,207
Balance at January 1, 2008, net of accumulated depreciation and amortization	P 38,795,276	P -	P 28,384,487	P 5,886,144	P 6,001,289	P 79,067,196
Additions/reclassification	(5,202,694)	28,508,603	82,143	1,026,786	364,705	24,779,543
Disposals	(47,123)	-	-	-	-	(47,123)
Depreciation and amortization charges for the year	(12,908,964)	(5,036,474)	(9,067,438)	(1,894,566)	(3,551,606)	(32,459,048)
Balance at December 31, 2008, net of accumulated depreciation and amortization	P 20,636,495	P 23,472,129	P 19,399,192	P 5,018,364	P 2,814,388	P 71,340,568

None of these assets are used as collateral for any of the Company's borrowings.

10. INTANGIBLE ASSETS

The gross carrying amounts and accumulated amortization and impairment at the beginning and end of 2010, 2009 and 2008 are shown below.

	Market Management System	Other System Software	Total
December 31, 2010			
Cost	P 681,264,498	P 37,183,708	P 718,448,206
Accumulated amortization	(347,021,088)	(21,558,773)	(368,579,861)
Net carrying amount	**P 334,243,410**	**P 15,624,935**	**P 349,868,345**

		Market Management System		Other System Software		Total
December 31, 2009						
Cost	P	574,909,649	P	34,852,286	P	609,761,935
Accumulated amortization		(251,522,971)		(11,537,223)		(263,060,194)
Net carrying amount	P	323,386,678	P	23,315,063	P	346,701,741
December 31, 2008						
Cost	P	574,909,649	P	23,923,560	P	598,833,209
Accumulated amortization		(179,659,265)		(3,316,158)		(182,975,423)
Net carrying amount	P	395,250,384	P	20,607,402	P	415,857,786
January 1, 2008						
Cost	P	574,909,649	P	-	P	574,909,649
Accumulated amortization		(107,795,559)		-		(107,795,559)
Net carrying amount	P	467,114,090	P	-	P	467,114,090

A reconciliation of the carrying amounts at the beginning and end of 2010, 2009 and 2008 is shown below.

		Market Management System		Other System Software		Total
Balance at January 1, 2010, net of accumulated amortization	P	323,386,678	P	23,315,063	P	346,701,741
Additions		106,354,849		2,331,422		108,686,271
Amortization charges for the year		(95,498,117)		(10,021,550)		(105,519,667)
Balance at December 31, 2010, net of accumulated amortization	**P**	**334,243,410**	**P**	**15,624,935**	**P**	**349,868,345**
Balance at January 1, 2009, net of accumulated amortization	P	395,250,384	P	20,607,402	P	415,857,786
Additions		-		10,928,726		10,928,726
Amortization charges for the year		(71,863,706)		(8,221,065)		(80,084,771)
Balance at December 31, 2009, net of accumulated amortization	P	323,386,678	P	23,315,063	P	346,701,741

		Market Management System		Other System Software		Total
Balance at January 1, 2008, net of accumulated amortization	P	467,114,090	P	-	P	467,114,090
Additions		-		23,923,560		23,923,560
Amortization charges for the year	(	71,863,706)	(	3,316,158)	(	75,179,864)
Balance at December 31, 2008, net of accumulated amortization	P	395,250,384	P	20,607,402	P	415,857,786

As mentioned in Notes 4.01 and 18, the Company did not amortize the cost of the MMS in prior years because the cost of the MMS is still provisional. In 2010, as a result of the management's re-evaluation as discussed in Note 4.01, the Company recognized the amortization of the MMS retrospective to July 2006 when the MMS was initially put into use.

Also, in 2010, the Power Sector Assets and Liabilities Management Corporation (PSALM) and the Company have reconciled and agreed in principle on the final amount of loan that is due to PSALM based on PSALM's letter to the Company in October 2010 (see Note 12.02). The reconciliation resulted in the recognition of additional loan and cost of the MMS amounting to P153.6 million and P106.4 million, respectively. The difference between the amount of additional loan and the additional cost of the MMS represents non-capitalizable professional fees and borrowing costs, hence, expensed outright. The additional cost in 2010 is amortized over the remaining useful life of the asset.

No impairment losses were recognized in 2010 and 2009 as the estimated recoverable amounts of the intangible assets are higher than their carrying values.

The MMS or its components are not used as collateral for any of the Company's borrowings.

11. ACCOUNTS AND OTHER PAYABLES

This account consists of:

	2010	2009	2008
Account payables	**P 19,346,829**	P 24,050,528	P 42,686,820
Accrued expenses	**19,906,367**	16,431,652	14,878,107
Withholding taxes payable	**15,426,056**	13,899,511	8,546,272
Output VAT payable – net	**8,240,124**	13,902,196	-
Interest payable	**1,490,043**	2,813,926	3,990,180
Others	**390,185**	379,866	344,115
	P 64,799,604	P 71,477,679	P 70,445,494

Significant part of the accrued expenses includes obligations to the Company's employees such as accrued bonuses and sick leaves, which are expected to be settled within 12 months after the reporting period.

The carrying amounts of trade and other payables, which are expected to be paid within the next 12 months from the reporting period, are a reasonable approximation of their fair values.

12. INTEREST-BEARING LOANS AND BORROWINGS

The short-term and long-term interest-bearing loans and borrowings, which represent loans from National Transmission Company (Transco) and PSALM, follow:

	2010	2009	2008
Current –			
Loan from Transco	**P 206,653,981**	P 120,531,453	P 107,955,550
Non-current:			
Loan from PSALM	**728,557,962**	574,909,649	574,909,649
Loan from Transco	**-**	134,685,743	255,217,196
	728,557,962	709,595,392	830,126,845
	P 935,211,943	P 830,126,845	P 938,082,395

12.01 Loan from Transco

Pursuant to the Operating Agreement (OPA) dated May 5, 2004 between Transco, DOE and the Company, Transco shall provide for the initial operational and capital expenditures of the Company prior to the collection of market fees. To ensure the recovery by Transco of its capital and operating expenditures, Transco and the Company formulated on October 22, 2004 a recovery mechanism.

Based on the recovery mechanism, the Company shall deliver to Transco a schedule of quarterly drawdown, indicating the amount of each availment and intended drawdown date. Each drawdown shall be evidenced by a promissory note issued by the Company, dated as at the drawdown date, and payable to Transco in the amount of such drawdown. The aggregate amount indicated in the promissory notes, or any portion thereof still unpaid and outstanding shall earn 12% interest per annum, compounded and capitalized annually. The principal amount and interest accruing thereon shall be amortized and paid quarterly over a five-year period starting three months from the date of collection of market fees from WESM trading participants.

In 2004 and 2005, the Company made six drawdowns totalling P422.4 million plus compounded interest amounting to P85.6 million which formed part of the principal as of the first amortization payment. Also during those years, Transco provided property and equipment for the Company's operations with carrying amount of P38.8 million at the time of transfer which was included as part of the loan (see Note 17.03). Based on the agreement between Transco and the Company, quarterly amortization amounted to P36.1 million. On November 25, 2006, the Company began collecting market fees from the WESM trading participants for the portion attributable to the repayment of the loan from Transco. Consequently, the first quarterly amortization was made in February 2007. The loan is expected to be fully settled in November 2011.

In September 2010, the Municipality of Labrador, Pangasinan (the Municipality) through the Municipal Treasurer issued a warrant of distraint ordering the Company to seize the loan repayment to Transco and, instead, deliver the amortization payments to the Municipality. The Company did not deliver the payment because of certain issues raised; however, it stopped the quarterly principal loan payment to Transco for August and November 2010 totalling P30.5 million and related interest of P10.0 million, net of withholding taxes, which were included in the balance of the loan as of December 31, 2010 (see Note 19.02).

12.02 Loan Payable to PSALM

The National Power Corporation (NPC) entered into loan agreements with the Asian Development Bank (ADB) and Japan Bank of International Cooperation for the purpose of securing financing for developments in the Philippine Power Industry.

Among the undertakings financed out of the loan proceeds is the cost of the MMS development for the WESM. Transco was the designated project executing agency for the development of the MMS and the Company was assigned as the project administrator.

On March 17, 2004, Transco, for the development of the MMS, entered into a "Contract for the Turnkey Implementation of the MMS" with ABB Inc. Network Management Unit and a "Contract for the Project Management Consultant" for the WESM with the Marketplace Company PTY Limited. The MMS was physically transferred to the Company and installed at its office during the development stage in December 2004 and was completed in June 2006.

Under the OPA dated May 5, 2004 entered into between the Company, Transco and the DOE, capital expenditures from the operation of the WESM shall be recovered from the market fees. The Memorandum of Agreement (MOA) between Transco and the Company dated October 22, 2004 covered the recovery mechanism for advances by Transco to the Company for the operations of the WESM but it did not include the cost and recovery for the MMS. In view of these conditions, as of December 31, 2006, the Company did not recognize the cost of the MMS in its accounts.

Without due resolution on the identity of the contracting party (i.e., whether NPC, Transco in whose accounting books the MMS is still recorded as of the date of the request, or PSALM), PSALM has requested payment of the MMS through the demand letters dated February 20, 2008 and May 30, 2008. During a meeting held on April 24, 2008 among PSALM, NPC, Transco and the Company, the parties agreed that PSALM will provide the documents supporting the amount being claimed by June 30, 2008 to enable the Company to include this cost in its application with the ERC for the 2009 market fees.

In its request on August 6, 2008, PSALM estimated the amount due from the Company to be P697.4 million, payable yearly for a period of five years. Aside from the loan drawdowns and project management costs, the amount being claimed by PSALM included accumulated financing costs and other transaction costs incurred from 2004 to 2008.

The MMS cost recovery and loan repayment was included in the market fees application filed with the ERC on September 11, 2008, with the intention that the ERC will decide on the cost to be recovered and manner of repayment. The filing for the WESM market fees for the years 2009 to 2011 includes a provision on the repayment of the loan based on the amortization schedule (5 years with the first repayment date scheduled in December 2009) and interest rate (12% per annum) provided by PSALM (see Note 13). In its Order dated September 28, 2009 ruling on the motion for reconsideration filed by the Company on the ERC's Decision on the market fees for the year 2009, the ERC stated that the cost and recovery mechanism for the loan repayments will be subject of a separate application with the agreement that there should be established recovery arrangements between NPC, Transco, PSALM and the Company.

As of December 31, 2009 and 2008, the Company is yet to receive all the documents supporting the amount being claimed from the Company as cost of the MMS and no agreement has been reached between NPC, as loan borrower, Transco, as executing agency and/or PSALM regarding the final payee. In the absence of complete supporting documents from PSALM for the cost of the MMS, based on management's estimate and as supported by project management invoices monitored by the Company, the MMS project cost (without considering loan administration cost) was approximately P574.9 million as of December 21, 2009 and 2008. Accordingly, the MMS is recorded as Intangible Assets at P574.9 million and the corresponding liability, of the same amount, is recorded as part of Interest-bearing Loans and Borrowings account in the 2009 and 2008 statements of financial position.

As discussed in Note 10, the Company and PSALM had agreed on the final amount of the loan which increased by P153.6 million in 2010 representing previously unreconciled MMS costs and expenses. However, the formal confirmation of the agreed amount is still pending with the Company as of December 31, 2010 and the payment for the loan would still require approval from ERC. Moreover, there is still no agreement as to the reckoning date when the principal loan payment and computation of the interest should commence. As a result, management presented the whole amount of the loan as part of non-current liabilities.

Both loans from PSALM and Transco bear an annual interest of 12%.

13. MARKET FEES

This account consists of:

	2010	2009
Market transaction fees	**P 768,809,098**	P 740,056,725
Market registration fees	**948,550**	603,310
	P 769,757,648	P 740,660,035

As mandated in Section 2.10 of the WESM Rules, the Company will recover all its costs of administering and operating the WESM through the market fees imposed on all WESM trading participants, provided that such market fees are approved by the ERC.

On September 11, 2008, the Company filed an application with the ERC for its 2009, 2010 and 2011 market fees amounting to P1,089.4 million, P988.1 million, and P977.6 million, respectively. This application includes a portion that is intended for the repayment of the first three amortizations of the MMS loan principal and interest amounting to P189.7 million in 2011, P206.4 million in 2010, and P223.2 million in 2009 pending resolution of the final cost of the MMS (see Note 12.02). For purposes of determining the market fees to be applied with the ERC, the portion intended for the MMS loan amortization is based on the computations provided by PSALM.

In May 2009, the Company received a copy of ERC's decision dated March 16, 2009 in the case docketed as ERC Case No. 2008-050 RC, regarding the Company's application of the level of market transaction fees for the years 2009 to 2011. Based on the decision, ERC deferred the (a) implementation of the proposed output-based methodology and (b) three-year regulatory period for the market fee determination to allow further study and development. In the meantime, ERC allowed a single fixed rate transaction fee for the year 2009 which was set at P0.0144/kWh. Based on a projected volume of transaction by the ERC, the budgeted amount is estimated to be at P622.9 million. Moreover, based on this ERC Decision, in case the Company needs more budgetary allotment for priority capital expenditure projects, the Company will be allowed to secure loans to finance such projects. The Company is also allowed to apply for a supplemental budget for urgent and important requirements which cannot be reasonably and timely financed through loans. A Motion for Partial Reconsideration and a Supplemental Motion for Partial Reconsideration were filed by the Company on May 19, 2009 and May 26, 2009, respectively, seeking an increase in the approved market fees for the year 2009 to a rate sufficient to cover the Company's budgetary requirements for the MMS enhancement projects and the PSALM MMS loan repayment. In its Order dated September 28, 2009, the ERC partially granted the motions and increased the market fee rate for the year 2009 to P0.0169/kWh to account for the amount of P108.7 million that will cover part of the requirements for the MMS enhancement projects.

The motion was denied in respect to the MMS loan repayment as the ERC reiterated its earlier ruling that the same should be subject of a separate and independent application after an agreement between NPC, PSALM, Transco and the Company establishing the cost and recovery mechanism of the MMS loan repayment shall have been submitted. Moreover, the ERC directed that the increase in budget shall be recovered only for the year 2009.

In April and May 2010, the Company filed a motion to continue collecting market fees at the rate of P0.0169/kWh for the MMS and for additional P0.0075/kWh to be recovered in year 2010 to finance the P331.5 million capital projects of the WESM. The prayer for provisional authority to collect P0.0169/kWh was denied by the ERC. However, the motion for the additional market transaction fee (AMF) of P0.075/kWh was granted by the ERC with modification. ERC allowed the Company to collect the P331.5 million budgeted capital expenditures but it will be spread over a period of 5 years with an annual rate of P0.0015/kWh. Accordingly, the rate used for the year 2010 is P0.0144/kWh plus the AMF fee of P0.0015/kWh, totaling to P0.0159/kWh.

14. OTHER REVENUES

Other revenues of the Company consist of:

	Note	2010	2009
Excess of standard over actual input VAT	16	**P 10,309,612**	P 16,958,982
Miscellaneous income		**411,923**	2,015,606
		P 10,721,535	P 18,974,588

The excess of standard over actual input VAT reflects the difference between 12% VAT and the 5% final VAT deducted and withheld by government-owned and controlled corporations from collections. This represents substantially the Company's taxable income for income tax purposes.

15. EMPLOYEE BENEFITS

15.01 Salaries and Employee Benefits

Details of salaries and employee benefits are presented below.

	Note	2010	2009
Short-term employee benefits	17.05	**P 188,922,961**	P 171,294,463
Post-employment defined benefit	17.05	**18,157,688**	14,006,874
		P 207,080,649	P 185,301,337

15.02 Post-employment Benefits

Starting in 2010, the Company maintains a partially funded, tax-qualified, noncontributory post-employment benefit plan that is being administered by a trustee covering all regular full-time employees. Actuarial valuations are made annually to update the retirement benefit costs and the amount of contributions.

The amounts of retirement benefit obligation recognized in the statements of financial position follow:

	2010	2009	2008
Present value of the obligation	**P 89,069,555**	P 46,225,786	P 11,244,100
Fair value of plan assets	**(40,638,959)**	-	-
Unfunded obligation	**48,430,596**	46,225,786	11,244,100
Unrecognized actuarial gains (losses)	**(18,810,032)**	11,293,014	16,522,500
Unrecognized past service cost	**(12,967,961)**	(16,209,951)	-
	P 16,652,603	P 41,308,849	P 27,766,600

The movements in the present value of the retirement benefit obligation recognized in the books follow:

	2010	2009	2008
Balance at beginning of year	**P 46,225,786**	P 11,244,100	P 17,571,200
Actuarial losses (gains)	**30,963,995**	4,560,004	(15,074,100)
Current service cost	**10,190,219**	9,520,374	6,968,800
Interest cost	**5,015,498**	1,664,127	1,778,200
Benefits paid by the plan	**(3,257,798)**	-	-
Benefits paid from book reserve	**(68,145)**	(464,625)	-
Past service cost – non-vested benefits	-	19,451,941	-
Past service cost – vested benefits	-	249,865	-
Balance at end of year	**P 89,069,555**	P 46,225,786	P 11,244,100

The Company started funding the plan only in 2010. The movements in the fair value of plan assets in 2010 are presented below.

Contributions paid into the plan	P 42,745,789
Benefits paid by the plan	(3,257,798)
Actuarial gains	1,150,968
Balance at end of year	P 40,638,959

The plan assets as of December 31, 2010 consist of the following:

Government securities	P 33,015,091
Unit investment trust funds	6,866,193
Mutual funds	757,318
Cash	357
	P 40,638,959

Actual return on plan asset was P1.2 million in 2010.

The amounts of post-employment benefits expense recognized in the statements of comprehensive income follow:

	2010	2009
Current service cost	P 10,190,219	P 9,520,374
Interest cost	5,015,498	1,664,127
Net actuarial gains recognized during the year	(290,019)	(669,482)
Past service cost – non-vested benefits	3,241,990	3,241,990
Past service cost – vested benefits	-	249,865
	P 18,157,688	P 14,006,874

Presented below are the historical information related to the present value of the retirement benefit obligation, fair value of plan assets and excess or deficit in the plan (in thousands of Philippine pesos), as well as experience adjustments arising on plan assets and liabilities.

	2010	2009	2008	2007	2006
Present value of the obligation	P 89,070	P 46,226	P 11,244	P 17,571	P 15,593
Fair value of the plan assets	40,639	-	-	-	-
Deficit in the plan/unfunded obligation	P 48,431	P 46,226	P 11,244	P 17,571	P 15,593
Experience adjustments arising on plan liabilities	P 2,413	P 4,560	(P 15,074)	(P 7,414)	P 2,506
Experience adjustments arising on plan assets	P 1,151	P -	P -	P -	P -

Management is still evaluating the amount to be contributed to the post-employment plan in 2011.

In determining the retirement benefit obligation, the following actuarial assumptions were used:

	2010	2009	2008
Discount rate	8.11%	10.85%	14.80%
Expected rate of return on plan assets	5.00%	-	-
Expected rate of salary increases	10.00%	10.00%	13% for 2009 and 9% thereafter

16. MISCELLANEOUS EXPENSES

This account consists of:

	Notes	2010	2009
Insurance		**P 7,379,025**	P 5,665,738
Conference		**4,569,340**	5,532,264
Tax expense	14	**3,199,819**	-
Training and education		**3,031,835**	5,036,008
Advertising and promotions		**1,922,111**	2,615,645
Litigations		**1,647,540**	1,833,300
Miscellaneous	23.06	**3,309,040**	4,038,784
		P 25,058,710	P 24,721,739

Tax expense represents the regular corporate income tax on income derived by the Company from activities regarded as for profit or not part of its principal activities (see Note 14). Miscellaneous mainly include membership and association dues.

17. RELATED PARTY TRANSACTIONS

The Company's related parties include WESM participants, which have representations in the Company's BOD (see Note 1.03), and the key management personnel and others as described below, together with the nature of transactions.

17.01 Sale of Services (Market Administration Fees)

The market fees charged to related parties and the unpaid portion thereon follow:

	Amount of Transactions		Outstanding Balances	
	2010	2009	**2010**	2009
PSALM	**P 111,857,275**	P 313,439,239	**P 3,588,782**	P 2,930,093
MASINLOC Power Partners Co. Ltd.	**58,228,087**	33,818,353	**3,870,376**	454,867
SN Aboitiz Power – Magat, Inc.	**8,598,182**	18,354,698	**1,045,132**	115,445
SN Aboitiz Power – Benguet, Inc.	**4,836,578**	7,672,020	**215,672**	42,876
NPC	**3,597,877**	61,581,054	**519,418**	126,333
	P 187,117,999	P 434,865,364	**P 9,239,380**	P 3,669,614

The market fees charged by the Company are based on the rates approved by ERC. Market fee rates approved by ERC were P0.00159/kWh in 2010 and P0.00169/kWh in 2009.

The outstanding market fee receivables are presented as part of Market Fees and Other Receivables account in the statements of financial position (see Note 7).

17.02 Loan from PSALM

The Company has an outstanding loan from PSALM related to the acquisition of the MMS. The outstanding balance of this loan as of December 31, 2010 amounted to P728.6 million and P574.9 million as of December 31, 2009 and 2008, (see Note 12.02) and is presented as part of Interest-bearing Loans and Borrowings in the statements of financial position.

17.03 Loan from Transco

The loan from Transco consists of cash advances and carrying amount of property and equipment transferred to the Company amounting to P508.0 million and P38.8 million, respectively (see Note 12.01).

The breakdown of the outstanding loan balance as of December 31 follows:

	2010	2009
Balance at beginning of year	**P 255,217,196**	P 363,172,746
Repayments	**(48,563,215)**	(107,955,550)
Balance at end of year	**P 206,653,981**	P 255,217,196

The balance of the loan as of December 31, 2010 includes the Company's principal and interest amortization for two quarters in 2010 that was put on hold (see Notes 12.01 and 19.02).

17.04 Lease Agreement with Transco

The Company has a three-year lease agreement with Transco commencing on January 1, 2008 for its office space at the National Control Center building in Diliman, Quezon City. The monthly rental covers the use of office space, cable trench right-of-way and GPS antenna attachment. In 2010 and 2009, total rental from this transaction amounted to P0.5 million for each year, presented as part of Rental in the statements of comprehensive income. The Company has no outstanding rental payable as of December 31, 2010, 2009 and 2008.

17.05 Key Management Personnel Compensation

The compensation of key management personnel included in salaries and employee benefits (see Note 15.01) is broken down as follows:

	2010	2009
Short-term benefits	**P 20,496,064**	P 18,266,168
Post-employment benefits	**1,248,639**	1,676,725
	P 21,744,703	P 19,942,893

18. PRIOR PERIOD ADJUSTMENTS AND RESTATEMENT OF ACCOUNTS

The Company recorded prior period adjustments to correct certain misstatements in its financial statements of prior years due to:

(a) the non-recognition of the amortization of the intangible assets; and

(b) the non-recognition of funds held for WESM trading participants and the related liability.

The prior period adjustments related to the amortization of intangible assets resulted in a decrease in Fund Balance as of January 1, 2010 and 2009 by P251.5 million and P179.7 million, respectively, and decrease in the 2009 excess of revenues over expenses by P71.9 million.

An analysis of the balance of Accumulated Excess (Deficiency) of Revenues Over Expenses as of January 1, 2010 and 2009 after the restatement is presented below.

	2010	2009
Balance as previously reported	**P 262,433,366**	(P 90,182,938)
Prior period adjustments	**(251,522,971)**	(179,659,265)
Balance as restated	**P 10,910,395**	(P 269,842,203)

The details of unrecognized amortization of the MMS are presented below. These represent amortization since July 2006.

Year	Amortization
2006	P 35,931,853
2007	71,863,706
2008	71,863,706
2009	71,863,706
	P 251,522,971

As discussed in Note 10, the cost of the MMS was P574.9 million until 2009, accordingly, the amortization was based on the estimated cost of the MMS during those years.

Also as part of the restatement in 2010, the Company recognized in its statements of financial position funds arising from WESM transactions that the Company collected for the WESM trading participants. The Company presented the asset and liability as Funds Held for WESM Trading Participants and Due to WESM Trading Participants, respectively, amounting to P260.1 million and P2,425.2 million as of December 31, 2009 and 2008, respectively. These were not reflected in the Company's 2009 and 2008 previously issued financial statements.

The restatement of the statements of financial position items as of January 1, 2010 and 2009 is summarized below.

	Notes	**As Previously Reported**	**Effects of Prior Period Adjustments**	**As Restated**
January 1, 2010				
Changes in assets:				
Funds held for WESM				
trading participants	6	P -	P 260,107,230	P 260,107,230
Intangible assets – net	10	598,224,712	(251,522,971)	346,701,741
		598,224,712	8,584,259	606,808,971
Change in liabilities –				
Due to WESM				
trading Participants	6	-	260,107,230	260,107,230
		P 598,224,712		P 346,701,741
Net adjustment to				
fund balance (deficiency)			**(P 251,522,971)**	

	Notes	As Previously Reported	Effects of Prior Period Adjustments	As Restated
January 1, 2009				
Changes in assets:				
Funds held for WESM				
trading participants	6	P -	P 2,425,150,709	P 2,425,150,709
Intangible assets – net	10	595,517,051	(179,659,265)	415,857,786
		595,517,051	2,245,491,444	2,841,008,495
Change in liabilities –				
Due to WESM				
trading participants	6	-	2,425,150,709	2,425,150,709
		P 595,517,051		P 415,857,786
Net adjustment to				
fund balance (deficiency)			(P 179,659,265)	

The effect of the restatement on the statement of comprehensive income for the year ended December 31, 2009 is summarized below.

	As Previously Reported	Effects of Prior Period Adjustments	As Restated
Revenues	P 767,264,064	P -	P 767,264,064
Expenses	414,647,760	71,863,706	486,511,466
Excess of revenues over expenses	**P 352,616,304**	**P 71,863,706**	**P 280,752,598**

The prior period adjustments did not have any effect on the previously reported cash flows of the Company for the year ended December 31, 2009 as the adjustment affected only noncash investing transactions of the Company.

19. COMMITMENTS AND CONTINGENCIES

The following are the significant commitments and contingencies involving the Company:

19.01 Operating Lease Commitments – Company as Lessee

The Company is a lessee under non-cancellable operating leases covering certain warehouse and offices. The leases have terms ranging from one to three years, with renewal options, and include annual escalation rates of 10%. The future minimum rentals payable under these non-cancellable operating leases are as follows as of December 31:

	2010	2009
Within one year	**P 14,802,046**	P 18,141,920
After one year but not more than five years	**12,394,566**	25,686,027
	P 27,196,612	P 43,827,947

Total rental expense from these operating leases amounted to P20.0 million a year in 2010 and 2009 and is presented as part of Rentals in the statements of comprehensive income.

19.02 Legal Claims

A. Garnishment of Transco Loan Payments

As mentioned in Note 12.01, a warrant of distraint was issued by the the Municipality of Labrador directing the Company to deliver to the Municipality the loan payments due to Transco, until Transco's alleged tax liability to the Municipality is extinguished.

As the Company refused to deliver the garnished loan payments, the Municipality filed a complaint with the Regional Trial Court of Lingayen, Pangasinan for the delivery of the garnished money and damages against the Company and the individual members of the PEM Board.

The Company's legal counsel believes that, in case of unfavorable outcome, the Company may be required to pay P36.0 million per quarter directly to the Municipality until Transco's alleged tax liability to the Municipality is extinguished or until the Company is deemed to have fully paid its loan repayments to Transco. This amount, however, has already been recorded as part of the Company's interest-bearing loans and borrowings to Transco (see also Note 12.01). Hence, no further obligation needs to be recorded should a ruling in favor of the Municipality be rendered.

B. Show Cause in the Matter of the Violation of ERC Orders, Rules and Regulations (ERC Case No. 2010-120 RC)

In relation to the establishment of the WESM in the Visayas, the ERC directed the Company to submit an explanation under oath why no penalty should be imposed upon the Company and/or its directors and officers for breach of the WESM Rules, particularly for allowing non-registered Visayas industry players to draw and inject power from and into the grid contrary to the WESM Rules.

As of December 31, 2010, the amount of potential penalty cannot be estimated reasonably, accordingly, no provision was recognized on this contingency. In February 2011, the Company submitted its explanation to the ERC.

C. Case Against Albay Electric Cooperative, Inc. (Aleco)

The Company, insofar as its capacity to collect on behalf of the trading participants and pursuant to the directive of the ERC to undergo the WESM dispute resolution procedure, facilitated the filing of a case seeking payment by Aleco of its outstanding obligations to the WESM for the billing months of February to June 2010.

The parties initially agreed on a partial settlement through an agreement where Aleco undertook to pay to the WESM participants through the Company all WESM bills from August to November 2010 on February 2011 and to replenish its prudential requirements on or before January 2011. Non-payment would automatically result in rendering all obligations due and demandable and would warrant the automatic disconnection of Aleco from the grid.

Aleco, however, defaulted in its obligation under the agreement resulting in the acceleration of the total obligation and the issuance of a suspension and disconnection notice. Prior to Aleco's disconnection, however, the members of the BOD of Aleco resigned and the National Electrification Administration (NEA) took over the management and control of Aleco. The takeover together with the assurance from the NEA that it would propose a repayment arrangement with the claimants prompted the DOE Secretary to direct the Company to lift its notice of suspension and disconnection.

As of December 31, 2010, total outstanding obligation of Aleco to the WESM participants amounted to P996.0 million exclusive of VAT and default interest.

19.03 Tax Claims

The Company is a nonstock, nonprofit corporation which, in the opinion of management, is exempt from income tax and consequently, from withholding tax, pursuant to Section 30(F) of the 1997 Tax Code, as amended, in relation to Section 31 of Revenue Regulations (RR) No. 2-40 (see also Note 4.01). Thus, the income from activities conducted in pursuit of the objectives for which the Company was established is exempt from income tax. However, any income on any of its properties, real or personal, or from any activity conducted for profit, regardless of the disposition of such income is subject to income tax.

The Company has a pending application for a ruling from BIR confirming its exemption from income tax as a nonstock, nonprofit entity. Pending the issuance of the BIR ruling, market participants continue to withhold portion of the market fees as withholding taxes, which is creditable against the income tax due of the Company should it get an unfavorable response on its request for ruling from the BIR. Since the Company does not have any taxable income (based on the premise discussed above) against which the withholding tax credits may be applied, the Company has chosen the option of claiming cash refund from the BIR for such credits. As of December 31, 2010 and 2009, the balance of the unutilized withholding taxes amounted to P8.4 million while as of December 31, 2008, the balance of the unutilized withholding taxes amounted to P3.3 million. These are classified as Prepaid Income Taxes in the statements of financial position.

19.04 Others

There are other commitments, guarantees, litigations and contingent liabilities that arise in the normal course of the Company's operations which are not reflected in the accompanying financial statements. Management is of the opinion that losses, if any, from these commitments and contingencies will not have a material effect on the Company's financial statements.

20. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company is exposed to a variety of financial risks in relation to financial instruments. The main types of risks are credit risk and liquidity risk.

The Company's risk management is coordinated in close cooperation with the BOD and focuses on actively securing the Company's short to medium-term cash flows by minimizing the exposure to financial markets.

The Company does not engage in the trading of financial assets for speculative purposes nor does it write options. The most significant financial risks to which the Company is exposed to are described below.

20.01 Operational Risk

The Company's exposure to significant operational risk exposure is related to its primary purpose as the market operator and governing body of the WESM. It oversees the transaction billing and settlement procedures of the WESM in accordance with the WESM Rules (see Note 1.02). Also, the Company is under the regulation of the ERC. Management is aware that the Company will always have operational risk, but seeks to minimize the probability and impact of such in its operations and financial statements.

The Company manages this risk through applicable controls, processes and procedures, including effective organization structure. Internal controls ensure compliance with laws and regulations, including the WESM Rules and ERC directives, and the overall protection of the Company's resources.

Although the Company governs the settlements of market transactions in the WESM, it is not, however, liable for unfulfilled obligations of any trading participants unless, such event is due to its negligence or failure to perform its responsibilities as operator of the WESM.

20.02 Market Risk

The Company is exposed to market risk through its use of financial instruments and specifically to currency risk and interest rate risk which result from both its operating and investing activities.

(a) Foreign Currency Sensitivity

The Company no longer has material exposure to foreign currency risks as the final amount of its interest-bearing loan from PSALM has already been determined and agreed between the Company and PSALM (see Note 12.02). The original loan obtained by PSALM from a financial institution and passed on to the Company is denominated in foreign currency. The effect of foreign exchange changes on such loan was also passed on to the Company. At present, most of the Company's transactions are carried out in Philippine pesos, its functional currency.

(b) Interest Rate Sensitivity

The Company's policy is to minimize interest rate cash flow risk exposures on long-term financing. Longer-term borrowings are therefore usually at fixed rates. At December 31, 2010 and 2009, the Company is exposed only to changes in market interest rates through its cash and cash equivalents since as of those dates, the Company has no other significant interest-bearing assets and liabilities, which are subject to variable interest rates (see Note 5). All other financial assets and liabilities have fixed rates.

The following table illustrates the sensitivity of the Company's excess of revenues over expenses and fund balance to a reasonably possible change in interest rates of +/- 1.19% in 2010 and +/- 4.81% in 2009. These changes are considered to be reasonably possible based on observation of current market conditions. The calculations are based on a change in the average market interest rate for each period, and the financial instruments held at the end of each reporting period that are sensitive to changes in interest rates, using standard deviations, in the previous 12 months. All other variables are held constant.

	Positive Change	Negative Change
Excess of revenues over expenses		
2010 (+/- 1.19%)	P 8,654,063	(P 8,654,063)
2009 (+/- 4.81%)	19,324,331	(19,324,331)

20.03 Credit Risk

Generally, the maximum credit risk exposure of financial assets is the total carrying amount of the financial assets as shown on the face of the statements of financial position (or in the detailed analysis provided in the notes to the financial statements), as summarized below.

	Notes	2010	2009 (As Restated - see Note 18)	2008 (As Restated - see Note 18)
Cash and cash equivalents	5	**P 722,737,512**	**P** 402,671,968	P 170,665,208
Funds held for WESM trading participants	6	**395,202,030**	260,107,232	2,425,150,709
Market fees and other receivables	7	**84,078,923**	128,527,717	91,753,546
Guaranty deposits	8	**6,168,166**	4,552,480	3,808,197
		P 1,208,186,631	P 795,859,397	P 2,691,377,660

The above represents the carrying values of the Company's financial assets categorized as loans and receivables, and none of which are either past due or impaired. Also, none of the other financial assets are secured by collateral or other credit enhancements.

The Company seldom encounters default of counterparties but should it happen, it continuously monitors defaults of such counterparties, identified either individually or by group, and incorporates this information into its credit risk controls. The Company considers the reputation and financial standing of every bank it does business with as part of its policy. To ensure the effective operation of the spot market by providing a level of comfort that WESM members will meet their obligations to make payments as required under the WESM Rules, each WESM member must satisfy the prudential requirements. A trading participant wishing to participate in the market transactions shall provide and maintain a security acceptable to the Company which is either:

(a) A bank guarantee in a form and from a bank;

(b) Another immediate, irrevocable and unconditional commitment in a form and from a bank or other institution;

(c) Surety bond issued by a surety or insurance company duly accredited by the Office of the Insurance Commission of the Philippines; or,

(d) Such other forms of security or guarantee acceptable to the Company.

In respect of market fees and other receivables, the Company is not exposed to any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics.

20.04 Liquidity Risk

Considering the nature of its operations, the Company manages its liquidity needs by carefully monitoring scheduled debt servicing payments for long-term financial liabilities, as well as cash outflows due in the day-to-day operations of the WESM. Liquidity needs are monitored in various time bands, on a day-to-day and week-to-week basis, as well as on the basis of a rolling 30-day projection. Long-term liquidity needs for a 6-month and one-year period are identified monthly.

The Company maintains cash to meet its liquidity requirements for up to 60-day periods. Excess cash is invested in time deposits or short-term marketable securities. Funding for long-term liquidity needs is additionally secured from Transco or PSALM.

As at December 31, 2010, the Company's financial liabilities have contractual maturities which are summarized below and further compared with financial liabilities as of December 31, 2009 and 2008 below.

	Current		Non-current	
	Within 6 Months	6 to 12 Months	1 to 5 Years	Later than 5 Years
2010				
Accounts and other payables	P 56,559,480	P -	P -	P -
Interest-bearing loans and borrowings	137,435,713	69,218,268	728,557,962	-
Due to WESM trading participants	395,202,030	-	-	-
	P 589,197,223	**P 69,218,268**	**P 728,557,962**	**P -**
2009				
Accounts and other payables	P 57,575,483	P -	P -	P -
Interest-bearing loans and borrowings	58,599,461	61,931,992	709,595,392	-
Due to WESM trading participants	260,107,232	-	-	-
	P 376,282,176	P 61,931,992	P 709,595,392	P -
2008				
Accounts and other payables	P 70,445,494	P -	P -	P -
Interest-bearing loans and borrowings	52,497,320	55,458,230	830,126,845	-
Due to WESM trading participants	2,425,150,709	-	-	-
	P2,548,093,523	P 55,458,230	P 830,126,845	P -

The contractual maturities reflect the gross cash flows, which is equivalent to the carrying values of the liabilities at the end of the reporting periods.

21. CAPITAL MANAGEMENT OBJECTIVES, POLICIES AND PROCEDURES

The Company aims to manage operational and strategic objectives.

The BOD has overall responsibility for monitoring of fund balance in proportion to risks. The Company manages its fund structure and makes adjustments to it, in the light of changes in economic conditions.

The Company defines capital as total fund balance (deficiency). It monitors capital on the basis of debt-to-fund balance ratio, which is calculated as total debt divided by fund balance (deficiency). Capital for the reporting periods December 31, 2010, 2009 and 2008 is summarized as follows (in thousands of Philippine pesos):

	2010	2009 (As Restated - see Note 18)	2008 (As Restated - see Note 18)
Total liabilities	**P 1,411,866**	P 1,203,021	P 3,461,445
Total fund balance (deficiency)	**220,754**	10,920	(269,832)

22. OTHER MATTERS

22.01 PEM Audit Committee and Operational Audit of the Market Operations

One of the working groups of the PEM Board includes the PEM Audit Committee. The PEM Audit Committee shall conduct audits of the operation of the spot market and of the market operator in accordance with Section 1.5.1 of the WESM Rules. In this regard, the PEM Audit Committee shall:

- conduct annual audits of the market operator and the settlement system and any other procedures, persons, systems or other matters relevant to the spot market;

- test and check any new items or version of software provided by the market operator for use by WESM Members;

- review any procedures and practices which are covered by the WESM Rules at the direction of the PEM Board;

- recommend changes to the WESM Rules where the PEM Audit Committee detects deficiencies as a consequence of an audit, review, test, check or other form of review; and,

- publish on the market information website the results of any findings and recommendations under this clause 1.5.1.

On April 27, 2007, the PEM Board appointed two members to the PEM Audit Committee. An operational audit of the Company's market operations was completed in December 2009. The audit was conducted by independent auditors engaged for this purpose and was overseen by the DOE and the PEM Audit Committee. Results of the audit included recommendations for best practices as well as enhancements to the existing market systems and processes.

22.02 Company's Investigation of Allegations of Anti-competitive Behavior of PSALM

In October 2006, the Company's Market Surveillance Committee (MSC) investigated allegations of anti-competitive behavior on the part of the PSALM, bidding on behalf of NPC's independent power producers, that was brought about by a spike in the load weighted average rates during the August 26 to September 25, 2006 billing period (third month of operations).

Based on the findings of the MSC, the PEM Board then issued a resolution on November 22, 2006 affirming the MSC's findings and ordering an adjustment in the WESM settlement prices to administered price in accordance with the ERC approved administered price methodology. At the instance of NPC, clarification was sought from the ERC on the price adjustments. On December 6, 2006, the ERC (i) directed the Company to submit the resolution; and (ii) initiated an inquiry into the resolution and the PEM Board's action in adjusting the WESM settlement prices.

In an Order dated December 13, 2006 (ERC Case NO. 2006-080), invoking its mandate under the EPIRA, the ERC provisionally declared "the action of the PEM Board, in correcting the WESM settlement prices and imposing the administered prices to be invalid for having been carried out beyond the scope of its authority and in violation of the EPIRA and the WESM Rules." However, the ERC provisionally applied the NPC-Time of Use (TOU) rates. The company's lack of authority was affirmed in ERC's subsequent Order dated August 14, 2007.

Pursuant to the January 2, 2007 order of the ERC, the Company issued to the WESM customer revised settlement statements on January 25, 2007 covering the billing period falling due, with payment due date for the generators on January 26, 2007.

On July 20, 2007, the Company filed a motion for clarification concerning the appropriate date by which late payment interest is to be reckoned considering the revisions made in the settlement statements due to the adjustments arising from the Order to use NPC-TOU rates.

Subsequently, after the ERC issued its order dated February 5, 2007, confirming the appropriate calculation on the customer metered quantities and, consequently, the Company issued on April 25, 2007 the second revised settlement statements with due dates for the customers set on May 5, 2007 and for the payment due to generators on May 6, 2007.

In ERC Case No. 2007-421 MC (IU Case No. 06-01), the ERC conducted its own investigation on the allegations, and on June 6, 2007, the ERC cleared PSALM of the accusations and found that no prima facie evidence for anti-competitive behavior exist against PSALM.

In view of its finding in ERC Case No. 2007-421, the ERC resolved on the aforementioned Order dated August 14, 2007, that the WESM settlement prices should be used for third and fourth month billing period.

On June 17, 2008, the Company received a copy of ERC's order ERC Case No. 2006-080 RC docketed June 16, 2008 regarding the prices from the third billing period. Although the ERC denied the Company's motion for reconsideration regarding the validity of the PEM Board's decision to adjust the prices, the ERC granted the Manila Electric Company's request that it intervene for the greater interest of the industry and the consumers, and set the WESM settlement prices at NPC-TOU rates. The ERC set the WESM settlement prices for the third and fourth billing periods of 2006 at the ERC-approved NPC-TOU rates.

PSALM filed a Motion for Reconsideration which was denied by the ERC in its Order dated October 20, 2008. PSALM then filed a Petition for Review with the Court of Appeals. On August 28, 2009 the Court of Appeals dismissed the Petition of PSALM and further denied in CA order dated November 6, 2009, the Motion for Reconsideration of PSALM. A petition was filed by PSALM to the Supreme Court. Management believes that should the Supreme Court rule in favor of PSALM, the monetary obligations will be collected from the WESM buyers. As of March 31, 2011, the petition is still pending with the Supreme Court.

22.03 Price Substitution Methodology

In September 2008, the DOE, through the Company, filed a Supplemental Application with the ERC, docketed as ERC Case NO. 2008-051 RC, for the approval of the proposed methodology for price substitution and settlement of energy transactions in the WESM for trading intervals affected by network congestions, and the immediate and provisional application of the proposed methodology to energy transactions in the WESM beginning June 26, 2008. The Price Substitution Methodology (PSM) is intended to form part of and will supplement the WESM Price Determination Methodology (PDM) which was approved by the ERC in its decision dated June 20, 2006 in ERC Case No. 2006-007 RC.

The prevailing provisions of the WESM Rules, market manuals and the approved WESM PDM do not adequately address or mitigate the pricing and subsequent impact of network congestion particularly the nodal price separations arising from the spring washer or loop constraint effect.

The PEM Board ratified the amendment of the WESM Rules Clause 3.10.5 to include the effects of the network congestion as cause for pricing errors and to authorize the formulation of a pricing and supplement methodology for the correction of errors, and the adoption of the WESM Manual on Methodology for Determining Pricing Errors and Price Substitution Congestion for Energy Transactions in the WESM Affected by Congestion.

The filing of the Supplemental Application and the formulation of the proposed PSM was prompted by the adverse effects on the prices and settlements in the WESM caused by network congestion and contingency events in the Luzon Grid in 2008 particularly the constraint caused by the shutdown of Transco's San Jose, Bulacan Transformer 2 from July 11, 2008 to September 30, 2008.

On September 15, 2008, the ERC directed that NPC-TOU rates be provisionally imposed for the July, August and September WESM Billing periods, while on October 20, 2008, the ERC directed that PEMC cease the implementation of NPC-TOU rate and utilize actual market clearing prices starting October 26, 2008, which is the next WESM billing period from the completion of the restoration works at the San Jose substation.

In ERC Case No. 2008-051 RC, docketed on April 2, 2009, the ERC approved the PSM, which would apply beginning July 11, 2008 onwards. Based on the ERC Ruling, if pricing error notices are triggered by the price trigger mechanism, the approved methodology of price substitution shall be used where it is applicable. With the retroactive application of the PSM, PEMC will issue revised settlement statements to the WESM participants to reflect the adjustment in settlement amounts beginning with the July 2008 billing month and onwards.

22.04 Visayas Supply Augmentation Auction (VSAA)

In a move to address the power supply situation in the Visayas Grid, the DOE released Department Circular No. DC 2009-01-001 on January 16, 2009, "Directing DOE attached agencies, all electric power industry, participants, consumers and various stakeholders to adapt and implement contingency measures to ensure adequate and reliable electric power supply in Visayas Grid particularly in the islands of Cebu, Negros and Panay." The VSAA is a day-ahead market which would allow embedded generators to sell their un-contracted capacity and grid-connected customers to sell an interruptible portion of their loads through an auction process.

The Company will act as administrator of the VSAA. The application for the approval of the pricing and cost recovery mechanism as well as the structure and level of Administration Fees was filed with the ERC by the DOE, through the Company, on March 6, 2009 and was set for jurisdictional hearing, expository presentation, pre-trial conference and evidentiary hearing for various dates scheduled in April and May 2009.

On April 4, 2009, the Company received a copy of ERC's order dated April 13, 2009 where the DOE was given provisional authority through PEMC to conduct the preparatory acts for the VSAA to operate, particularly the commencement of registration process to determine the market.

On September 17, 2009, the Company received the Decision of the ERC dated August 24, 2009, which approved the pricing and cost recovery methodology and the administration fees for the VSAA.

On the ground that the methodology approved by the ERC is fundamentally different from the methodology applied for, a motion for reconsideration was filed by the Company, on behalf of the DOE. Acting on the motion reconsideration, the ERC in its Order dated November 3, 2009 and received by the Company on November 26, 2009 allowed for an interim implementation of the pricing and cost recovery methodology as originally applied for with some modifications for a period of three months, to allow the Company to prepare for the implementation of the approved methodology. The ERC also directed compliance with additional conditions, including the audit of the software to be used, the conduct of information dissemination and formulation of mitigation measures as well as enforcement and penalty mechanisms.

On December 26, 2009, the DOE filed a Petition for Review with the Court of Appeals. As of March 31, 2011, the Petition is still pending with the Court of Appeals.

23. SUPPLEMENTARY INFORMATION REQUIRED UNDER REVENUE REGULATIONS 15-2010

On November 25, 2010, the BIR issued RR 15-2010, which required certain information on taxes, duties and license fees paid or accrued during the taxable year to be disclosed as part of the notes to financial statements. This supplementary information, which is not a required part of the basic financial statements in accordance with PFRS, is presented below.

23.01 Output Value-Added Tax

In 2010, the Company declared output VAT as follows:

	Tax Base	Output VAT
Taxable receipts:		
Market fees	P 810,581,153	P 97,269,738
Other revenues	1,044,717	125,366
	811,625,870	97,395,104
Zero-rated other revenues	147,056	-
	P 811,772,926	**P 97,395,104**

The Company's VAT zero-rated receipts were determined pursuant to Section 108 (B), *Zero-rated VAT on Sale of Services and Use or Lease of Properties*. The Company has no VAT exempt receipts for 2010.

The tax bases are included as part of Market Fees and Other Revenues in the 2010 statement of comprehensive income. The tax bases for Market Fees and Other Revenues are based on the Company's gross receipts for the year, hence, may not be the same with the amounts accrued in the 2010 statement of comprehensive income. The VAT related to accruals is recognized as deferred output VAT.

The output VAT payable as of December 31, 2010, which is presented as part of Trade and Other Payables account in the 2010 statement of financial position (see Note 11), consists of the following:

Deferred output VAT	P 8,607,280
Output VAT	6,449,117
Deferred input VAT	(6,816,273)
	P 8,240,124

Deferred input VAT represents unamortized portion of input VAT related to the purchase of capital goods subject to amortization and input VAT related to taxable expenses not yet paid.

23.02 Input Value-Added Tax

The movement in creditable input VAT in 2010 is summarized below.

Balance at beginning of year	P -
Goods other than for resale or manufacture	1,109,627
Capital goods subject to amortization	3,563,833
Capital goods not subject to amortization	150,632
Services lodged under other accounts	10,092,475
Applied against output VAT	(14,916,567)
Balance at end of year	**P -**

23.03 Taxes on Importation

The Company does not have taxes on importation in 2010 since it does not have any importations for 2010.

23.04 Excise Tax

The Company does not have excise tax in 2010 since it does not have any transactions which are subject to excise tax.

23.05 Documentary Stamp Tax

The Company did not pay any documentary stamp tax in 2010 as it did not execute any documents, instruments, loan agreements and paper evidencing the acceptance, assignment, sale or transfer of an obligation, and any right or property during the year.

23.06 Taxes and Licenses

Taxes and licenses are broken down as follows for the year ended December 31, 2010:

Licenses and business tax	P 286,002
Fringe benefit tax	210,095
Miscellaneous	47,993
	P 544,090

The amount of taxes and licenses is presented as part of Miscellaneous Expenses in the 2010 statement of comprehensive income (see Note 16).

23.07 Withholding Taxes

The details of total withholding taxes for the year ended December 31, 2010 are shown below.

Compensation and benefits	P 48,736,525
Expanded withholding tax	6,853,377
	P 55,589,902

23.08 Deficiency Tax Assessment and Tax Cases

As of December 31, 2010, the Company does not have any deficiency tax assessments from the BIR nor does its have tax cases outstanding or pending in courts or bodies outside of the BIR in any of the open years.

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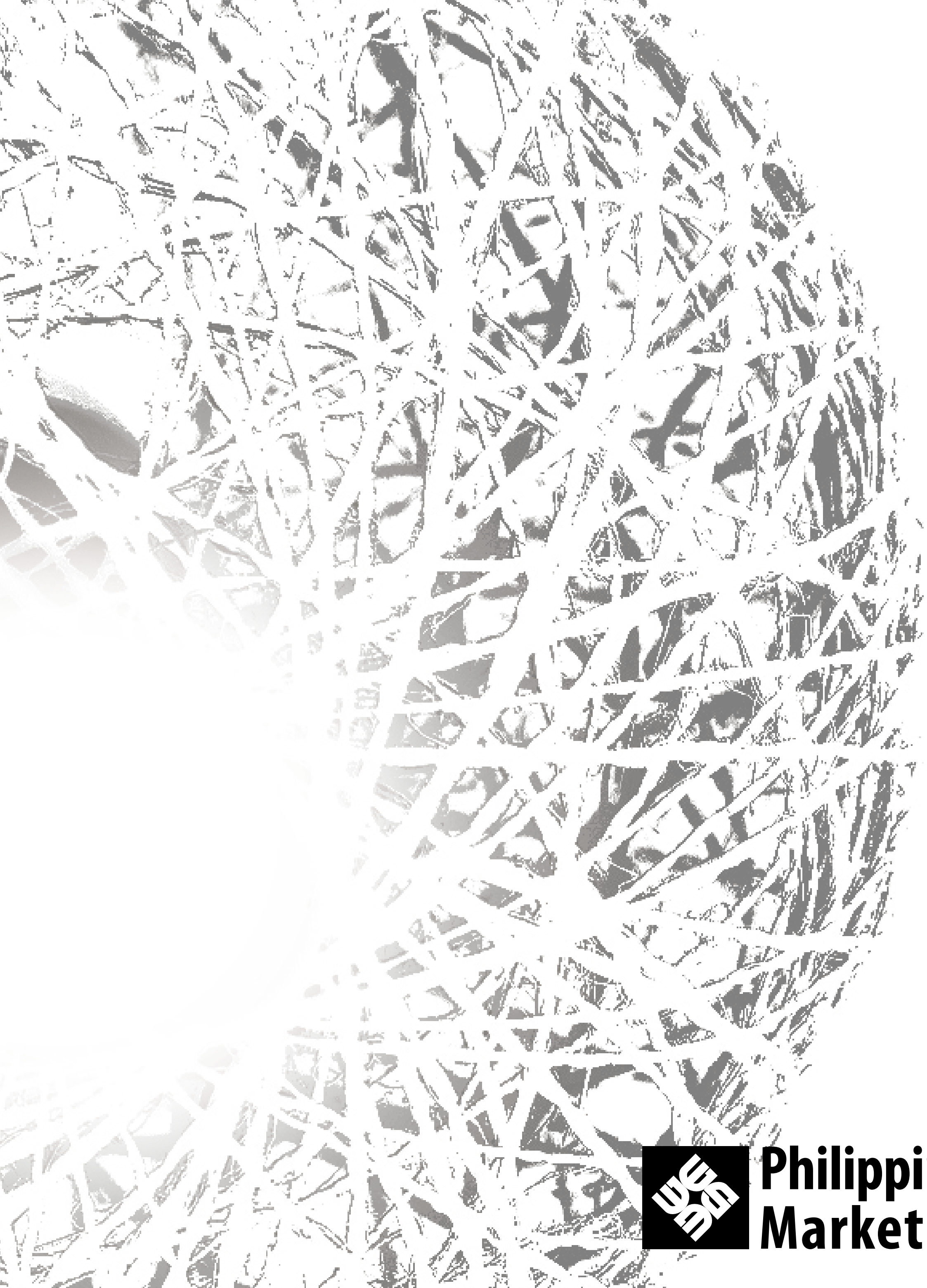

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