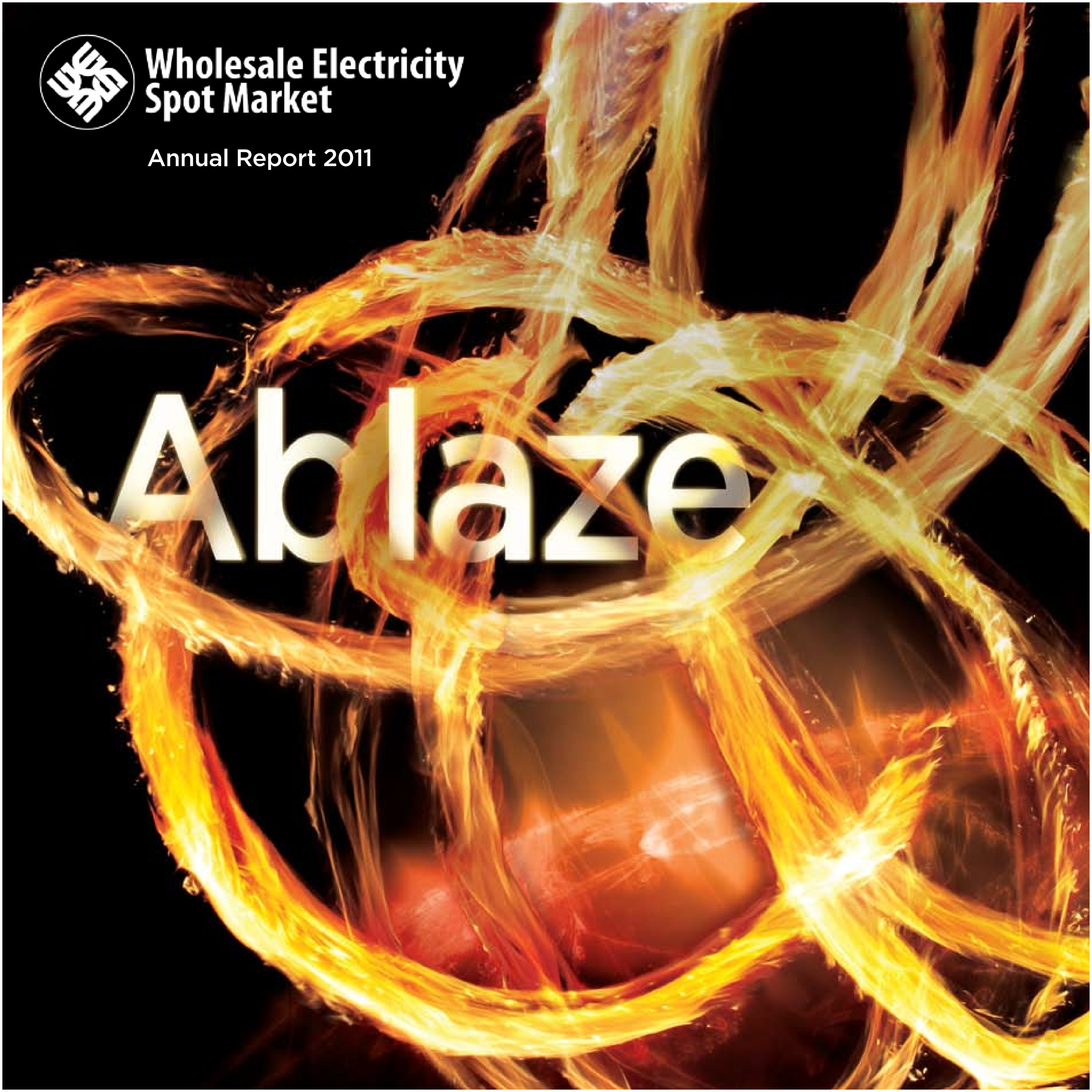
Wholesale Electricity Spot Market

Annual Report 2011



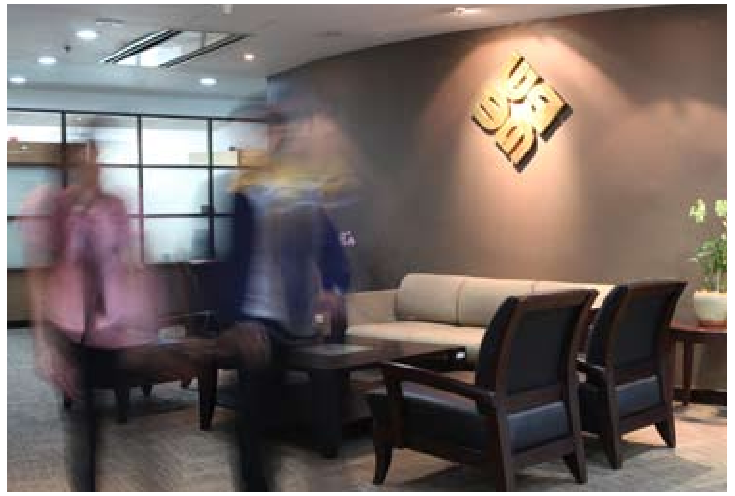
Wholesale Electricity
Spot Market

Market Report
June 2011 - July 2012

Ablaze

The success of the energy market ignited a spark that boosted the desire for making the power industry more robust and efficient. Fuelled by its significant milestones, WESM on its fifth year is ready and burning to take on a host of undertakings – Reserves Market, Open Access and Retail Competition and the Renewable Energy Market to name a few. Once a small ember, the market is now set ablaze by the invaluable lessons learned and the courage gained through experience, towards the vision of a transparent and competitive Electricity Market.

WESM Rules & Objectives



The objective of the WESM as expressed in the WESM Rules, is primarily to establish a competitive, efficient, transparent and reliable market for electricity where:

- A level playing field exists among WESM Participants;
- Trading of electricity is facilitated among WESM Participants within the spot market;
- Third parties are granted access to the power system in accordance with EPIRA;
- Prices are governed as far as practicable by commercial and market forces; and
- Efficiency is encouraged

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The Department of Energy remains steadfast in its vIsion to transform the electric power industry and ensure that our future electricity supply is secure, low-carbon, and cost-effective. The slew of reforms which we have presented through the years will mean that we will have a flexible, smart and responsive electric system, powered by a diverse and secure range of low-carbon sources of electricity complemented with firm efforts to pursue demand management; improve storage and interconnection; enhance competition between low-carbon technologies that will help to keep costs down; and strengthen the network that will be able to meet the increasing demand.

Electricity is an essential part of every aspect of modern life and is vital to our economic and social infrastructure. It is crucial, therefore, for our international competitiveness and economic development that the Wholesale Electricity Spot Market (WESM) continues its operation as this has become more efficient in enabling power to be traded in a very transparent manner. It cannot be denied that WESM has played a pivotal role in a restructured power industry.

The WESM serves as an ideal venue for cooperation to flourish among all stakeholders in order to attain winnable solutions and strategic actions that can only take us forward. Hence, it is very important that participants and other stakeholders work together to promote WESM's competitiveness, transparency, and sustainable development. I truly believe that our shared commitment to achieve increased accessibility, clean energy development, market growth, and sustained industrial prosperity will lead us to a much brighter future.

In closing, I congratulate the Philippine Electricity Market Board, PEMC management, employees, and participants for your contributions that help in establishing WESM as a tool for development today and in the years to come. Here's to more success to PEMC!

Mabuhay and more power!

JOSE RENE D. ALMENDRAS
Chairman and DOE Secretary

The WESM serves as an ideal venue for cooperation to flourish among all stakeholders in order to attain winnable solutions and strategic actions that can only take us forward.

In 2011, we witnessed the unbridled growth of the Philippine Wholesale Electricity Spot Market (WESM) as we made great strides in improving market operations and in developing internal processes that address the increasing needs of stakeholders. We have focused our efforts on continuing our compliance with the operational metrics for market operations which led to improvements in MMS (Market Management System) availability, forecast performance and participant services.

With the integration of the Luzon and Visayas regions into a single market, substantial improvements and adjustments were made, like the implementation of a market-based high voltage direct current (HVDC) scheduling in April 2011 which effectively minimized occurrences of submarine cable congestions in the Visayas and lessened the incidence of under-generation constraint violation coefficients (CVCs) in Luzon. In addition, the regional application of the Price Substitution Methodology (PSM) and Administered Price Determination Methodology (APDM) as well as the regional issuance of pricing error notices (PEN) were implemented in May 2011 which significantly contributed to the reduction of Visayas pricing errors. Concurrent to these developments, we endeavored to complete and update procedures and business processes and systems to incorporate the Visayas market.

It cannot be denied that critical issues may arise for a newly integrated market as seen in the Visayas for its first year of operation. Some of the issues raised are the cost impact of line rentals, the occurrence of price spikes and price separation, and the manner of redistributing the net settlement surplus (NSS). Considering the peculiarities of the Visayas grid, we acknowledge the exigency or weight of these issues. That is why we are constantly striving to muster the stakeholders' support for their eventual resolution. With the support of the industry stakeholders, I believe that considerable progress will be attained in the coming years.

In the past year, the WESM launched a number of vital market development initiatives aimed at advancing our operational efficiency and revitalizing our institutional integrity. Alongside the completion of the second independent operational audit of the systems and procedures of market operations, we made sure to substantially complete tasks in compliance with the recommendations made from the first market audit. Moreover, we submitted to the Department of Energy (DOE) the Philippine Electricity Market Board (PEM Board)-approved Market Operator Performance Standards (MOPS) that will serve as our benchmark in operating the market with utmost efficiency and in providing excellent service to our valued participants. To strengthen our IT systems and services, we have undertaken projects to develop the Wholesale Billing and Settlements (WBSS) system, the WESM public website and the Business Development and External Services.

As a service-oriented organization, we have to ensure that our internal structure and business processes are fine-tuned and meet certain widely accepted standards in order to effectively keep up with the market's growth and to continue to deliver significant value for all our stakeholders. That is why for 2011 we have decided to apply and make preparations for the ISO certification on Information Security Management System (ISMS). Furthermore, personnel realignment and strategic planning activities were conducted to boost our operational excellence and improve service delivery.

With regard to the large scale reforms and opening of new markets in the WESM, conceptual designs and proposals were developed to address the requirements on energy security and to prepare for the implementation of retail competition and open access and renewable energy markets.

This was a year of breakthroughs for the WESM, and despite having a few operational issues, we can see that great progress has been made and that this market is uniquely positioned to grow and succeed and to thoroughly build value to our participants – all geared up to set the industry ablaze. We are prepared to lead the reformation of the electric power industry which can only be made possible through stakeholder support and institutional cooperation.

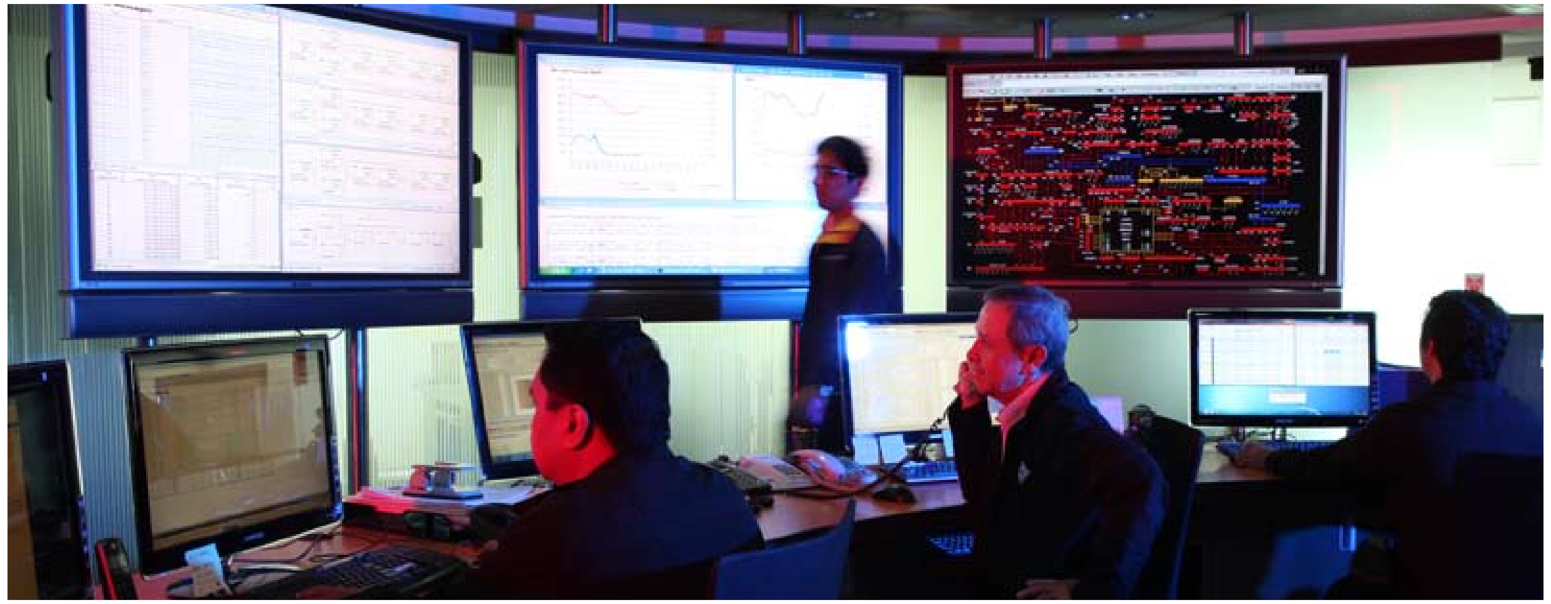
The success we have accomplished in 2011 may not have been possible without support from the PEM Board and the worthy contribution of all employees. With this, I would like to extend my gratitude and recognition. Our 2011 accomplishments will be used as a solid platform in taking on the challenges that are presented to us in 2012 and beyond.

To end, we have the fervent hope that all our efforts will contribute in promoting and maintaining fairness, transparency, efficiency, reliability and competitiveness in the sole electricity market in the country and that the WESM will continue to help stimulate industry development and promote the welfare of all stakeholders.

MELINDA L. OCAMPO
President

We are prepared to lead the reformation of the electric power industry which can only be made possible through stakeholder support and institutional cooperation.

WESM Overview



BRIEF HISTORY

The establishment of the Wholesale Electricity Spot Market (WESM) is part of the package of electric power industry reforms mandated in Republic Act No. 9136, or the Electric Power Industry Reform Act (EPIRA) of 2001, signed into law on 8 June 2001.

The Philippine Department of Energy (DOE) was mandated by law to establish the WESM and, jointly with the electric power industry participants, to formulate the detailed rules that will govern the conduct of the WESM. The WESM Rules were promulgated in June 2002, a year after the enactment of the EPIRA.

In November 2003, the Philippine Electricity Market Corporation (PEMC) was incorporated as a non-stock, non-profit corporation, and was designated the following year, in August 2004, to serve as the autonomous group market operator (AGMO) that will undertake the preparations for and the initial operations of the WESM.

After several months of trial operations, the WESM commenced commercial operations in the Luzon grid on 26 June 2006. Four years into the commercial operations in Luzon, the Visayas grid was integrated into the WESM and commenced commercial operations on 26 December 2010.

FEATURES OF THE **WESM**

The WESM serves as a venue for the centralized scheduling of generation and supply of electricity through the Luzon and Visayas grids; and for determining prices of un-contracted quantities and the settlement of spot market transactions.

The WESM is a real-time, bid-based and hourly market for energy, and eventually for reserves.[1] It operates as a gross pool and net settlement market where all electricity supplied through the Luzon and Visayas grids are scheduled regardless of whether or not they are covered by bilateral contracts, but quantities covered by bilateral contracts are netted out of the WESM settlements to be settled between the contracting parties outside of the WESM.

The WESM operates around the following principles:

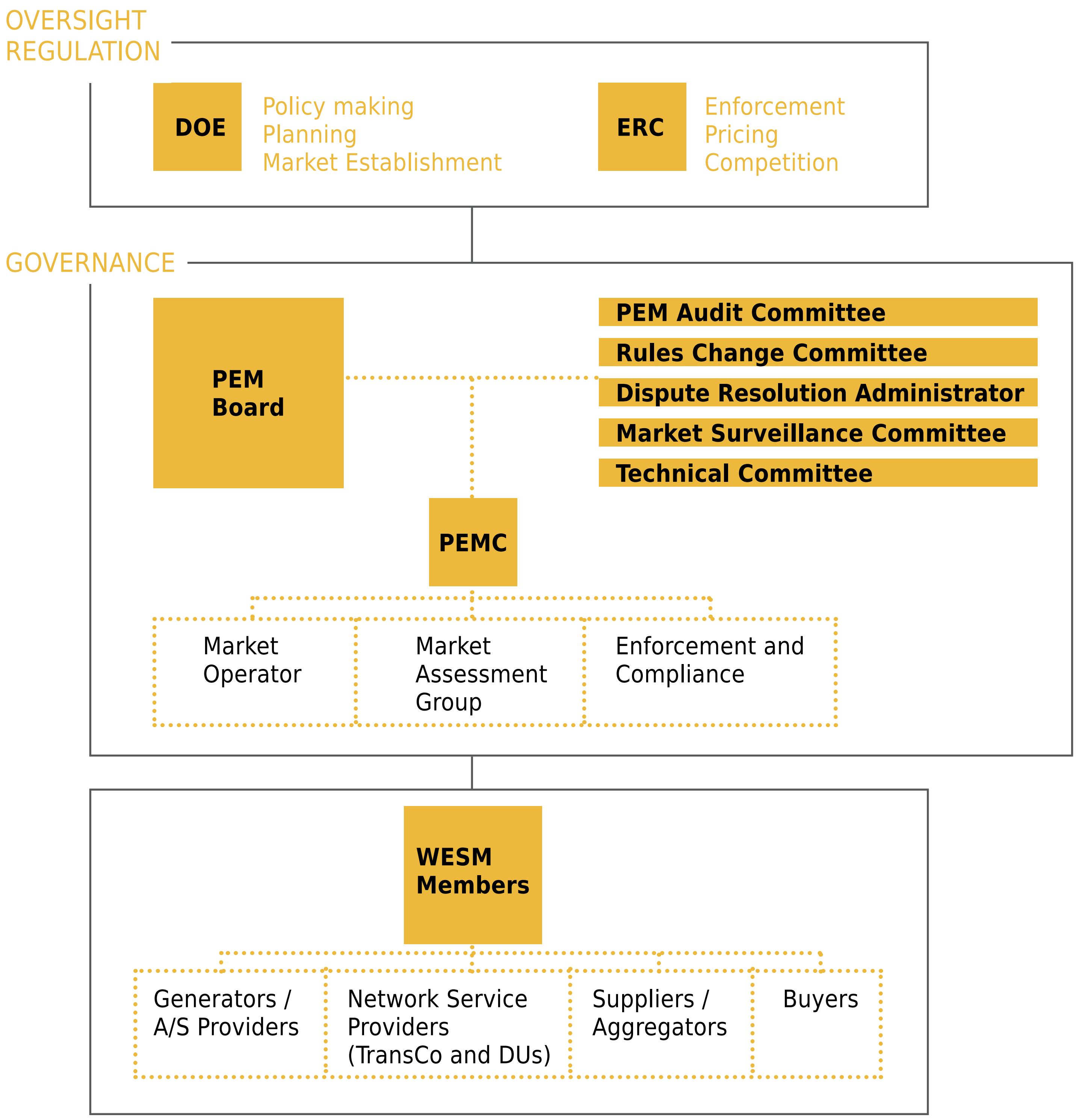
- The WESM adopts the gross pool concept where each generator submits offers for both price and quantity for energy for central scheduling and dispatch, while customers may also submit demand bids. The generator offers are matched with system demand requirements, taking into account system conditions and security requirements to arrive at a security-constrained economic dispatch. Once reserves are traded in the WESM, the principle of co-optimization of energy and reserves will likewise be applied.
- The WESM adopts the principle of self-commitment whereby participants assume full responsibility for how and when their plants are operated.
- The WESM adopts locational pricing to provide the correct economic signals to market participants when they properly account for the economic impact of losses and constraints that result from the operation of the electricity network.
- The WESM adopts a full nodal pricing regime for both generation and customers. Nodal pricing is a mechanism for revealing, at different points in the system, the cost incurred to ensure sufficient power flows to meet all loads in all locations.
- The WESM adopts the scheme of *ex-ante* and *ex-post* pricing to account for discrepancies between planned (ex-ante) and actual outcomes (ex-post).

WESM trading can be illustrated in four basic steps. The first step is where the offers of the generators and demand bids of customers are submitted to the system on an hourly basis. The second step involves scheduling, where the WESM Market Management System (MMS) matches generation offers with demand, while taking into consideration the system conditions. It then comes up with a schedule of generation quantities to be dispatched with prices at each location. The third step, the dispatch, involves the System Operator implementing the dispatch schedule. Finally, the last step is the settlement, where participants settle their transactions through the WESM settlement system or among themselves for quantities covered by bilateral contracts.

[1] Trading of reserves in the WESM has not yet commenced.

TIMELINE

- **2003 November** — The Philippine Electricity Market Corporation was incorporated as a non-stock, non-profit corporation
- **2004 March** — The WESM project commenced
- **2004 August** — The PEMC was designated as the Autonomous Group Market Operator
- **2005 January** — WESM Luzon Trial Operations
- **2006 26 June** — WESM Luzon Commercial Operations
- **2007 October** — WESM Visayas Trial Operations
- **2010 26 December** — WESM Visayas Commercial Operations



WESM STRUCTURE

The Department of Energy is the government agency mandated to supervise the restructuring of the power industry, including the establishment of the WESM. It is primarily responsible for energy policy making and planning, and formulates and updates the Philippine Energy Plan and the Philippine Power Development Plan. In the WESM, it is responsible for the formulation of the WESM Rules and changes thereto, jointly with the industry participants.

The Energy Regulatory Commission is a quasi-judicial regulatory body with the mandated function of promoting competition, encouraging market development, ensuring customer choice and penalizing abuse of market power. In relation to the WESM, it approves the price determination methodology to be employed in the WESM, and enforces the rules and regulations governing the operations of the WESM and the activities of the market operator and market participants for the purpose of ensuring greater supply and rational pricing of electricity.

The WESM is governed by the Philippine Electricity Market Board (PEM Board). Chaired by the Secretary of Energy, the PEM Board is a 15-member body consisting of an equitable representation from the power industry sectors and independent members. Membership in the PEM Board consists of: (a) four representatives from the generation sector, (b) four representatives from the distribution utilities with two representing the electric cooperatives and two representing the private distribution utility, (c) one representative from the supply sector, (d) one representative from the transmission sector, (e) one representative from the Market Operator and (f) four independent members.

Governance of the WESM is supported by several WESM Governance Committees, namely, the Rules Change Committee (RCC), the Market Surveillance Committee (MSC), the Technical Committee (TC), the PEM Audit Committee (PAC) and the Dispute Resolution Administrator (DRA). These Committees are appointed by the PEM Board. Except for the RCC, the members of the Committees are independent of the industry participants. The composition of the RCC mirrors that of the PEM Board, which is composed of independent members and an equitable representation from among the industry participants.

The Philippine Electricity Market Corporation (PEMC) was constituted as the autonomous group market operator (AGMO), and as such, performs the Market Operator functions in the WESM. PEMC also serves as the governance arm of the WESM, with its Board of Directors as the PEM Board. The performance of its governance function is supported by two units within PEMC, namely, the Market Assessment Group (MAG) and the Enforcement and Compliance Office (ECO), which are mandated to implement market monitoring and assessment, and to conduct investigations for breach, respectively. The MAG also serves as the primary support unit of the various WESM Committees.

The National Grid Corporation of the Philippines (NGCP) serves as the System Operator (SO). The NGCP is the company that was awarded the concession to operate and maintain the Philippine transmission system, and as such, serves as the SO. In the WESM, it is also registered as a wholesale metering services provider.

WESM Members include the trading participants, the ancillary services provider, the metering services provider, the network services provider and the SO. The trading participants are the generation companies and the customers. Customers may be distribution utilities, suppliers and bulk users.

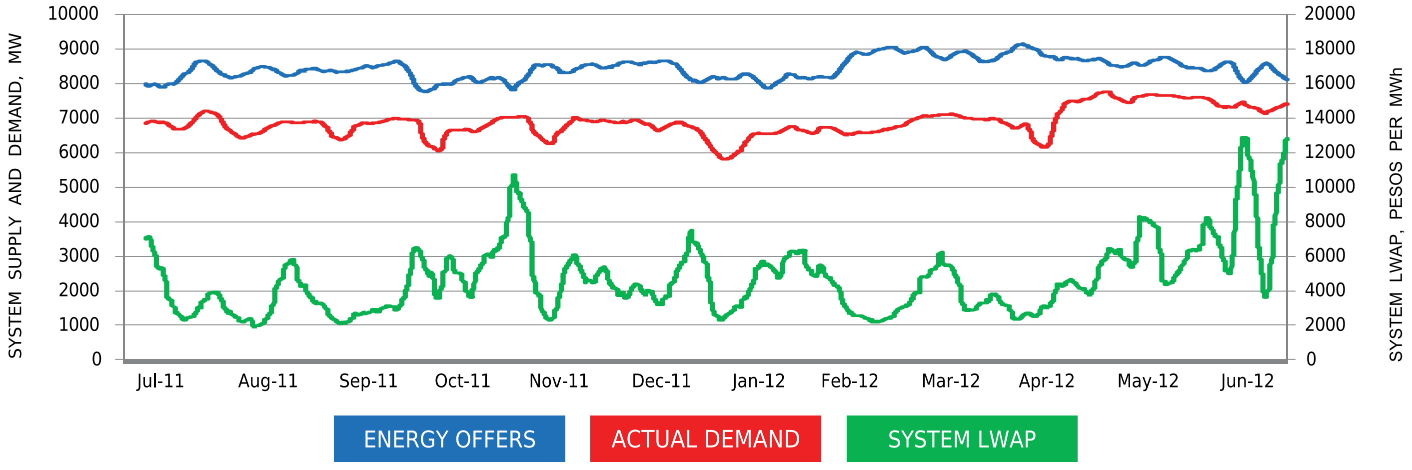
Market Operations Highlights

The Wholesale Electricity Spot Market (WESM) recorded a steady increase in electricity demand, particularly in Luzon, over its six years of operations. While total energy traded in the WESM increased, the level of spot market transactions decreased significantly starting 2011 with customers increasing their supply contract levels even as the Default Wholesale Supply arrangement was already terminated.

Table 1
Summary of Market Results
January 2007 – June 2012

		2007	2008	2009	2010	2011	2012 Jan-Jun
PEAK DEMAND	SYSTEM	--	--	--	--	8,849	9,303
	LUZON	6,590	6,681	6,932	7,643	7,530	7,898
	VISAYAS	--	--	--	--	1,447	1,460
TOTAL ENERGY VOLUME, GWH		40,052	41,153	42,168	46,228	54,360	27,926
SPOT MARKET VOLUME, GWH		5,960	5,451	6,180	6,150	4,274	1,962
AVERAGE SPOT VOLUME, %		15%	14%	15%	14%	8%	7%

Figure 1
Supply, Demand and Prices (Seven-Day Moving Averages)
July 2011 – June 2012



Demand and Supply

Peak demand requirements increased over the 12-month period from July 2011 to June 2012, although weather conditions were milder compared to the previous period. Highest system peak demand for the period was at 9,303 MW and was recorded at 1400H of 27 April 2012 which was the same time that the Luzon grid recorded its highest demand by far at 7,898 MW.

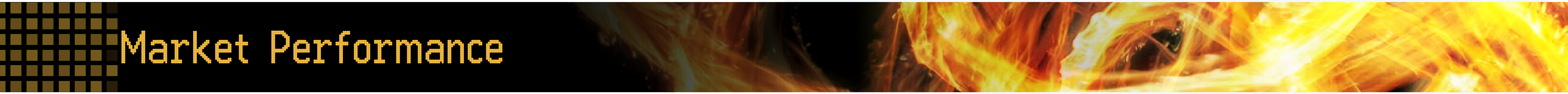
Supply was generally sufficient to meet demand in most trading intervals over the 12-month period. As illustrated, particularly in the events that occurred in October 2011 and again in May and June 2012, supply was still significantly affected by outages – whether planned or forced – and de-rating or limitations in the availability of generating units, particularly those with large capacities, and there were thus some periods when the market experienced tight supply. Curtailment or limitation in the Malampaya-supplied natural gas is one event that had always significantly affected over-all supply availability considering that the natural gas power plants contribute more than 30% to the total generation mix for any given month.

In October 2011, several major generating units, including particularly the coal and natural gas power plants, were either on outage or were de-rated at various times during the month. Natural gas supply from the Malampaya natural gas complex was curtailed as the complex went on scheduled maintenance shutdown from 20-26 October 2011 while the Leyte-Luzon high voltage direct current (HVDC) link was on annual preventive maintenance from 10-19 October 2011 limiting the export of power from Visayas to Luzon, and effectively contributing to tight supply conditions in Luzon during the month.

Increasing demand while some large generating units, particularly the coal and natural gas power plants, were either unavailable or de-rated resulted in tight supply conditions, particularly during peak periods in May and June 2012. The Malampaya natural gas supply was limited from 8-12 June 2012 causing significantly reduced capacity from the natural gas plants. Shortage in supply prompted the System Operator to place the Luzon grid on Red Alert status, implement manual load dropping on 9 June 2012 and declare market intervention for several trading intervals. On other days during these months, the System Operator declarations of Yellow Alert conditions were frequent because of insufficient operating reserves.

The interaction of supply between Luzon and Visayas remained dynamic with both the scheduling and level of power flows through the Luzon and Visayas HVDC interconnection. This is determined through the market scheduling processes that take into consideration actual thermal limits of the HVDC link. Prior to April 2011, the schedules and levels of power flow were set by the System Operator. Power flow is mostly exported from Visayas to Luzon averaging 174.3 MW 90.7% of the time from July 2011 to June 2012.

System voltage requirements, inadequate reserve levels and compliance with commercial operations requirements for testing of generation units prompted the designation by the System Operator of must-run units (MRUs). In the Visayas, the designation of the MRUs was mostly to address system voltage requirements in the Panay island. In Luzon, Bacman G01 generating unit ran as MRU starting December 2011 while it was undergoing testing and commissioning, and accounted for most of the MRU designations in Luzon due to commercial operations requirements.



Demand and Supply

Table 2
Actual Demand Levels, MW
Monthly, July 2011 – June 2012

		Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12
SYSTEM	MIN	4,860	4,833	4,795	3,614	4,671	4,407	4,170	4,842	5,217	4,482	5,644	5,383
	MAX	8,773	8,463	8,490	8,554	8,512	8,569	8,309	8,473	8,801	9,286	9,303	8,998
	AVE	6,886	6,750	6,771	6,658	6,789	6,695	6,414	6,673	7,011	7,024	7,636	7,338
LUZON	MIN	4,034	4,052	3,999	2,539	3,901	3,634	3,434	4,122	4,439	3,760	4,786	4,534
	MAX	7,404	7,188	7,099	7,219	7,193	7,137	7,034	7,164	7,500	7,894	7,898	7,685
	AVE	5,814	5,699	5,686	5,594	5,713	5,610	5,395	5,650	5,942	5,939	6,484	6,220
VISAYAS	MIN	726	771	781	723	749	747	736	664	776	716	837	620
	MAX	1,381	1,355	1,405	1,377	1,407	1,447	1,369	1,348	1,369	1,460	1,444	1,423
	AVE	1,071	1,051	1,085	1,064	1,076	1,084	1,020	1,024	1,069	1,085	1,153	1,118

Table 3
Energy Offer Levels, MW
Monthly, July 2011 – June 2012

		Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12
SYSTEM	MIN	6,362	6,977	6,410	6,949	7,448	7,456	7,371	7,604	7,438	7,653	7,710	6,840
	MAX	9,328	8,961	9,069	8,835	9,432	9,186	8,946	9,422	9,712	9,631	9,483	9,353
	AVE	8,212	8,357	8,348	8,047	8,475	8,423	8,149	8,714	8,821	8,855	8,585	8,328
LUZON	MIN	4,923	5,480	4,984	5,559	6,136	5,982	5,895	6,028	5,872	6,074	6,074	5,324
	MAX	7,752	7,494	7,418	7,302	7,864	7,677	7,436	7,945	8,159	7,978	7,869	7,657
	AVE	6,722	6,847	6,789	6,552	7,015	6,896	6,622	7,183	7,289	7,251	6,985	6,710
VISAYAS	MIN	1,327	1,242	1,354	1,272	1,178	1,343	1,356	1,314	1,338	1,443	1,481	1,198
	MAX	1,606	1,705	1,703	1,628	1,669	1,689	1,669	1,660	1,706	1,723	1,703	1,736
	AVE	1,490	1,509	1,559	1,494	1,460	1,527	1,527	1,531	1,532	1,603	1,600	1,618

Figure 2
Energy Offers, MW
Monthly, July 2011 – June 2012

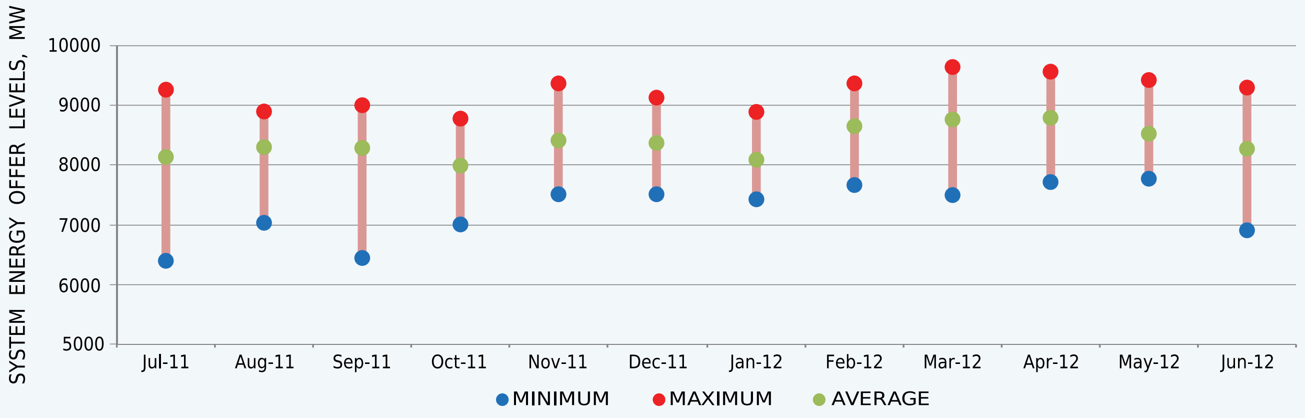


Figure 3
Actual HVDC Flow, MW
Hourly, July 2011 – June 2012

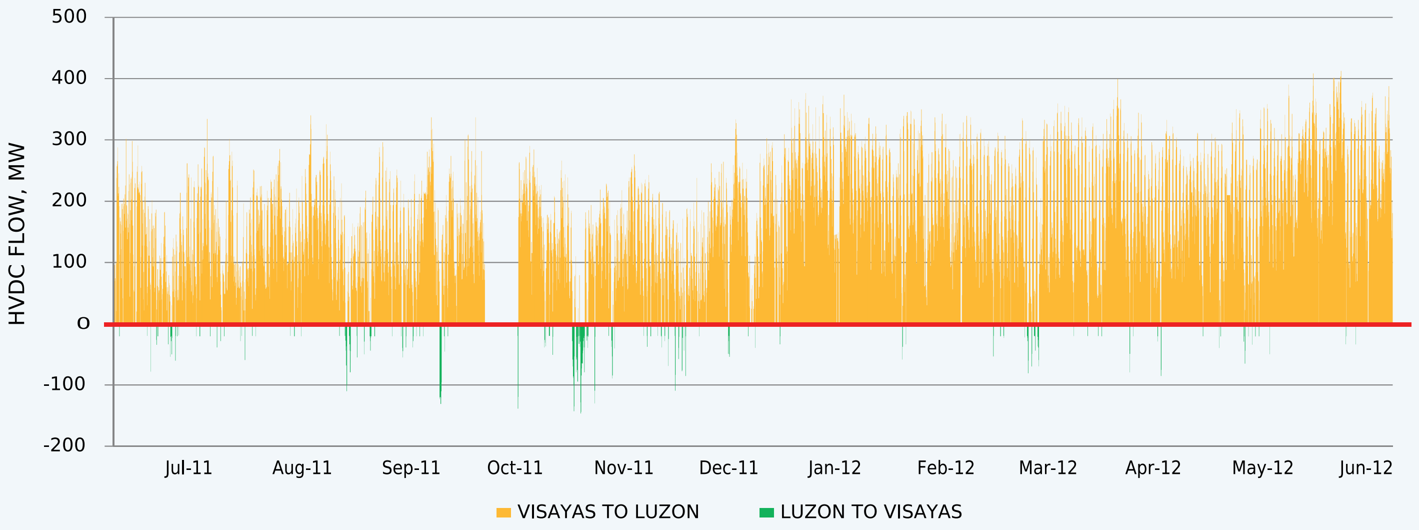


Figure 4
Must-Run Units, Luzon
Monthly, July 2011 – June 2012

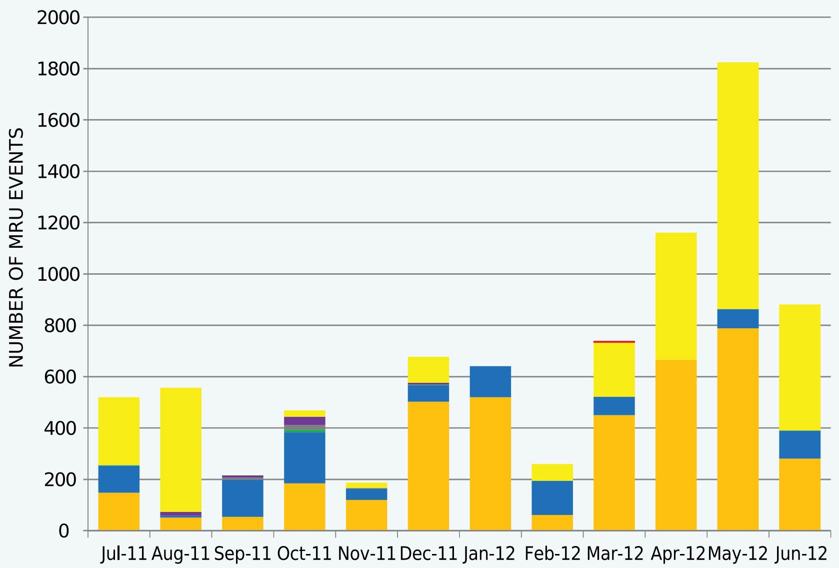
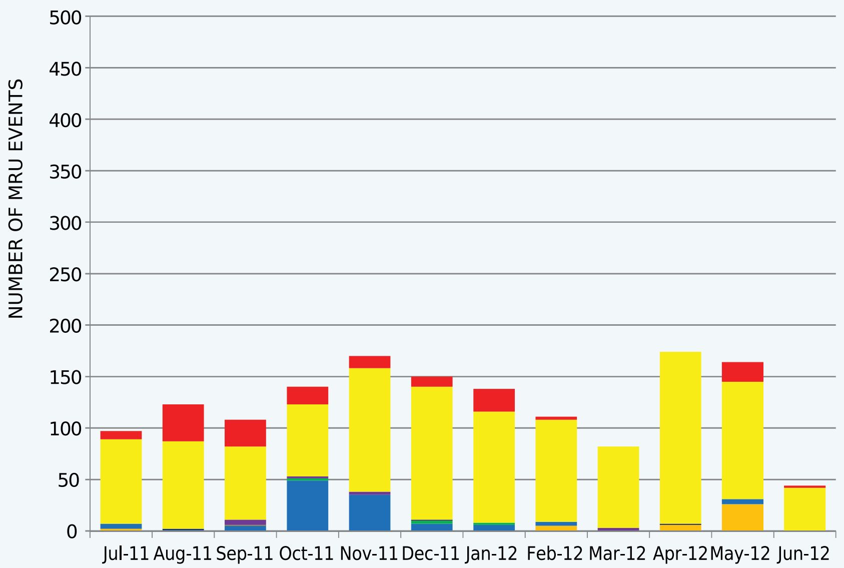


Figure 5
Must-Run Units, Visayas
Monthly, July 2011 – June 2012



COMMERCIAL OPERATION REQUIREMENTS
INADEQUATE RESERVE LEVELS
INSUFFICIENT OFFERS FROM GENERATORS
INTRA-HOUR VARIATION
LOCAL CALAMITIES AND EMERGENCIES
REGULATORY REQUIREMENTS
SYSTEM TESTS OF NGCP FACILITIES/EQUIPMENT
SYSTEM VOLTAGE REQUIREMENT
THERMAL LIMITS OF T/L AND POWER EQUIPMENT

Market Prices

Market price outcomes continue to be driven primarily by supply availability, although transmission grid reliability and security requirements and weather conditions also impact market price outcomes.

Market prices were at their highest levels in October 2011 and June 2012 when supply was mostly limited because of the de-rating and unavailability of large generating units and the curtailment of natural gas supply to the natural gas power plants. On two other occasions when the Malampaya-supplied natural gas was also restricted, particularly in September and November 2011, demand levels were relatively lower so that the fuel limitations did not significantly drive prices up as much as the natural gas supply curtailment in October 2011 and June 2012.

Constraints arising from the violation of the N-1 contingency requirement imposed by the System Operator at the sub-stations serving the Manila Electric Company (MERALCO) are the primary cause of pricing errors over the 12-month period. This is particularly evident in March and April 2012 when one of the transformers of the Araneta and of the Zapote sub-stations were on outage resulting in frequent violation of the N-1 contingency requirement that, in turn, caused pricing errors even during off-peak hours of the day. With the regional application of the pricing error rules, these pricing errors were mostly limited to the market outcomes in Luzon.

Price separations frequently occurred in February 2012, particularly in the Visayas, because of congestion at the Kabankalan-Bacolod 138 kV lines arising from the lines' reduced capacities. Congestion was also frequent in other lines, particularly the New Naga-Quiot and New Naga-Cebu 138 kV lines, but these generally did not result in significant price separations.

Figure 6
Load Weighted Average Prices, PHP/MWh
Monthly, July 2011 – June 2012

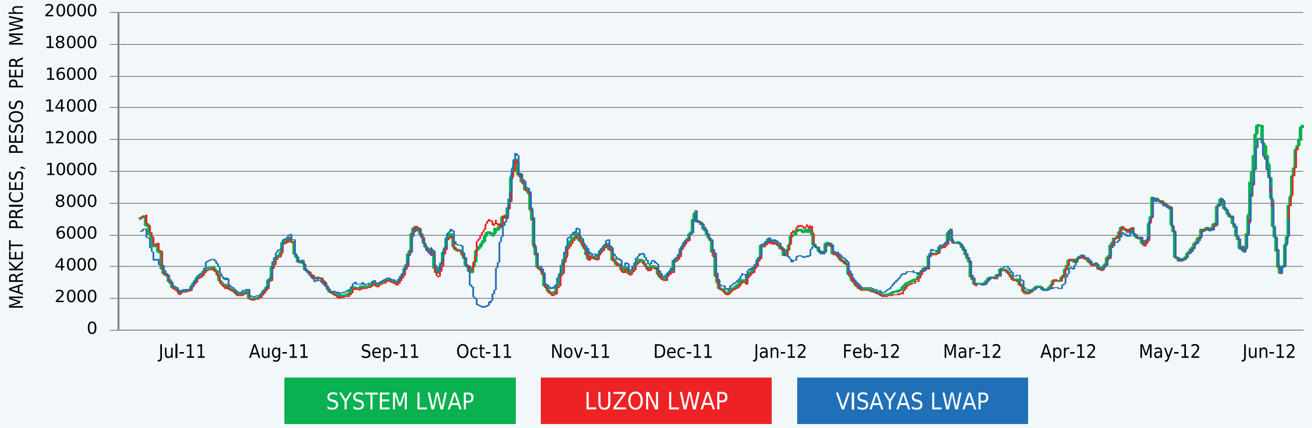


Table 4
Load Weighted Average Prices, PHP/MWh
Monthly, July 2011 – June 2012

		Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12
SYSTEM	MIN	0	0	0	0	0	0	0	0	1,035	0	1	951
	MAX	34,841	62,552	45,667	47,583	44,262	64,696	46,547	18,551	40,917	21,814	63,092	56,979
	AVE	4,485	3,688	3,799	6,803	5,089	5,074	5,165	3,386	4,498	3,710	6,837	9,145
LUZON	MIN	0	0	0	0	0	0	0	0	1,035	0	1	954
	MAX	34,841	62,686	46,679	51,507	46,669	64,732	46,584	18,575	40,917	25,337	63,092	62,859
	AVE	4,480	3,672	3,772	6,976	5,019	5,026	5,218	3,324	4,476	3,719	6,835	9,141
VISAYAS	MIN	0	0	0	0	0	0	0	0	726	0	1	0
	MAX	59,083	61,808	40,470	48,174	43,359	64,716	46,357	18,417	45,380	18,452	63,092	56,979
	AVE	4,513	3,780	3,938	5,895	5,461	5,322	4,884	3,734	4,625	3,660	6,845	9,171

Generation Mix

While the capacity mix registered in the WESM is fairly diverse, coal and natural gas power plants accounted for more than two-thirds of the monthly generation mix. As in previous years, oil/diesel-based power plants round up the generation mix in times when supply from natural gas, coal or hydro-electric power plants is limited. Monthly contribution of oil/diesel-fired power plants were highest in May and June 2012 at 4% of the monthly generation and in October 2011 at 3% of the total generation. In these three months, over-all supply condition was tight due to the unavailability or de-rating of large generation plants.

Figure 7
Registered Capacities
June 2012

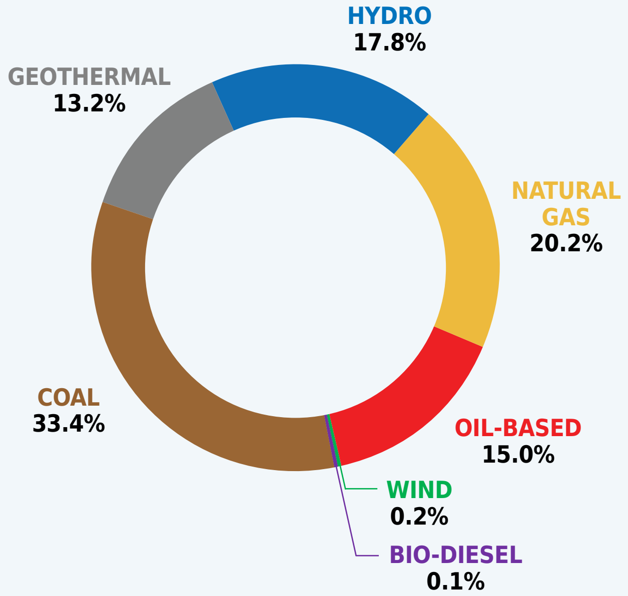
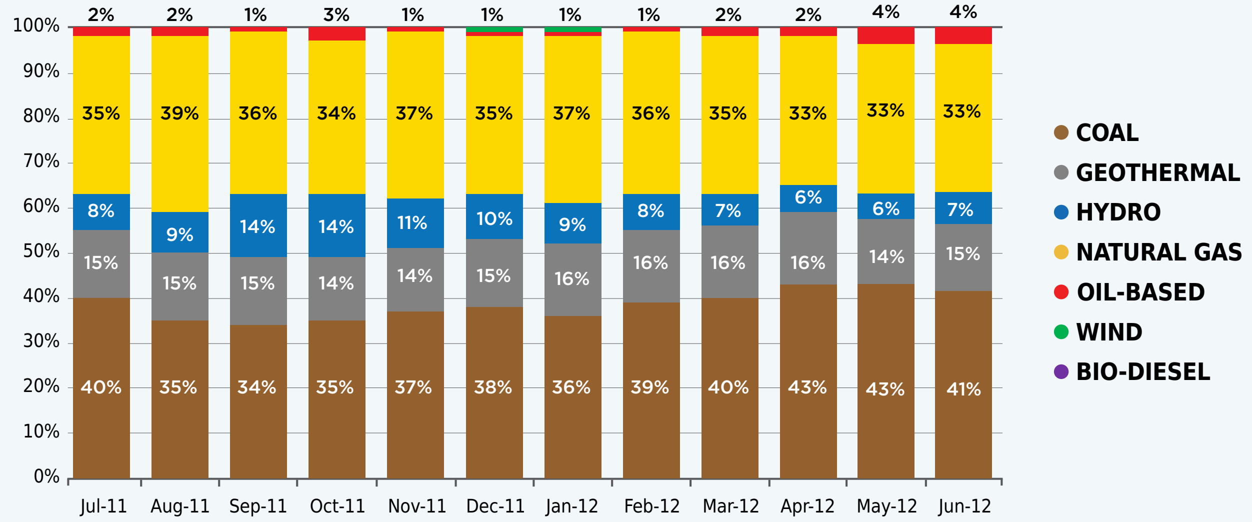


Table 5
Generation Mix
Monthly, July 2011 – June 2012



Market Transactions Volumes and Values

Energy transaction volumes have been increasing steadily since the WESM started operations in 2006. Notably, spot market transaction volumes significantly decreased in 2011 and in the first half of 2012. With the termination of the Default Wholesale Supply arrangement in September 2010 and the privatization of most government-owned generation assets and IPP contracts, contracting levels have gone up with most customer trading participants already entering into long-term supply contracts with other generators.

Total transactions for the 12-month period amounted to 54,946 GWh, with 8 % transacted in the spot market while the rest were netted out of the market settlements as bilateral contract quantities. Total spot market generator trading amounts for the period amounted to PHP 35,237 million. For their spot market transactions, the WESM customers transacted at Effective Spot Settlement Prices ranging from PHP 4,122.00/MWh in February 2012 to PHP 12,667/MWh in June 2012.

Figure 8
Energy Transaction Volumes and Trading Amounts
Monthly, July 2011 – June 2012

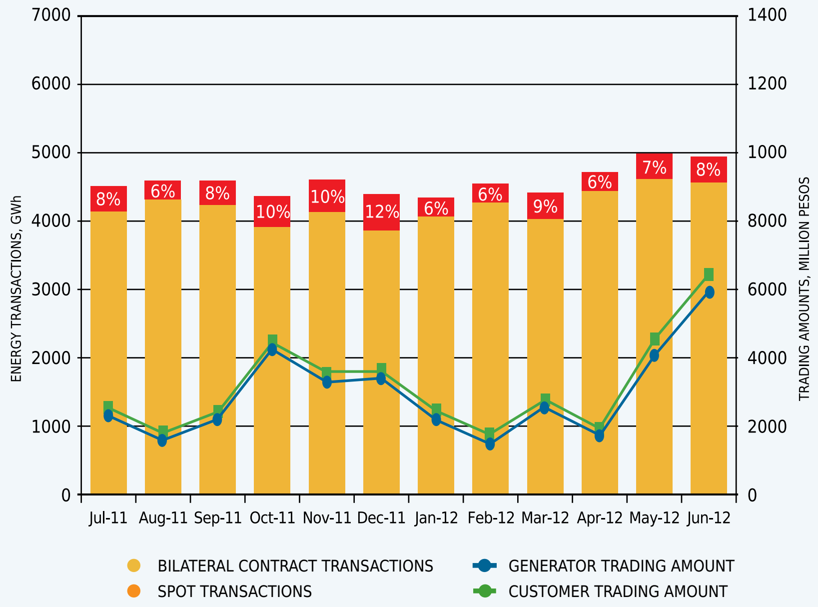


Figure 9
Customer Effective Spot Settlement Price
Monthly, July 2011 – June 2012

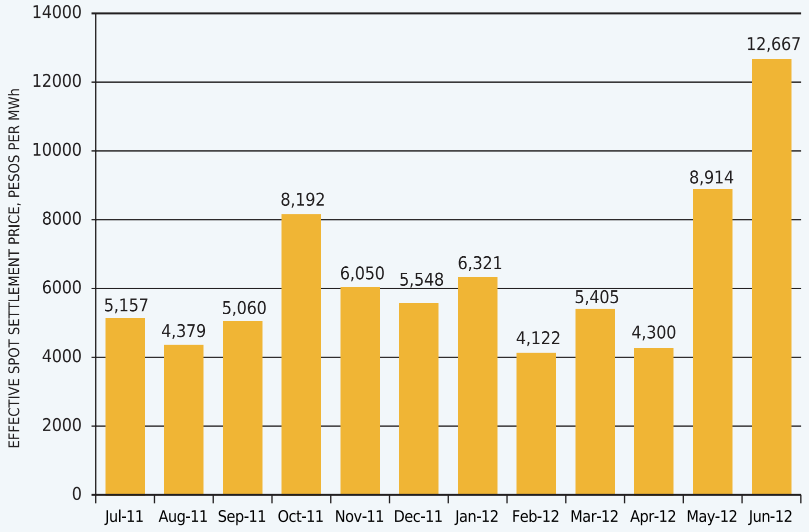


Table 6
Energy Transaction Volumes and Trading Amounts
Monthly, July 2011 – June 2012

	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12
CUSTOMER TRANSACTIONS, GWh	4,496	4,589	4,591	4,359	4,598	4,387	4,335	4,520	4,416	4,725	4,981	4,949
SPOT PERCENTAGE	8%	6%	8%	10%	10%	12%	6%	6%	9%	6%	7%	8%
GENERATOR TRADING AMOUNT, MILLION PESOS	2,323	1,634	2,224	4,282	3,280	3,429	2,207	1,498	2,564	1,758	4,101	5,936
CUSTOMER TRADING AMOUNT, MILLION PESOS	2,574	1,829	2,419	4,516	3,562	3,652	2,496	1,764	2,797	1,954	4,588	6,443

Market Concentration Indices

The level of competition in the WESM for July 2011 to June 2012 is assessed using various market indices including Market Share, Herfindahl-Hirschman Index (HHI), Residual Supply Index (RSI), Pivotal Supply Index (PSI) and Price Setting Frequency Index (PSFI).

Market Share

The monthly trend in the market share of major participant groups based on registered capacity is presented in Tables 1 and 2. The registered capacities of the generating units of the grouped generators are all attributed to their respective groups. Derivation of accurate market concentration indices that properly take into consideration the ownership, control and affiliation of the market participants has been a challenge.

Table 1
Major Participant Groups, Luzon
July 2011 – June 2012

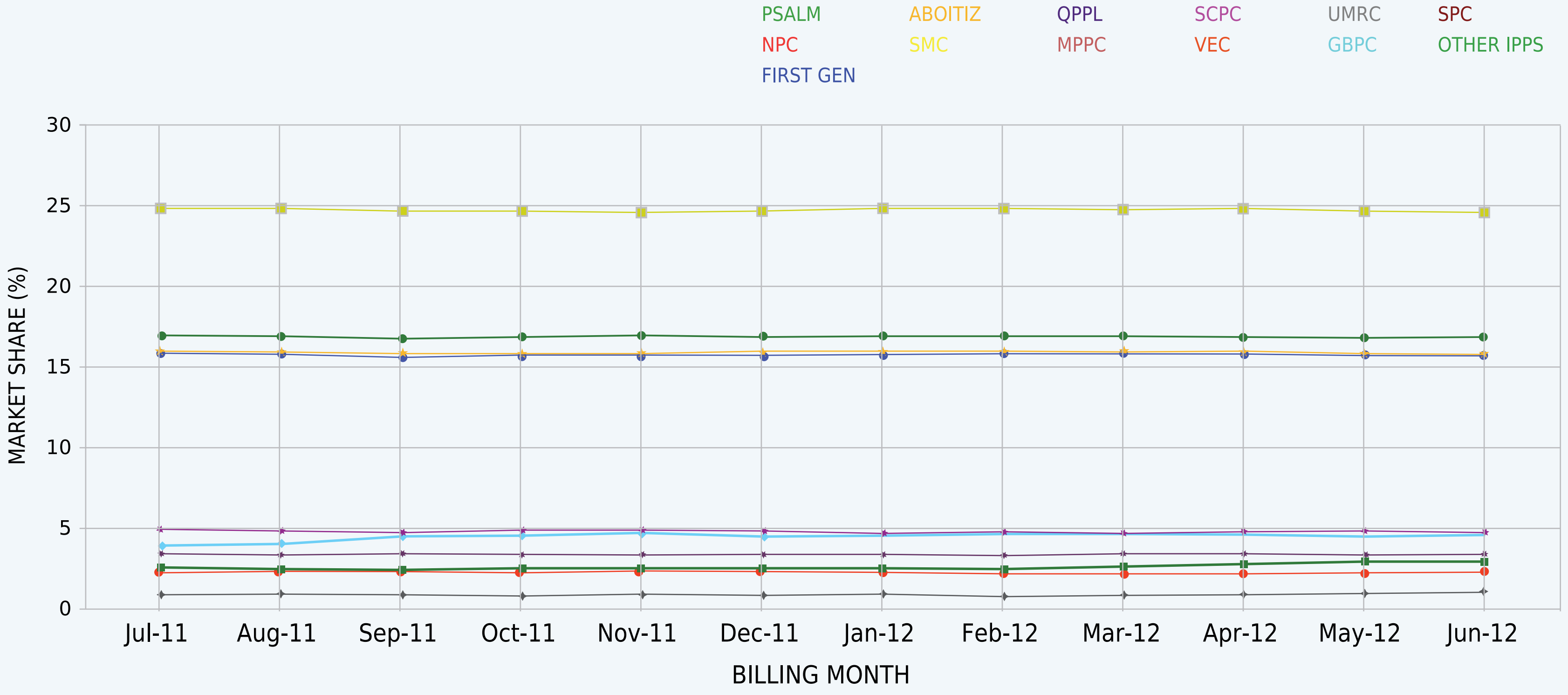
MAJOR GROUPING	WESM PARTICIPANT	RESOURCES
PSALM	Power Sector Assets and Liabilities Management Corp.	Botocan HEP, Caliraya HEP, Kalayaan PSPP, Casecnan HEP, HEDCOR, Malaya TPP
NPC	National Power Corp.	Angat HEP
SMC	PANASIA Energy Holdings, Inc. San Miguel Energy Corp. Strategic Power Development Corp. South Premier Power Corp.	Limay CCGT Sual CFTPP San Roque HEP Ilijan NatGas Plant
First Gen	Bacman Geothermal, Inc. FGP Corp. First Gas Power Corp. First Gen Hydro Power Corp.	BacMan GPP San Lorenzo FGPP Sta. Rita FGPP Masiway HEP, Pantabangan HEP
Aboitiz	AP Renewables, Inc. SN Aboitiz Power - Magat, Inc. SN Aboitiz Power - Benguet, Inc. Therma Luzon, Inc. HEDCOR, Inc.	Makban GPP, Tiwi GPP Magat HEP Ambuklao HEP, Binga HEP Pagbilao CFTPP Irisan 3 HEP, Sal-Angan HEP
VEC	1590 Energy Corp. Vivant Sta. Clara Nothern Renewables Generation Corp.	Bauang DPP Bakun HEP
MPPC	Masinloc Power Partners Co. Ltd.	Masinloc CFTPP
QPPL	Quezon Power (Phils.) Ltd. Co.	QPPL CFTPP
SCPC	SEM-Calaca Power Corp.	Calaca CFTPP
UMRC	Udenna Resource Mgmt. Corp.	Subic DPP
Other IPPs	National Irrigation Administration North Wind Power Development, Inc. People's Energy Services, Inc. Trans-Asia Power Generation Corp. Asia Pacific Energy Corp.	NIA-Baligatan NWPDC Wind Power Plant Barit HEP TAPGC DPP APEC CFTPP

Table 2
Major Participant Groups, Visayas
July 2011 – June 2012

MAJOR GROUPING	WESM PARTICIPANT	RESOURCES
PSALM	Power Sector Assets and Liabilities Management Corp.	Leyte A (Tongonan II & III), Cebu DPP I, Cebu DPP II, Cebu TPP I, Cebu TPP II
NPC	National Power Corp.	Power Barges 101, 102 & 103
First Gen	Energy Development Corp. Green Core Geothermal, Inc.	Northern Negros GPP Leyte (Tongonan) GPP, Palinpinon GPP I, Palinpinon GPP II
Aboitiz	Cebu Private Power Corp. East Asia Utilities Corp.	CPPC DPP EAUC DPP
GBPC	Cebu Energy Development Corp. Panay Energy Development Corp. Panay Power Corp. Toledo Power Corp.	CEDC CFTPP PEDC CFTPP Avon (La Paz) DPP, Avon (Nabas) DPP, Avon (New Wash.) DPP, PPC DPP TPC (Carmen) TPP, TPC (Sangi) CFTPP
SPC	KEPCO SPC Power Corp. SPC Island Power Corp.	KSPC CFTPP Bohol DPP, Panay DPP I, Panay DPP III
Other IPPs	Bohol I Electric Cooperative, Inc. Central Azucarera de San Antonio ICS Renewables Sta. Clara Power Corp. Trans-Asia Oil Development Corp. First Farmers Holdings Corp. San Carlos Bioenergy, Inc.	Janopol HEP CASA Biomass Cogen. Amlan HEP Loboc HEP Trans-Asia DPP FFHC Biomass SCBI Biomass

Based on their registered capacities, there was no change observed in the ownership/control of the generators registered with the WESM as shown in Figure 1. The San Miguel group maintained a market share of about 25% of the registered capacities in Luzon and Visayas, while both the First Gen and Aboitiz groups had market shares of about 16% each. After the privatization of most of the generation assets and contracts, the Power Sector Assets and Liabilities Management (PSALM) Corporation still managed and traded about 17% of the capacities in Luzon and the Visayas.

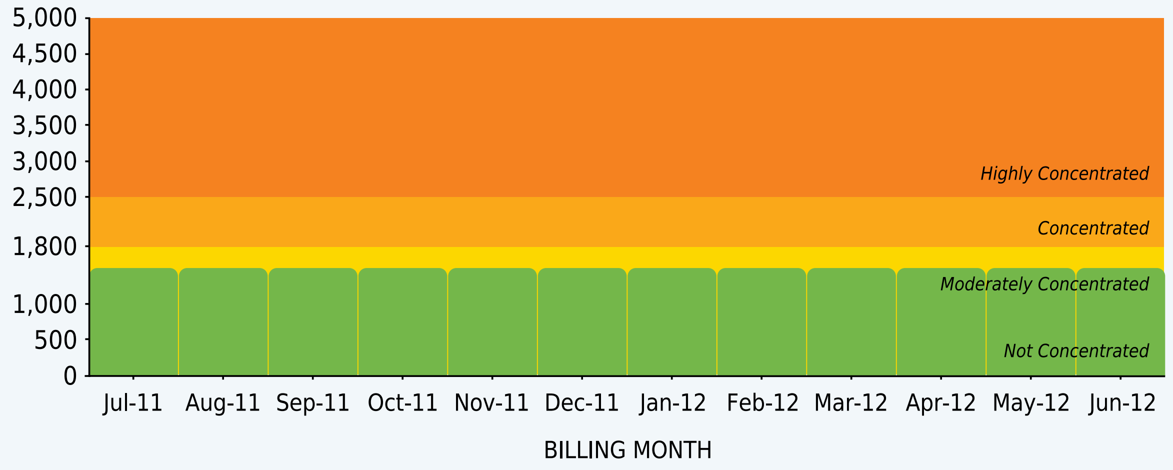
Figure 1
Share of Registered Capacity by Major Participant
Monthly, July 2011 – June 2012



Herfindahl-Hirschman Index (HHI)

Figures 2 to 4 show the monthly Herfindahl-Hirschman Index (HHI)[1] calculated on the market share of major participant groups based on (a) registered capacity, (b) registered capacity net of outage, (c) offered capacity, (d) metered quantities or actual generation and (e) metered quantities net of bilateral contract quantity declarations. In calculating this index, the market participants were likewise grouped into major participant groups as discussed in the previous section.

Figure 2
HHI Based on Share of Registered Capacity
Monthly, July 2011 – June 2012

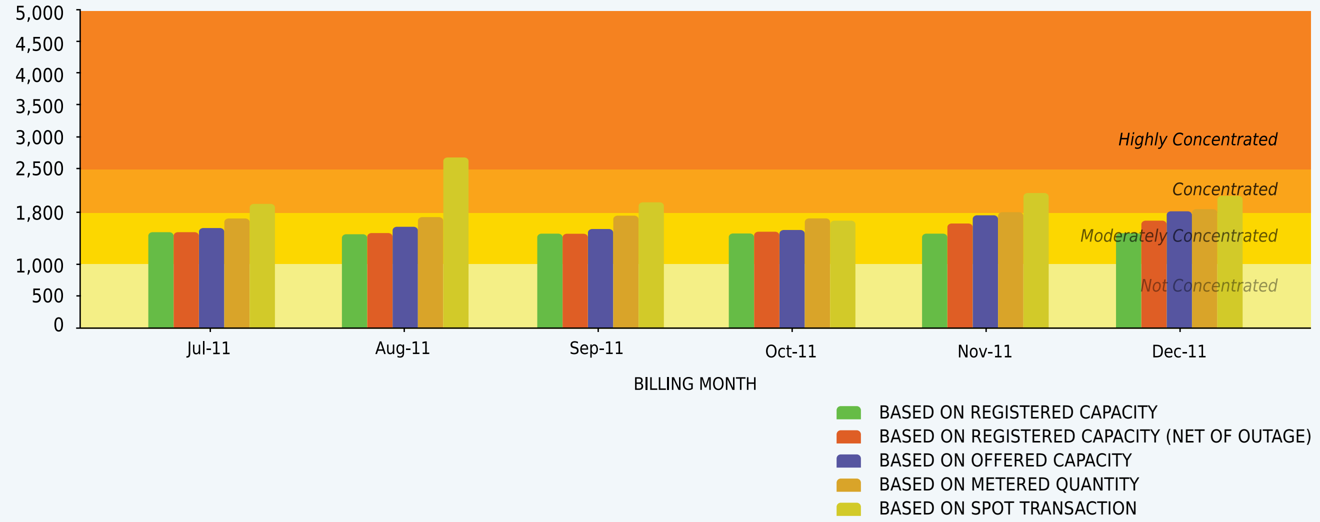


The HHI based on registered capacity provides the base scenario in assessing market concentration. It will not vary over time unless there is a (a) change in the ownership of generators, (b) change in the registered capacity of generators, (c) registration of new generator/s and (d) deregistration of generator/s. On the other hand, the HHI results based on the other four scenarios may vary for each study period.

It can be seen in Figure 2 that the HHI based on registered capacity remained constant throughout the period with about 1,490 falling within the moderately concentrated region. As discussed in the previous section, there was no change in the ownership/control of the generators in Luzon and Visayas. While there were approved changes in the registered capacities of certain generators (upward and downward changes), these changes had minimal impact in the resulting market shares of the major

[1] The HHI is a commonly accepted measure of market concentration that takes into account the relative size and distribution of participants in the market. The HHI is a number between 0 and 10,000, which is calculated as the sum of squares of the participant's market share. The HHI approaches 0 when the market has a very large number of participants with each having a relatively small market share. In contrary, the HHI increases as the number of participants in the market decreases, and the disparity in the market shares among the participants increases. The following are the widely used HHI screening numbers: (a) less than 1,000 – not concentrated; (b) 1,000 to 1,800 – moderately concentrated; (c) greater than 1,800 – concentrated; and (d) greater than 2,500 – highly concentrated.

Figure 3
HHI Based on Various Scenarios
Monthly, July – December 2011

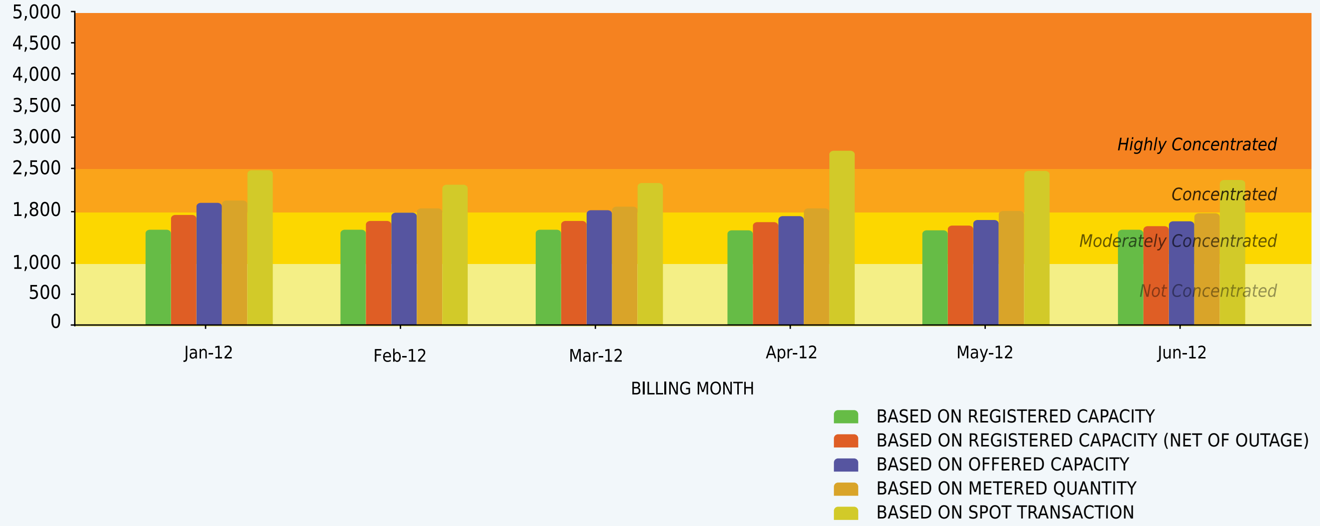


participant groups. The new participants have relatively small generating capacities and had minimal impact on the resulting market shares. These new entrants are (a) San Carlos Bioenergy, Inc. registered effective 26 February 2012 for its 8.3 MW plant in San Carlos City, Negros Occidental, and (b) Asia Pacific Energy Corporation registered effective 11 April 2012 for its 52 MW coal-fired plant in Mabalacat, Pampanga. These are classified under the "Other" participant group category.

The HHI based on registered capacity net of outage (Figures 3 and 4) also indicated a "moderately concentrated market." The calculated HHI values tend to be lower when there was considerable outage from the San Miguel group, which owned about 25% of the registered capacities. This was observed in the billing months of July to October 2011 and May to June 2012.

The market bordered from a "moderately concentrated" to "concentrated" condition looking at HHI results based on offered capacity. The HHI values tend to be lower also from July to October 2011 and May to June 2012 coincident with lower level of offered capacity from the San Miguel group, which was attributed to plant outages. Ideally, in compliance with the must-offer rule, the HHI results based on offered capacity should be the same as the HHI based on registered capacity (net of outage). Notwithstanding, higher values were derived from the

Figure 4
HHI Based on Various Scenarios
Monthly, January – June 2012



former scenario, which was influenced by the prevailing gaps between the registered capacity (net of outage) and offered capacity of the generators.

Similarly, the market bordered from a "moderately concentrated" to "concentrated" condition looking at HHI results based on metered quantities. Meanwhile, the HHI based on metered quantities net of bilateral showed a "highly concentrated" market, except in the October 2011 billing month. These results were influenced, among others things, by the market conditions and the bidding behavior and contractual obligations of the generator trading participants.

Residual Supply Index (RSI)

During the period in review, except for the billing months of July and October 2011 and May to June 2012, the market demonstrated a robust environment as indicated by the high percentage of time with Market Residual Supply Index (RSI)[2] above 100% indicating the absence of pivotal generators. The highest percentage of time where RSI was above 100% occurred in February 2012 at about 76.3%, which was attributed to improved supply condition resulting from lower capacity on outage. On the other hand, the percentage of time with RSI less than 100% reached about 54%, 66% and 64% in October 2011, May and June 2012, respectively. The higher level of outage capacity drove the RSI results in October 2011 and June 2012, while higher demand level drove the RSI results in May 2012. Looking at the market prices as discussed in previous sections, it was noted that the three highest monthly prices during the period occurred in the billing months of October 2011, May and June 2012.

Figure 5
Market RSI Based on Offered Capacity of Generators
Hourly, July 2011 – June 2012

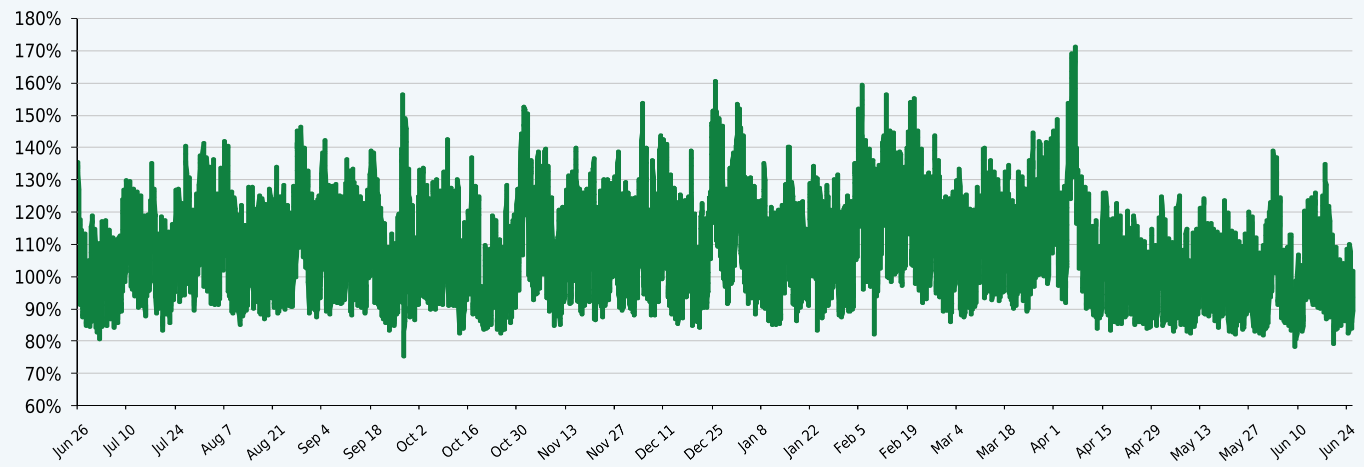


Table 3
Market RSI Summary
Monthly, July 2011 – June 2012

MARKET RSI	PERCENT OF TIME											
	2011						2012					
	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	APR	MAR	MAY	JUN
<100%	51.8	40.3	40.9	54.3	37.4	39.3	33.9	23.7	38.1	35.3	65.8	64.2
>100%	48.2	59.7	59.1	45.7	62.6	60.7	66.1	76.3	61.9	64.7	34.2	35.8

[2] The RSI is a dynamic continuous index measured as ratio of the available generation without a generator to the total generation required to supply the demand. The RSI is measured for each generator. The greater the RSI of a generator, the less its potential ability will be to exercise market power and manipulate prices as there will be sufficient capacity from the other generators. In contrary, the lower the RSI, the greater the market power of a generator (and its potential benefit of exercising market power), as the market is strongly dependent on its availability to be able to fully supply the demand. In particular, an RSI greater than 100% for a generator means that the remaining generators can cover the demand, and in principle, that generator cannot manipulate market price. On the other hand, an RSI less than 100% means that the generator is pivotal in supplying the demand. The RSI for the whole market (Market RSI) is measured as the lowest RSI among all the generators in the market. A Market RSI less than 100% indicates the presence of pivotal generator/s.

Pivotal Supplier Index (PSI)

The most frequent pivotal generators include the coal plants Sual, Pagbilao, Masinloc and QPPL, and the natural gas plants Ilijan, Sta. Rita and San Lorenzo taking into account their large generating capacities. Tables 4 and 5 list the pivotal generators in Luzon and Visayas, and the percentage of time that said generators were pivotal in any billing month.

Table 4
PSI by Plant Based on Offered Capacity
Monthly, July 2011 – June 2012, Luzon

PLANT NAME	PERCENT OF TIME											
	2011						2012					
	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
AMBUKLAO HEP	3.3	0.7	2.2	5.6	0.8	0.4	0.8	0.1	0.4	2.6	14.3	16.4
ANGAT HEP	3.3	0.5	2.2	6.7	0.9	0.4	0.7	0.1	0.1	1.9	9.3	13.3
APEC										0.1		
BAKUN HEP	4.0	0.5	2.2	3.8	0.7							
BATANGAS CFTPP	9.6	0.9	1.3	9.6	2.4	0.7	1.5	0.4	0.6	6.2	23.6	15.5
BAUANG DPP	6.5	1.1	3.8	7.9	1.5	0.7	1.2	0.3	0.4	4.0	18.9	20.7
BINGA HEP						0.1		0.1	0.1	1.6	8.2	12.4
BOTOCAN HEP	1.1	0.3	1.9	1.7								
CALIRAYA HEP	3.5	0.3	1.9	3.8	0.7	0.4	0.1	0.1	0.1	1.1	6.9	7.1
CBK (KPSPP)	3.8	0.8	2.7	7.4	1.9	0.7	0.8	0.5	0.3	2.8	14.3	15.3
CE CASECNAN	4.0	0.5	2.0	6.0	0.8	0.3	0.1	0.1		0.4	4.0	7.9
HEDCOR	3.3	0.3	2.0	3.6	0.5		0.1	0.1	0.1	1.7	7.9	12.5
KEPCO ILIJAN	36.4	39.8	39.8	35.7	35.5	38.1	33.2	21.2	34.5	33.3	63.9	60.1
LIMAY CCGT	4.9	1.2	2.8	8.6	2.3	0.3	0.1	0.1	1.1	0.7	10.8	15.2
MAGAT HEP	1.4	0.3	1.7	3.6	0.4	0.1	0.1	0.1	0.1	1.7	8.9	14.0
MAKBAN GPP	9.3	3.0	5.5	10.0	3.6	1.9	2.6	0.4	1.4	6.5	25.6	24.7
MALAYA TPP				0.8								
MASINLOC CFTPP	23.9	11.6	19.1	26.7	14.4	9.3	5.0	5.4	8.3	16.8	46.9	40.9
MASIWAY HEP	1.7	0.1	1.9	2.2	0.4	0.1	0.1	0.1	0.1	0.8	7.9	11.0
PAGBILAO CFTPP	24.6	20.4	23.5	15.4	4.8	4.0	1.6	7.3	14.1	21.0	48.3	36.0
PANTABANGAN HEP	2.4	0.1	1.7	2.9	0.5	0.4	0.7	0.1	0.4	1.2	10.8	12.5
QUEZON POWER	10.3	7.4	7.8	14.3	7.7	4.4	5.0	0.1	0.7	11.4	38.3	33.6
SAN LORENZO FGPP	18.2	9.5	13.0	20.6	6.6	6.9	8.2	2.8	5.0	14.4	41.1	34.0
SAN ROQUE POWER	6.5	5.8	9.8	11.4	5.8	4.4	5.8	1.3	2.7	2.4	12.6	7.1
STA RITA FGPP	39.6	31.6	32.7	45.1	29.4	23.5	22.2	13.8	23.9	27.7	58.2	54.6
SUAL CFTPP	45.6	15.7	19.5	32.5	34.8	39.3	33.1	15.2	31.6	34.3	60.8	59.3
SUBIC POWER CORP	4.2	0.8	2.2	6.4	0.9	0.4	0.8	0.1	0.3	2.8	14.3	16.7
TIWI GPP	5.4	0.8	2.2	6.9	0.9	0.4	0.8	0.1	0.4	3.4	15.8	17.1
TRANS-ASIA	3.5	0.4	2.0	4.0	0.7	0.1	0.1	0.1	0.1	1.9	9.4	12.9

Table 5
PSI by Plant Based on Offered Capacity
Monthly, July 2011 – June 2012, Visayas

PLANT NAME	PERCENT OF TIME											
	2011						2012					
	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
AVON (NABAS) DPP				1.5	0.1						1.7	5.2
BOHOL DPP	2.4	0.3	1.3	3.2	0.4	0.1	0.1	0.1	0.1	1.7	6.9	8.9
CEBU DPP I	2.4	0.3	1.7	3.2	0.4	0.1	0.1	0.1	0.1	1.7	8.1	11.7
CEBU DPP II	2.6	0.3	1.9	3.1	0.4	0.1	0.1	0.1	0.1	1.7	8.1	11.8
CEBU TPP I	2.4	0.3	2.0	0.8	0.3	0.3	0.1	0.1	0.1	1.9	7.1	12.1
CEBU TPP 2	3.6	0.4	2.0	4.2	0.7	0.3	0.1	0.1	0.1	1.3	9.3	7.9
CEDC CFTPP	8.3	2.6	5.1	8.5	1.9	1.9	1.9	0.4	0.4	6.2	24.6	23.9
CPPC DPP	3.6	0.5	2.2	4.3	0.7	0.4	0.3	0.1	0.1	1.9	11.3	14.4
EAUC DPP	3.5	0.4	2.0	3.8	0.7	0.3	0.1	0.1	0.1	1.9	9.7	13.2
KSPC CFTPP	6.1	1.5	2.4	8.3	1.5	1.1	1.5	0.4	0.4	4.4	21.1	19.4
LEYTE A	16.0	6.3	10.8	16.3	6.5	6.0	6.2	1.3	3.2	11.6	36.3	33.9
NNEGROS GPP	0.8											
PALINPINON GPP I	3.9	0.5	2.2	4.7	0.7	0.4	0.8	0.1	0.4	2.7	13.9	16.0
PALINPINON GPP II	4.0	0.7	2.2	4.7	0.7	0.4	0.4	0.1	0.1	2.3	11.5	15.2
PANAY DPP I										1.5	4.2	6.5
PANAY DPP III	3.6	0.4	2.0	4.0	0.5	0.3	0.1	0.1	0.1	1.9	9.9	13.3
PB 101	0.6	0.3	1.9	3.1	0.4					1.1	7.8	7.0
PB 102	1.5	0.1	1.9	3.3	0.4	0.1	0.1	0.1	0.1	1.7	7.9	12.0
PB 103		0.1	1.9	2.2	0.4		0.1				1.5	5.5
PEDC CFTPP	4.0	0.4	2.8	7.5	1.1	0.6	0.7		0.4	3.6	18.1	20.6
TONONGAN GPP	3.9	0.5	2.2	4.6	0.7	0.4	0.5	0.1	0.1	2.3	12.1	14.9
TPC (CARMEN)	3.5	0.4	2.0	3.8	0.7	0.4	0.1	0.1	0.1	1.9	8.8	13.2
TPC (SANGI)	3.6	0.5	2.2	4.3	0.7	0.4	0.3	0.1	0.1	1.9	10.4	14.2

Price Setting Frequency Index (PSFI)

Tables 6 to 8 list the generating plants that qualified as price setters and the percentage of time that they became price setters[3] in any billing month are determined for prices equal to PHP 5,000.00/MWh and below; between PHP 5,000.00 to PHP 10,000.00/MWh; and PHP 10,000.00 and above.

Table 6
PSFI at Prices Equal to PHP 5,000/MWh and Below
Monthly, July 2011 – June 2012

PLANT NAME	PERCENT OF TIME											
	2011						2012					
	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
LUZON												
AMBUKLAO HEP	1.0	3.2	3.5	3.1	12.0	10.6	6.9	1.1	0.7	4.7	2.1	3.5
ANGAT HEP	0.1	1.3	1.1	2.1	1.9	7.2	3.2	4.2		0.8		
BAKUN HEP	1.9	4.0	5.9	3.1	3.1							
BATANGAS CFTPP	9.7	2.4	5.0	3.9	5.2	7.1	1.6			2.8		
CBK (KPSPP)		0.1	0.3		1.1	0.3		1.1	2.2	5.5	0.7	
CE CASECNAN		1.7	1.1	1.3	1.7	7.2	1.9	0.5		0.8		
HEDCOR	0.1	1.3	1.1	2.1	1.9	7.2	3.2	4.2		0.8		
KEPCO ILIJAN	3.8	9.4	8.3	7.2	6.3	7.8	8.5	8.6	13.5	4.3	2.9	4.6
MAGAT HEP		1.3	1.2	2.1	2.0	7.4	3.5	4.3		2.0		1.6
MAKBAN GPP	4.4	6.3	8.9	7.8	4.2		0.8			0.1		
MASINLOC CFTPP	36.5	35.6	27.2	32.9	31.6	30.3	28.1	48.3	41.5	27.4	26.1	25.7
MASIWAY HEP	0.3		0.3	0.3	0.9	7.2	3.2	3.6		0.8		
PAGBILAO CFTPP	32.8	32.7	32.4	26.9	20.0	20.8	10.2	43.8	51.3	50.3	28.3	26.2
QUEZON POWER	0.4	3.0	1.1	5.0	2.6	6.9	8.5	4.6	4.0	9.3	7.6	5.0
SAN LORENZO FGPP	0.1	1.5	1.2	2.1	2.2	6.9	9.1	4.6	0.9	5.8	3.5	2.6
SAN ROQUE POWER	1.3	25.1	3.4	3.6	6.2	0.4	0.9	5.0	0.3			
STA RITA FGPP	0.1	1.5	1.2	2.1	2.0	7.2	8.3	4.4	0.4	5.9	9.0	6.2
SUAL CFTPP	42.1	28.4	27.3	24.6	27.6	22.8	32.4	45.0	50.9	45.2	35.3	37.6
VISAYAS												
CEBU TPP 1	0.4	1.3	2.0	1.7	1.6	6.0	2.8	0.9				0.5
CEDC CFTPP	13.8	12.2	6.6	13.6	8.3	16.5	18.5	11.0	5.2	12.8	9.0	12.6
KSPC CFTPP	28.8	28.5	20.0	19.3	15.7	14.0	23.3	41.0	31.3	38.7	23.5	14.9
LEYTE A	28.5	21.1	16.8	35.6	21.1	20.1	20.3	23.9	19.8	14.7	10.0	5.4
PALINPINON GPP I		1.3	1.3	1.8	1.2	6.1	3.9	4.8	1.1	1.5	0.1	0.8
PALINPINON GPP II		1.3	1.2	1.7	1.3	6.1	4.0	4.2		1.3		0.4
PEDC CFTPP	3.6	9.3	19.8	10.8	4.7	9.6	10.1	14.8	2.6	5.1	4.9	4.0
TONGONAN GPP		1.7	1.2	1.4	1.2	6.1	3.6	4.2		1.3		0.4
TPC (SANGI)	16.8	10.2	2.7	5.6	3.6	7.4	5.2	6.3	1.1	10.6	4.2	4.7

NOTE: Plants with PSFI above 5% in any given month

[3] The Price Setting Index identifies the generators that set the price or are near setting the spot price in a trading interval. A generator is considered a price setter if its last accepted offer price is within 95% to 100% of its nodal price. The PSFI is calculated as the percentage of time that a generator qualifies as price setter in a period (i.e. monthly). A generator that frequently sets the price may have greater opportunities to design bidding strategies to influence the prices.

At prices equal to PHP 5,000/MWh and below (Table 6), the coal plants Masinloc, Pagbilao and Sual are the most frequent price setters in Luzon, while the geothermal plant Leyte A and coal plants of Kepco-Salcon Power Corporation and Cebu Energy Development Corporation topped the frequent price setters in the Visayas.

Meanwhile, at prices between PHP 5,000/MWh and PHP 10,000/MWh (Table 7), the oil-based plants Subic, Trans-Asia and Bauang were the consistent frequent price setters in Luzon. In certain billing months, natural gas plant Ilijan and hydro-electric plants San Roque, KPSPP and Ambuklao figured as frequent price setters. In the Visayas, the most frequent price setters include the coal plant of Panay Energy Development Corporation and oil-based plants Panay III and East Asia Utilities Corporation (EAUC).

Oil-based plants Bauang (from Luzon) and Panay III and EAUC (from the Visayas) were also the frequent price setters at prices above PHP 10,000/MWh (Table 8).

Table 7
PSFI at Prices between PHP 5,000/MWh and PHP 10,000/MWh
Monthly, July 2011 – June 2012

Plant Name	PERCENT OF TIME											
	2011						2012					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
LUZON												
AMBUKLAO HEP		0.1			1.9	0.4	2.6	2.0	3.6	2.4	5.3	4.0
BATANGAS CFTPP				0.3	0.1							
BAUANG DPP	1.5	0.8	1.2	2.4	2.3	5.6	4.0	2.3	3.9	3.9	11.7	5.0
BINGA HEP								0.3	1.0			
CBK (KPSPP)	0.8	2.0	1.3	3.1	2.8	2.4	2.6	0.8	2.4	0.9	1.9	1.2
KEPCO ILIJAN	0.3	0.1	0.3	2.9	13.2	9.7	7.8	0.9				
LIMAY CCGT			0.4									
MALAYA TPP				0.6								
PAGBILAO CFTPP	0.4		0.1							1.2		
SAN LORENZO FGPP												1.2
SAN ROQUE POWER	2.4	2.6	0.8	1.1	5.1	2.2	1.1	0.1	1.7		2.5	
STA RITA FGPP												1.2
SUAL CFTPP					0.4				0.1			
SUBIC POWER CORP	3.8	3.4	4.3	5.6	4.8	5.8	5.5	1.9	3.3	1.1	8.2	5.6
TRANS-ASIA	2.4	2.0	2.0	3.2	3.1	1.8	3.4	2.8	3.9	1.1	6.0	3.4
VISAYAS												
CEBU DPP I			0.5	0.3	0.1		0.3	0.1	0.3		1.4	
CEBU DPP II	0.1		0.7	0.3	0.1				0.1		0.7	0.1
CEBU TPP 1							3.4	1.2		0.1		1.3
CEBU TPP 2							2.3	1.5		0.9	1.7	0.3
CEDC CFTPP	5.4	2.0		0.1	1.7	3.2	0.8	1.1	0.4	0.9	0.7	0.7
CPPC DPP	2.4				0.5	3.2	0.7				3.3	5.9
EAUC DPP	4.6	3.4	2.0	3.3	3.9	4.4	4.8	3.2	4.7	3.2	8.5	3.2
KSPC CFTPP	2.6	1.9	2.0	1.5	0.4	1.1	0.3			0.1		
LEYTE A		0.8	0.5	0.4	1.2	0.8	1.7	0.5	1.7	0.7	1.0	0.7
PANAY DPP III	6.3	4.6	1.7	2.4	3.9	2.8	4.4	2.7				
PB 101				0.4	1.5				0.3	0.4	1.8	0.4
PB 102				0.4	1.5		0.9	2.4	1.1	3.1	2.5	0.4
PB 103				0.4	1.2	0.1	0.4					0.3
PEDC CFTPP	3.2	0.9	6.2	7.8	8.9	13.5	2.6	11.8	10.1	7.4	11.7	9.1
TPC (CARMEN)	0.1		0.8	1.4		1.4	0.5	0.1	0.7	0.3	1.7	
TPC (SANGI)		0.3										

Table 8
PSFI at Prices Equal to PHP 10,000/MWh and Above
Monthly, July 2011 – June 2012

Plant Name	PERCENT OF TIME											
	2011						2012					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
LUZON												
AMBUKLAO HEP		0.3			0.5	0.1			0.6			0.1
BAUANG DPP	4.6	3.0	3.9	11.7	5.1	4.4	5.8	1.5	2.3	1.3	4.6	7.4
BINGA HEP									0.1			
CBK (KPSPP)	0.1			1.1	0.3			0.1	0.4			
KEPCO ILIJAN			0.1		0.1							
LIMAY CCGT	1.3		0.1	3.6	0.7	0.4	0.3	0.1	0.3		2.9	4.7
MAKBAN GPP												0.4
MALAYA TPP				3.2								
PAGBILAO CFTPP				0.3						0.4		
SAN ROQUE POWER	0.6	0.1	0.4	3.1	2.4	3.2	1.1		0.4		1.1	0.1
SUBIC POWER CORP			0.4	1.3	0.1	0.7		0.3	0.6	0.7	0.4	1.1
TRANS-ASIA	0.1	0.1	0.1	0.1						0.1	0.3	0.7
VISAYAS												
BOHOL DPP	0.8	1.6	1.2	4.0	2.8	4.9	3.6	1.5	0.9	0.4	2.9	2.8
CEBU DPP II											0.3	
CEBU TPP 1			0.3	0.3	0.5	0.4	0.4		0.4		1.1	1.2
CEBU TPP 2	0.6	0.3		0.1	0.4	0.3	0.5		0.6		0.3	0.7
CPPC DPP	0.7	2.0	3.8	2.9	1.1	1.1	2.6	6.0	1.9	1.7	9.7	1.7
EAUC DPP	1.1	1.7	4.8	6.4	2.8	5.6	6.2	1.9	3.0	1.1	6.3	2.6
LEYTE A								0.1	0.1			
KSPC CFTPP	0.1			0.3								
PANAY DPP I										0.3	0.7	0.3
PANAY DPP III	2.6	3.5	6.0	4.0	4.2	6.3	8.2	11.2	6.0	7.0	13.9	9.0
PB 101	1.1	0.3	0.4	0.6	1.3	0.3				0.1	0.7	0.5
PB 102	0.8	0.3	0.4	1.0	1.9	1.1	1.6	1.6	0.1	0.5	0.7	1.1
PB 103	0.1	0.3	0.3	0.8	0.7		0.3				0.1	0.5
PEDC CFTPP												2.0
TPC (CARMEN)	1.3	0.5	2.0	2.1	2.7	1.8	1.5	0.1	1.6	0.7	2.6	4.2
TPC (SANGI)						0.3						

Rules Change Updates

WESM RULES CHANGES

The Department of Energy (DOE) approved and promulgated amendments to the WESM Rules as follows:

- **Amendment to the WESM Rules: Dispute Resolution Framework.** Amendment to various provisions of the WESM Rules pertaining to dispute resolution were approved and promulgated through Department of Energy Circular No. DC 2012-02-0001 dated 15 February 2012. The approved changes covered the following: (a) amendments on the structure of the WESM dispute resolution framework, spinning off the functions of the Dispute Resolution Group (DRG) as mediators and arbitrators to a pool of accredited mediators and arbitrators outside of the WESM; (b) clarification on the coverage of disputes cognizable under the WESM dispute resolution process; and (c) establishment of a Dispute Management Protocol prior to the formal dispute resolution process. Intended to streamline and make effective the dispute resolution process, these amendments were approved by the Philippine Electricity Market Board (PEM Board) of Directors in its regular meeting on 24 January 2012 for endorsement to the DOE.

WESM MANUAL CHANGES

The following were approved by the PEM Board:

- **New Manual: WESM Manual on the Segregation of Line Rental.** Approved by the PEM Board on 25 August 2011, the WESM Manual on the Segregation of Line Rental is a new manual which presents the methodology for calculating the components of the line rental trading amounts, namely cost of losses and cost of congestion. The adoption of this market manual is in compliance with a directive from the Energy Regulatory Commission (ERC) contained in its Order dated 7 March 2011. The new manual was proposed by PEMC.

- **Amendment to WESM Manual: WESM Dispatch Protocol (Inclusion of Merit Order Table).** The amendment includes new provisions in the WESM Dispatch Protocol Manual to define the Merit Order Table (MOT) and the manner of its implementation, with the end view of ensuring consistency of generating units' dispatch with the ex-post results of the Market Dispatch Optimization Model (MDOM). The PEM Board approved the amendments to the Manual on 27 February 2012. The proposal to amend this manual was submitted by 1590 Energy Corporation, Aboitiz Power Inc., AES Philippines-Masinloc Power Partners Co. Ltd., SN Aboitiz Power and San Miguel Energy Corporation.

RULES/MANUALS CHANGE PROPOSALS

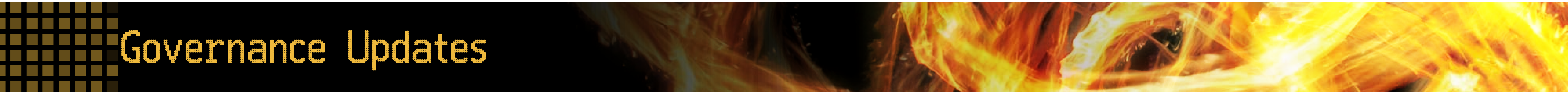
Final action on the following proposals to amend certain provisions of the WESM Rules and market manuals is still pending.

- **Proposed Amendment to WESM Rules: Market Audit.** Submitted by the PEM Audit Committee, the proposed rule changes include (a) setting out the Committee's oversight functions; (b) clarification that the Committee does not directly undertake the market audit; (c) providing for the conduct of audit as regards compliance with security arrangements associated with metering systems and adequacy of security arrangements by the Market Operator and work procedures by the Metering Service Provider; and (d) requiring the review of System Operator upon the request of the PEM Audit Committee and upon the direction of the ERC or the DOE. The Rules Change Committee endorsed the proposal to the PEM Board which, on 24 January 2012, decided to defer action on the Committee-approved proposal pending the discussion between the DOE and the ERC on the possible conduct of simultaneous audits of the System Operator and Market Operator.

- **Proposed Amendment to WESM Rules: Notice of Non-Approval of Application for Registration as WESM Members.** Submitted by the PEMC, the proposed changes involve revisions to WESM Rules Clauses 2.5.6.1 and 2.5.6.2. The proposed rule change is to require that the Market Operator submit to the ERC copies of notices of disapproval of applications for registration issued to an applicant. The submission of the notice applies regardless of the reason for the disapproval. The Rules Change Committee approved the proposed amendments during its 6 June 2012 meeting. The PEM Board approved the proposed amendments on 28 June 2012 for endorsement to the DOE for final approval and promulgation.

- **Proposed Amendment to Market Manual: WESM Manual on Criteria and Guidelines for the Issuance of Pricing Error Notices and Conduct of Market Re-Run (Localized Non-Congestion Pricing Error).** The proposal was submitted by several WESM Members, namely, 1590 Energy Corporation, Aboitiz Power Inc., AES Philippines-Masinloc Power Partners Co. Ltd., SN Aboitiz Power, Inc. and San Miguel Energy Corporation. It was proposed that pricing errors arising from violation of the contingency (N-1) requirement at load-end transformers be classified as "Localized Non-Congestion Pricing Error." The substitute price in such cases is proposed to be determined based on the percentage weight of the Locational Marginal Price (LMP) of the five customer nodes nearest the node affected by the contingency constraint violation. The selection of these five nodes shall be based on the difference of the inverse of the Transmission Loss Factor (TLF) between a customer node not affected by load-end contingency Constraint Violation Coefficients (CVCs) and the affected node. On 24 January 2012, the PEM Board deferred action on the proposed amendments, subject to the comprehensive review by the DOE on issues affecting Pricing Error Notices (PENs) and conduct of market re-run.

- **Proposed Amendments to the WESM Manual on the Management of Must-Run Units.** The amendments involve redefinition of Must-Run Units (MRUs), designation and definition of Must Stop Unit (MSU), revisions to the criteria and selection of MRU and introduction of a new pricing mechanism by which MRUs will be compensated in place of the current Generation Price Index (GPI) formulation. The RCC approved the proposed amendments during its 29 June 2012 meeting and accordingly submitted the same to the PEM Board for approval.



Market Audit

The second independent operational audit of the WESM covering the period July 2009 to June 2011 was completed in October 2011. The audit covered market operations systems and processes of the WESM, the Market Assessment System being administered by the Market Assessment Group (MAG) and the interfaces with the Systems Operator, the Metering Services Providers, the WESM Participants, the Energy Regulatory Commission (ERC) and the Department of Energy (DOE).

The independent auditor, PA Consulting Group Ltd., confirmed that the operations of the WESM are generally compliant with the obligations set out in the WESM Rules. The auditor further certified that, except for the Market Settlement Software which was for replacement at the time of the audit, the software used in the WESM, the Market Network Model, Load Forecasting Software, Market Clearing Software and the Market Assessment System generally comply with industry standards and with their specified formulations.

The auditor also submitted recommendations to further improve the efficiency of the operations of the WESM. As a continuing activity, the PEM Audit Committee, through the Market Assessment Group, monitors the progress of PEMC's action plans addressing the market operations audit findings and recommendations. Regular updates on the said action plans are provided in monthly audit assessment reports.

The next audit will be performed in the latter part of 2012 to cover operations from July 2011 to June 2012.

Dispute Resolution

Re-structuring of the WESM Dispute Resolution Mechanism

Amendments to the WESM Rules have been adopted, which included, among other things, the amendments on the structure of the WESM dispute resolution framework, spinning off the functions of the Dispute Resolution Group (DRG) as mediators and arbitrators to a pool of accredited mediators and arbitrators outside of the WESM. On 28 July 2011, the PEM Board dissolved the then Dispute Resolution Group, appointed a new Dispute Resolution Administrator and established the Dispute Management Protocol between the Market Operator and WESM Members. As there were pending cases at the time of the implementation of the changes, the Dispute Resolution Panel already created continued the resolution of the pending cases, until these were completed.

Dispute Resolution Cases

During the covered period, the following disputes have been formally settled through the WESM dispute resolution process.

- DRG Case No. 10-001 (PEMC, et. al. vs. ALECO)

  DRG Case No. 10-001 is the first official WESM dispute initiated through the filing by the PEMC, together with co-claimants Therma Luzon Inc. (TLI), Masinloc Power Partners Co. Ltd. (MPPCL), San Miguel Energy Corp. (SMEC), PANASIA Energy Holdings, Inc. (PEHI) and Strategic Power Devt. Corp. (SPDC) on 6 August 2010 of its Statement of Claim before the Dispute Resolution Administrator. Said claim was against Albay Electric Cooperative, Inc. (ALECO) to seek the full payment by ALECO of its outstanding obligations with the claimants for its WESM transactions.

  The Dispute Resolution Panel for this case was chaired by Prof. Alfredo F. Tadiar, Esq. with Commissioner Alfredo J. Non and Atty. Romulo R. Maristaza, Sr. as members. On 1 December 2011, the Panel issued a final award incorporating the terms and conditions agreed upon by the parties in their Compromise Agreement dated 5 October 2011 together with the Special Payment Arrangement (SPA).

- DRG Case No. 11-001 (1590 EC, et. al. vs. PEMC, et. al.)

  DRG Case No. 11-001 is a dispute filed on 9 March 2011 by 1590 EC against PEMC seeking the recovery of approximately PHP 143 million representing alleged negative variances between its offered prices and PEMC's final settlement prices. Nine market participants joined the proceedings either as co-claimants or as co-respondents. Upon the unanimous nomination of the parties, Dean Rogelio M. Avenido was appointed as mediator on 7 April 2011.

  On 11 July 2011, the mediation concluded with the signing of the parties of a formal Agreement on the settlement of the issues raised in the case.

Technical Reviews/Studies

The Technical Committee, on request, concluded the following studies:

- Review of Forced and Scheduled Outages, including, Deactivated and Reserve Shutdown. The Technical Committee reviewed the outage classifications adopted in the WESM. As result of the Committee's review, the National Grid Corporation of the Philippines (NGCP) adopted a new set of outages classified as Forced Outage, Planned Outage, Unplanned Outage and Other Outage. The NGCP System Operator started adopting the foregoing outage classifications on 16 September 2011 for Luzon and on 26 September 2012 for the Visayas. In order to harmonize the new outage classifications adopted by the System Operator and the classification of outages in the Philippine Grid Code, the NGCP and Grid Management Committee conducted a series of meetings to finalize the outage classification and incorporate the same in the Grid Code.
- Report on ESAMELCO's Case. Acting upon the request of Eastern Samar Electric Cooperative, Inc. (ESAMELCO) regarding the relocation of its market trading node (MTN), the Technical Committee submitted on 21 March 2012 its report to the PEM Board citing the requirements for relocation of the trading node. The report also stated the parties responsible for implementing the relocation in accordance with the WESM Manual on the Market Network Model Development & Maintenance and the Philippine Grid Code.

Compliance Monitoring

Monitoring and Requests for Investigation

Consistent with its mandate to identify acts or omissions which may constitute breach, the Market Surveillance Committee conducted a monthly review and assessment of the compliances by individual generator trading participants with the must-offer rule and with the real-time dispatch (RTD) schedules and instructions. Following the Committee-approved process, the trading participants are required to submit an explanation and supporting documents in respect to observed discrepancies in their registered and offered capacities, as well as observed deviations from their RTD schedules.

As a result of this monitoring, nine Requests for Investigation (RFIs) were filed by the Committee to the PEM Board during the covered period. The requests were for possible breach of the WESM Rules on the ground of non-compliance with the must-offer rule. Pursuant to established rules and procedures, the PEM Board then directed PEMC's Enforcement and Compliance Office (ECO) to conduct the investigation of the concerned trading participant/s.

Recommendations for Market Improvements

Upon recommendation by the Market Surveillance Committee, the PEM Board approved the implementation of the following measures pertaining to the conduct of investigations:

a. The development and implementation of an investigation program based on the framework provided under the Market Surveillance Compliance and Enforcement Market Manual (MSCEMM) for guidance and to ensure the quality of the investigation process;

b. The establishment of an internal document control system to ensure that all relevant documents cited in the investigation report are complete, authenticated and/or validated by the authorities concerned and attached/annexed to form part of the Investigation Report;

c. The determination of a reasonable timetable in the conduct of assessment, review and investigation; and

d. The establishment and implementation of a continuing education program in the field of electricity market investigation.

Enforcement

PEMC's Enforcement and Compliance Office (ECO) supports the integrity of the WESM through investigation of possible breaches of WESM Rules and Market Manuals. The PEM Board directs the ECO to investigate possible breaches if the PEM Board has reasonable ground to believe that a violation of the WESM Rule is being committed, or based on requests for investigation submitted to the PEM Board. The ECO follows the investigation procedures provided in the WESM Rules and Manuals.

As of June 2012, the ECO has completed the investigation of 22 of the 24 cases that were directed by the PEM Board before January 2011. The ECO has submitted the 22 Investigation Reports to the Market Surveillance Committee (MSC) in June 2012. All the cases investigated are for possible non-compliance to the must-offer rule and the dispatch schedule and instruction. These 22 Investigation Reports submitted by the ECO to the MSC resulted in the reduction in the number of pending investigations by almost one-half.

Fostering a Culture of Compliance in the WESM through the WESM Compliance Officers

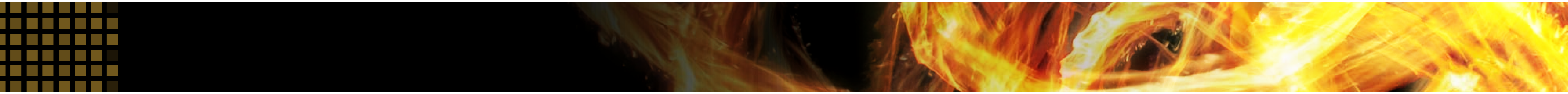
In line with the thrust to promote good governance in the WESM, all WESM members, Market Operator, System Operator, Metering Service Provider and other WESM Service Providers are now required to designate their own WESM Compliance Officers (WCO). The WCOs are expected to help the PEMC in fostering a culture of compliance for the WESM and in increasing market confidence. This requirement was implemented beginning 2010 among the Luzon WESM Members. Compliance by the Visayas WESM members followed after commencement of WESM commercial operations in the Visayas.

Pursuant to this requirement, WESM members, including the generators, distribution utilities, electric cooperatives and suppliers have designated their own internal WCOs.

One of the responsibilities of a WCO is the submission of a report concerning their respective organization's compliance with WESM Rules and the WESM Market Manuals on an annual basis or as may be determined by the ECO or any of the WESM Governance Committees. The WCO's Annual Report is submitted to the ECO who shall, in turn, provide the Department of Energy (DOE) with a copy of all the Annual Reports for policy studies and evaluation. The deadline set for the WCO's Annual Report is on or before 31 January of the succeeding year covered by the report.

The WCO's Annual Report contains a description of the compliance activities or accomplishments of the WCO and his or her company, as well as the WCO's activities in relation to the responsibilities as spelled out in the WESM Rules clause 7.2.9. The WCO's Annual Report is also a venue for the WESM members to state their issues and concerns on any provisions of the WESM Rules that needs to be reviewed for amendment to enhance the WESM Rules.

For calendar year 2011, which is the first full year of implementation of the requirement, the WCOs of the Luzon WESM members submitted their WCO Annual Report to the ECO. The WCOs' Annual Reports for 2011 submitted by the Luzon WCOs were submitted by PEMC to the DOE. From the reports submitted, it is noted that the WCOs in Luzon have, in general, been cooperative and performed their responsibilities to foster compliance in their respective companies. For the first year that the Luzon WCOs are required to submit their reports, the ECO received the WCO's Annual Reports from 30 of the WCOs representing 38 WESM members in Luzon. The various Luzon WCOs reported different compliance activities undertaken by their respective corporations in 2011. Among these activities were: company-wide roll out of the corporation's Code of Ethics and Business Conduct; participation in trainings related to compliance and the WESM; echo trainings for their co-employees on WESM Compliance; contribution of articles on WESM operations for his own organization's official newsletter; various independent audits; and development of a compliance program.



Regulatory Updates

"In the Matter of the Application for the Approval of the Pricing and Cost Recovery Mechanism for Reserves in the Philippine Wholesale Electricity Spot Market," ERC Case No. 2007-004RC

In this Application, PEMC sought the approval of the pricing and cost recovery mechanism (PCRM) for reserve categories to be traded in the WESM. The WESM Reserve PCRM consists of the mechanisms for the determination of reserve trading amounts, reserve cost recovery charges and administered reserve price and reserve cost recovery charges. On 7 July 2008, the Energy Regulatory Commission (ERC) approved the adoption of the gross pool concept for reserves, zonal reserve pricing for Luzon (with reservation on the approval of the zonal pricing scheme for the Visayas region), ex-ante price settlement, co-optimization of energy and reserves and administered pricing mechanism for reserves. In addition, the ERC directed compliance with several operational directives.

On 5 June 2008, PEMC filed a Motion for [the] Approval of [the] Phased-In Implementation of the WESM Reserve PCRM. The first phase of the proposal involved the initial implementation of the reserve market pending the development of further studies, incorporation of the required changes in the Open Access Transmission Service (OATS) Rules and the Ancillary Services Procurement Plan (ASPP) and the introduction of operational enhancements. The second phase involved the introduction of operational enhancements in accordance with the directives of the ERC.

In an Order dated 6 June 2011 and received by PEMC on 9 September 2011, the ERC denied the proposed phased-in implementation of the WESM Reserve PCRM. However, the ERC granted PEMC's Motion to implead the System Operator, the National Grid Corporation of the Philippines (NGCP). NGCP as System Operator was directed to coordinate with PEMC with the objective of accomplishing the operational enhancements earlier directed by the ERC (as embodied in the Commission's Order dated 15 November 2010, as modified in its Order dated 6 June 2011).

"In Re: Petition for Dispute Resolution, MERALCO vs. PEMC, Transco, NPC and PSALM," ERC Case No. 2008-83MC

This is a Petition filed by the Manila Electric Company (MERALCO) on its claim that it is double-charged for the cost of transmission losses: first, in the 2.98% transmission loss embedded in the National Power Corporation-Time of Use (NPC-TOU) rates, and second, in the line rental collected by PEMC. In a Decision dated 10 March 2010 and received by PEMC on 26 May 2010, the ERC found double charging in transmission line costs for Transition Supply Contract (TSC) quantities for the preceding months up to the start of the WESM Luzon commercial operations on 26 June 2006. In a subsequent Order dated 7 March 2011 and received by PEMC on 5 May 2011, the ERC allowed PEMC to submit an alternative methodology for the segregation of line rental into its line loss and congestion cost components. It was also clarified that the line rental adjustment directed under the Decision applies only to MERALCO, and not to other direct WESM members who were not made parties to the Petition. However, the Commission reserved the right to issue a subsequent Resolution directing that the line rental adjustment be applied to all WESM members with TSCs.

In compliance with the ERC's Order, PEMC submitted the Manual for Segregation of Line Rental Trading Amounts Issue 1.0 on 2 September 2011. The Manual provided the methodology for the prospective segregation of the line loss and congestion cost components of line rentals.

Pending resolution by the ERC is the Motion to Implement the Decision filed by MERALCO in November 2011. MERALCO proposed that instead of segregating line rentals into transmission loss and congestion cost components, it may be more practical and feasible to just deduct 2.98% from the NPC-TOU rate by: (a) for retroactive application – directing NPC to refund 2.98% of the TOU rate including NPC rate adjustments (Generation Rate Adjustment Mechanism (GRAM), Incremental Currency Exchange Rate Adjustment (ICERA), Fuel and Purchased Power Cost Adjustment (FPPCA) and Foreign Exchange Analytics (FxA)) but excluding Franchise and Benefits to Host Community (FBHC), and (b) for prospective application – directing NPC to extend a discount to MERALCO equivalent to 2.98% of the TOU rate including NPC adjustments.

"In the Matter of the Establishment of the Wholesale Electricity Spot Market in the Visayas Grid," ERC Case No. 2010-120RC

In this Application filed on 23 November 2010, PEMC sought approval of the revisions to the Price Substitution Methodology (PSM) and the Administered Price Determination Methodology (APDM) relevant to the integration of the Visayas into the WESM. The revisions involved the regional application of these methodologies where the occurrences of network congestion or intervention occur in one region only. Thus, the price adjustment mechanism is applied only in the region (i.e., Luzon or Visayas) where the cause of adjustment occurs and the prices of the non-affected region are preserved. In this manner, the market prices (and not the substitute prices) are applied in 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. Related changes include the regional application of the procedures and price substitution rules for pricing errors.

The ERC provisionally approved PEMC's proposed refinements in an Order dated 14 February 2011 and received by PEMC on 17 March 2011. PEMC was further directed to conduct a study, based on actual market results, on the possibility of enhancing the PSM and APDM to mitigate the impact of extreme congestion arising from the network limitations of the Visayas grid. PEMC filed the study required by the ERC on 24 August 2011.

The regional issuance of PENs and the regional application of the PSM and the APDM were implemented starting the billing month of 26 May to 25 June 2011.

"In the Matter of the Application for Approval of the (A) Inclusion of Formula for Determining Substitute Prices that Will be Used if the Ex-Ante Run is Affected with Non-Congestion Pricing Error while the Ex-Post Run is Affected with Congestion Pricing Error; and (B) Inclusion of Price Threshold if the Resulting MCP_H is Equal to Zero, in the Price Determination Methodology for the Wholesale Electricity Spot Market," ERC Case No. 2011-019RC

In this Application filed on 18 February 2011, PEMC sought approval of the refinements to the PSM to provide for the computation of substitute load prices where (a) pricing error due to congestion occurs in the Ex-ante (RTD) run and (b) PSM is triggered in the Ex-post (RTX) run, to harmonize WESM Rules, 3.10.5 (a) and (b) and the approved PSM. The refinement also covers a proposed price threshold to address instances when network congestion occurs and the highest market clearing price (MCP_H) is PHP 0.00/MWh. Under the approved PSM, the value of the trigger factor "F" cannot be determined in such instances because the formula will result in an undefined number.

On 17 October 2011, PEMC received the Decision dated 18 July 2011 of the ERC approving: (1) the inclusion of a formula for determining Customer Substitute Prices for use when the Ex-ante run is affected with non-congestion pricing error while the Ex-post run is affected with congestion pricing error; and (2) the inclusion of a Price Threshold if the resulting MCP_H is equal to zero. The Decision authorized retroactive application from 11 July 2008.

"In the Matter of the Application for the Approval of the Level of Market Transaction Fees for Calendar Years 2010-2011 for the Philippine Wholesale Electricity Spot Market (WESM) with Prayer for Issuance of Provisional Authority," ERC Case No. 2011-085RC

In this Application, PEMC sought approval of, among other things, funding for the Market Dispatch Optimization Model (MDOM) Software Modification Project. The Project aims to address findings relating to scheduling and pricing in the WESM as a result of the software certification testing conducted by independent auditor, Deloitte Touche Tohmatsu. The findings to be addressed include the management of reserve requirement violations; joint energy-reserve ramping consideration (Ramping Limits); and modeling of transmission losses. The MDOM is expected to provide a more accurate solution upon completion of the enhancement. The MDOM application is also expected to be more closely aligned with the WESM Rules and to produce dispatch instructions that are more attainable for generations, in anticipation of the operations of the WESM Reserve Market.

In a Decision dated 5 December 2011 and received by PEMC on 28 February 2012, the ERC authorized the allocation of PHP 26.518 million from the unutilized market fees in CY 2010 to the MDOM Software Modification Project.

WESM Members

DIRECT MEMBERS - GENERATION COMPANIES		
Member	**Registered Facility**	**Effective Date**
LUZON		
1590 Energy Corporation	Bauang Diesel Power Plant	6 September 2010
AP Renewables, Inc.	Makban Geothermal Power Plant	26 May 2009
	Tiwi Geothermal Power Plant	26 May 2009
Asia Pacific Energy Corporation	APEC Co-Generation Power Plant	26 March 2012
Bac-Man Geothermal, Inc.	Bac-Man Geothermal Power Plant	26 May 2011
FGP Corporation	San Lorenzo Natural Gas Power Plant	26 June 2006
First Gas Power Corporation	Sta. Rita Natural Gas Power Plant	26 June 2006
First Gen Hydro Power Corporation	Pantabangan Hydro Electric Power Plant	18 November 2006
	Masiway Hydro Electric Power Plant	18 November 2006
HEDCOR, Inc.	Irisan 3 Hydro Electric Power Plant	26 August 2010
	Sal-angan Hydro Electric Power Plant	13 September 2010
Masinloc Power Partners Co. Ltd.	Masinloc Coal Fired Thermal Power Plant	17 April 2008
National Irrigation Administration	NIA-Baligatan Hydro Electric Power Plant	26 October 2008
National Power Corporation	Angat Hydro Electric Power Plant	26 June 2006
Northwind Power Development Corporation	NWPDC Wind Power Plant	26 November 2006
PANASIA Energy Holdings, Inc.	Limay Combined Cycle-Gas Turbine Power Plant	19 January 2010
People's Energy Services, Inc.	Barit Hydro Electric Power Plant	26 February 2011
Power Sector Assets & Liabilities Management Corporation	Casecnan Hydro Electric Power Plant	26 June 2006
	Hedcor Hydro Electric Power Plant	26 June 2006
	Malaya Oil Thermal Power Plant	26 June 2006
	Caliraya Hydro Electric Power Plant	26 June 2006
	Botocan Hydro Electric Power Plant	26 June 2006
	Kalayaan Hydro Electric Power Plant	26 June 2006
Quezon Power (Philippines) Ltd. Co.	QPPL Coal-Fired Power Plant	26 June 2006
San Miguel Energy Corporation	Sual Coal-Fired Thermal Power Plant	6 November 2009
SEM-Calaca Power Corporation	Batangas Coal Fired Thermal Power Plant	4 December 2009
SN Aboitiz Power - Benguet, Inc.	Binga Hydro Electric Power Plant	11 July 2008
	Ambuklao Hydro Electric Power Plant Unit 1	1 June 2011
SN Aboitiz Power - Magat, Inc.	Magat Hydro Electric Power Plant	26 April 2007
South Premier Power Corporation	Ilijan Natural Gas Power Plant	26 June 2010
Strategic Power Development Corporation	San Roque Hydro Electric Power Plant	26 January 2010
Therma Luzon, Inc.	Pagbilao Coal-Fired Power Plant	1 October 2009
Trans-Asia Power Generation Corporation	TAPGC Diesel Power Plant	5 January 2007
Udenna Management & Resource Corporation	Subic Diesel Power Plant	17 February 2011
Vivant Sta. Clara Northern Renewables Generation Corporation (formerly Amlan Hydro Power, Inc.)	Bakun Hydro Electric Power Plant	23 February 2010

DIRECT MEMBERS - GENERATION COMPANIES		
Member	**Registered Facility**	**Effective Date**
VISAYAS		
Bohol I Electric Cooperative, Inc.	Janopol Hydro Electric Power Plant	26 December 2010
Cebu Energy Development Corporation	CEDC Coal-Fired Thermal Power Plant	26 December 2010
Cebu Private Power Corporation	CPPC Diesel Power Plant	26 December 2010
Central Azucarera de San Antonio	CASA Biomass Co-Generation Power Plant	26 February 2011
East Asia Utilities Corporation	EAUC Diesel Power Plant	26 December 2011
Energy Development Corporation	Northern Negros Geothermal Power Plant	26 March 2011
First Farmers Holding Corporation	FFHC Biomass Co-Generation Power Plant	26 December 2010
Green Core Geothermal, Inc.	Tongonan Geothermal Power Plant	26 December 2010
	Palinpinon Geothermal Power Plant I	26 December 2010
	Palinpinon Geothermal Power Plant II	26 December 2010
ICS Renewables Inc.	Amlan Hydro Electric Power Plant	26 March 2011
KEPCO SPC Power Corporation	KSPC Coal Fired Thermal Power Plant Unit 1	28 February 2011
	KSPC Coal Fired Thermal Power Plant Unit 2	31 May 2011
National Power Corporation	Power Barge 101	26 December 2010
	Power Barge 102	26 December 2010
	Power Barge 103	26 December 2010
Panay Energy Development Corporation	PEDC Coal-Fired Thermal Power Plant	19 March 2011
Panay Power Corporation	Avon New Washington Diesel Power Plant	26 December 2010
	Avon River Diesel Power Plant	26 December 2010
	PPC Nabas Diesel Power Plant	26 December 2010
	PPC Diesel Power Plant	26 December 2010
Power Sector Assets & Liabilities Management Corporation	Leyte A (HVDC)	26 December 2010
	Cebu Diesel Power Plant 1	26 December 2010
	Cebu Diesel Power Plant 2	26 December 2010
	Cebu Coal Fired Thermal Power Plant 1	26 December 2010
	Cebu Coal Fired Thermal Power Plant 2	26 December 2010
SPC Island Power Corporation	Bohol Diesel Power Plant	26 December 2010
	Panay Diesel Power Plant I	26 December 2010
	Panay Diesel Power Plant III	26 December 2010
Sta. Clara Power Corporation	Loboc Hydro Electric Power Plant	26 December 2010
Toledo Power Company	TPC Diesel Power Plant	26 December 2010
	TPC Coal Fired Thermal Power Plant	26 December 2010
Trans-Asia Oil and Energy Development Corporation	Guimaras Diesel Power Plant	26 February 2011

DIRECT MEMBERS - PRIVATE DISTRIBUTION UTILITIES			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
Cabanatuan Electric Corporation	26 January 2010	Bohol Light Company, Inc.	26 December 2010
Dagupan Electric Corporation	26 November 2009	Mactan Electric Company	26 December 2010
Manila Electric Company	26 June 2006	Visayan Electric Company	26 December 2010

DIRECT MEMBERS - ELECTRIC COOPERATIVES			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
Albay Electric Cooperative, Inc.	26 August 2007	Aklan Electric Cooperative, Inc.	26 December 2010
Batangas I Electric Cooperative, Inc.	26 December 2009	Antique Electric Cooperative, Inc.	26 December 2010
Batangas II Electric Cooperative, Inc.	5 March 2010	Biliran Electric Cooperative, Inc.	26 December 2010
Benguet Electric Cooperative, Inc.	26 April 2008	Bohol I Electric Cooperative, Inc.	26 December 2010
Cagayan I Electric Cooperative, Inc.	26 December 2011	Bohol II Electric Cooperative, Inc.	26 December 2010
Cagayan II Electric Cooperative, Inc.	26 December 2011	Capiz Electric Cooperative, Inc.	26 December 2010
Camarines Norte Electric Cooperative, Inc.	26 May 2010	Cebu I Electric Cooperative, Inc.	26 December 2010
Camarines Sur I Electric Cooperative, Inc.	26 November 2011	Cebu II Electric Cooperative, Inc.	26 December 2010
Camarines Sur II Electric Cooperative, Inc.	6 December 2006	Cebu III Electric Cooperative, Inc.	26 December 2010
Camarines Sur III Electric Cooperative, Inc.	26 January 2010	Central Negros Electric Cooperative, Inc.	26 December 2010
Camarines Sur IV Electric Cooperative, Inc.	25 June 2010	Don Orestes Romualdez Electric Cooperative, Inc.	26 December 2010
First Laguna Electric Cooperative, Inc.	26 December 2010	Guimaras Electric Cooperative, Inc.	26 December 2010
Ilocos Norte Electric Cooperative, Inc.	26 November 2006	Iloilo I Electric Cooperative, Inc.	26 April 2011
Ilocos Sur Electric Cooperative, Inc.	26 October 2010	Iloilo II Electric Cooperative, Inc.	26 December 2010
Isabela I Electric Cooperative, Inc.	26 July 2009	Iloilo III Electric Cooperative, Inc.	26 December 2010
Kalinga-Apayao Electric Cooperative, Inc.	26 March 2009	Leyte II Electric Cooperative, Inc.	26 December 2010
La Union Electric Cooperative, Inc.	26 September 2011	Leyte IV Electric Cooperative, Inc.	26 December 2010
Mountain Province Electric Cooperative, Inc.	26 December 2009	Leyte V Electric Cooperative, Inc.	26 December 2010
Nueva Ecija II Area I Electric Cooperative, Inc.	26 August 2009	Negros Occidental Electric Cooperative, Inc.	26 December 2010
Nueva Ecija II Electric Cooperative, Inc. - Area II	26 July 2010	Negros Oriental I Electric Cooperative, Inc.	26 December 2010
Pangasinan III Electric Cooperative, Inc.	26 November 2011	Negros Oriental II Electric Cooperative, Inc.	26 December 2010
Peninsula Electric Cooperative, Inc.	26 November 2009	Samar II Electric Cooperative, Inc.	26 December 2010
Quezon I Electric Cooperative, Inc.	26 November 2011	Southern Leyte Electric Cooperative, Inc.	26 March 2012
Quezon II Electric Cooperative, Inc.	26 August 2011	VMC Rural Electric Cooperative, Inc.	26 December 2010
Sorsogon I Electric Cooperative, Inc.	26 June 2008		
Sorsogon II Electric Cooperative, Inc.	26 November 2010		

DIRECT MEMBERS - ELECTRIC COOPERATIVES			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
Tarlac I Electric Cooperative, Inc.	26 May 2008		
Tarlac II Electric Cooperative, Inc.	26 July 2009		

DIRECT MEMBERS - BULK USERS			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
First Gen Hydro Power Corporation (Pantabangan Housing)	26 February 2011	Alturas Group of Companies, Inc.	26 January 2012
Linde Philippines, Inc.	26 December 2011	Balamban Enerzone Corporation	26 December 2010
Pilipinas Shell Petroleum Corporation	26 October 2010	Mactan Enerzone Corporation	26 December 2010
Steel Corporation of the Philippines	26 April 2012	Marcela Farms, Inc.	26 January 2012
Subic Enerzone Corporation	26 December 2011	Philippine Phosphate Fertilizer Corporation	26 December 2011
TeaM Energy Corporation (Pagbilao Reserve Auxiliary Transformer)	26 September 2010		
United Pulp and Paper Company, Inc.	26 November 2011		

DIRECT MEMBERS - WHOLESALE AGGREGATORS			
Member	**Effective Date**	**Member**	**Effective Date**
Aboitiz Energy Solution, Inc.	4 June 2007	Manta Energy, Inc.	15 November 2010
AES Philippines Inc.	13 April 2008	Team (Philippines) Energy Corporation	2 January 2008
Angeles Power Inc.	8 April 2008	Trans-Asia Oil and Development Corporation	20 September 2007
First Gen Energy Solutions	26 January 2010		

INDIRECT MEMBERS - PRIVATE DISTRIBUTION UTILITIES			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
Angeles Electric Corporation	5 September 2006	Panay Electric Company	26 December 2010
Ibaan Electric and Engineering Corporation	7 November 2011		
San Fernando Electric Light & Power Co.	26 October 2010		
La Union Electric Company, Inc.	25 September 2009		
Tarlac Electric, Inc.	20 September 2010		

INDIRECT MEMBERS – ELECTRIC COOPERATIVES			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
Abra Electric Cooperative, Inc.	31 October 2006	Eastern Samar Electric Cooperative, Inc.	26 December 2010
Aurora Electric Cooperative, Inc.	26 August 2010	Leyte III Electric Cooperative, Inc.	26 December 2010
Central Pangasinan Electric Cooperative, Inc.	22 September 2006	Northern Samar Electric Cooperative, Inc.	26 December 2010
Ifugao Electric Cooperative, Inc.	26 November 2010	Samar I Electric Cooperative, Inc.	26 December 2010
Isabela II Electric Cooperative, Inc.	26 May 2012		
Nueva Ecija I Electric Cooperative, Inc.	4 August 2011		
Nueva Vizcaya Electric Cooperative, Inc.	14 October 2011		
Pampanga I Electric Cooperative, Inc.	20 September 2010		
Pampanga Rural Electric Service Cooperative, Inc.	26 August 2010		
Pangasinan I Electric Cooperative, Inc.	4 October 2006		
Quirino Electric Cooperative, Inc.	26 November 2010		
San Jose City Electric Cooperative, Inc.	15 October 2010		
Zambales I Electric Cooperative, Inc.	26 July 2010		
Zambales II Electric Cooperative, Inc.	26 November 2010		

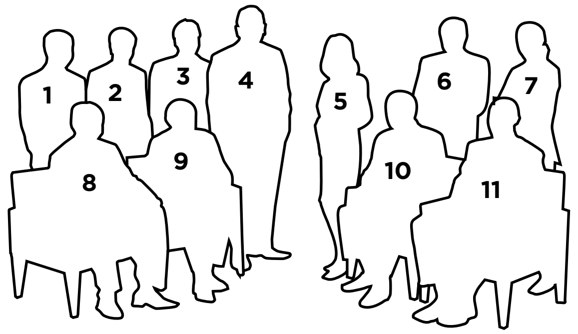
INDIRECT MEMBERS – BULK USERS			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
Atlantic Gulf and Pacific Co.	26 October 2010	Bohol Enterprises, Inc.	26 December 2010
The Authority of the Freeport Area of Bataan	8 November 2010	Carmen Copper Corporation	26 December 2010
Albay Agro-Industrial Development Corporation	8 November 2010	Dumaguete Coconut Mills	26 December 2010
Babcock-Hitachi Philippines, Inc.	15 October 2010	Lide Management Corporation	26 December 2010
Batangas Bay Terminal, Inc.	14 February 2011	Orica Nitrates Philippines, Inc.	26 December 2010
Bicol Ice Incorporated	26 October 2010	Philippine Associated Smelting and Refining Corporation	26 December 2010
Cenon Cordero & Sons Enterprises, Inc.	4 August 2011	Philippine Economic Zone - MEPZ I	26 December 2010
Central Luzon State University	14 October 2011	Philippine Foremost Milling Corporation	26 December 2010
Coastal Bay Chemicals, Inc.	15 October 2010	Philippine Mining Service Corporation – Bohol Plant	26 December 2010
Consort Land, Inc.	9 August 2011	Philippine Mining Service Corporation – Alcoy Plant	26 December 2010
Currimao Aluminum Corporation	8 November 2010	San Miguel Corporation (Bacolod Brewery & Distilleria de Bago)	26 December 2010
Ecosystem Research and Development Bureau	4 August 2011	SC Global Coco Products, Inc.	26 December 2010
ECSCO, Inc.	15 November 2010	Specialty Pulp Manufacturing, Inc.	26 December 2010
Edong Cold Storage and Ice Plant	15 November 2010	Taiheiyo Cement Philippines, Inc.	26 December 2010

INDIRECT MEMBERS – BULK USERS			
Member	**Effective Date**	**Member**	**Effective Date**
LUZON		**VISAYAS**	
EEI Corporation	21 March 2011	Visayan Oil Mills, Inc.	26 December 2010
Formosa Ceramic Tiles Mfg. Corporation	15 November 2010	Waterfront Airport Hotel and Casino	26 December 2010
Gapan Ice Plant/Oscar Tinio	18 July 2011		
Goodfound Cement Corporation	15 November 2010		
High Street (SPV-AMC), Inc.	26 September 2010		
Holcim Philippines, Inc.	12 March 2007		
INGASCO, Inc.	15 October 2010		
International Rice Research Institute	26 September 2010		
Itogon-Suyoc Resources, Inc.	26 March 2012		
JORAM, Inc.	26 November 2010		
Keppel Philippines Marine, Inc.	20 July 2011		
Lepanto Consolidated Mining Company	11 November 2011		
Lima Utilities Corporation	5 August 2011		
Melters Steel Corporation	26 October 2010		
National Power Corporation (Napot and Bagac facilities)	26 May 2012		
Oliver Enterprises	15 March 2011		
Pacific Mall Corporation	9 August 2011		
Partido Rice Mill Corporation	20 September 2010		
Petron Corporation	26 October 2010		
Philippine Economic Zone – BCEZ	11 November 2011		
Philippine Hydro (PH), Inc.	26 October 2010		
Philippine Polypropylene, Inc.	5 August 2011		
Purity Ice Plant & Cold Storage	15 October 2010		
Puyat Steel Corporation	7 March 2011		
Republic Cement Corporation	11 April 2011		
San Miguel Yamamura Packaging Corporation	11 November 2011		
SKK Steel Corporation	15 October 2010		
Stronghold Steel Corporation	15 February 2011		

The National Grid Corporation of the Philippines (NGCP) is a registered WESM Member particularly as System Operator, Metering Services Provider and Network Services Provider. Its registration as such is pursuant to the WESM Rules which requires such registration.

The Philippine Electricity Market Board

The Philippine Electricity Market Board (PEM Board) of Directors is a 15-man body whose members are appointed by the Department of Energy from representatives of the various electricity industry sectors in the WESM, as well as independent members. The Board of Directors is chaired by the Secretary of the Department of Energy.



1 JOSEPH FERDINAND M. DECHAVEZ
2 RENATO A. BALINTEC
3 GERARDO P. VERZOSA
4 SEC. JOSE RENE D. ALMENDRAS
5 MELINDA L. OCAMPO
6 NIXON G. HAO
7 LUIS MIGUEL ABOITIZ
8 FROILAN A. TAMPINCO
9 PETER G. NEPOMUCENO
10 JESUS L. ARRANZA
11 DEON JAMES

Not in picture:

FELIXBERTO U. BUSTOS
EMMANUEL R. LEDESMA, JR.
JUAN IGNACIO RUBIOLO
ANTONIO AGBAYANI VER

SEC. JOSE RENE D. ALMENDRAS
Chairman
Secretary, Department of Energy (DOE)
1 July 2010 – Present

MELINDA L. OCAMPO
Member, Market Operator
President, Philippine Electricity Market Corporation (PEMC)
27 March 2009 – Present

JOSEPH FERDINAND M. DECHAVEZ
Member, System Operator
Sr. Adviser to the President, National Grid Corporation of the Philippines (NGCP)
25 August 2010 – Present

PETER G. NEPOMUCENO
Member, Supply
President, Angeles Power, Inc.
17 June 2009 – Present

RENATO A. BALINTEC
Member, Distributor
General Manager, Ilocos Norte Electric Cooperative, Inc. (INEC)
17 June 2009 – Present

NIXON G. HAO
Member, Distributor
Vice President for Energy Management, Manila Electric Company (MERALCO)
27 January 2010 – Present

DEON JAMES
Member, Distributor
Chief Executive Officer, Dagupan Electric Corporation (DECORP)
27 September 2005 – Present

GERARDO P. VERZOSA
Member, Distributor
General Manager, Benguet Electric Cooperative, Inc. (BENECO)
26 April 2004 – Present

LUIS MIGUEL ABOITIZ
Member, Generator
Sr. Vice President for Power Marketing and Sales, SN Aboitiz Power
17 June 2009 – Present

EMMANUEL R. LEDESMA, JR.
Member, Generator
President, Power Sector Assets Liabilities Management Corporation (PSALM)
5 October 2010 – Present

JUAN IGNACIO RUBIOLO
Member, Generator
Vice President for Commercial Affairs, AES Masinloc Power Partners Co., Ltd.
23 July 2009 – 20 April 2012

FROILAN A. TAMPINCO
Member, Generator
President, National Power Corporation (NPC)
1 August 2007 – Present

JESUS L. ARRANZA
Member, Independent
Chairman, Federation of Philippine Industries (FPI)
17 June 2009 – Present

FELIXBERTO U. BUSTOS
Member, Independent
Adjunct Professor, Asian Institute of Management (AIM)
17 June 2009 – 8 January 2012

ANTONIO AGBAYANI VER
Member, Independent
President, H&BW Corporation
17 June 17 2009 – Present

The PEMC Advisory Board

Left to right:

MYLENE C. CAPONGCOL
PEMC Advisory Board
Director, Electric Power Industry Management Bureau, DOE

EDITA S. BUENO
PEMC Advisory Board
Administrator, National Electrification Administration (NEA)

ROLANDO T. BACANI
PEMC Advisory Board
President, National Transmission Corporation (TransCo)

WESM Governance Committees

The WESM has several governance committees, namely, the Market Surveillance Committee (MSC), Rules Change Committee (RCC), PEM Audit Committee (PAC), Technical Committee (TC) and Dispute Resolution Administrator (DRA).

Market Surveillance Committee

ENGR. FRANCIS V. MAPILE
Chairperson
Managing Director – FVMapile & Associates
Member – Professional Regulatory Board for Electrical Engineering
1 July 2010 – Present

ATTY. BERNARDA C. LAVISORES
Member
Financial and Legal Consultant
27 April 2007 – Present

MS. EULINIA M. VALDEZCO
Member
Radiation Protection and Nuclear Safety Consultant
1 July 2010 – Present

DR. PETER LEE U
Member
Dean – School of Economics, University of Asia & the Pacific
1 July 2010 – Present

Dispute Resolution Administrator

ATTY. JESUSITO G. MORALLOS
Dispute Resolution Administrator
Senior Partner – Follosco Morallos and Herce Law Offices
1 August 2011 – Present

Rules Change Committee

DR. ROWENA L. GUEVARA
Chairperson, Independent
Professor – University of the Philippines
Member since 1 September 2011; appointed Chairperson on 11 October 2011 – Present

DR. EPICTETUS E. PATALINGHUG
Member, Independent
Professor – University of the Philippines
17 September 2009 – Present

MR. FRANCISCO L.R. CASTRO, JR.
Member, Independent
Consultant – Tensaiken Consulting
1 September 2011 – Present

ATTY. MAILA G. DE CASTRO
Member, Independent
In-House Corporate Counsel & VP Corporate Planning – Unitel Productions, Inc.
1 September 2011 – Present

MS. CHERRY AQUINO-JAVIER
Member, Generator
Trading Director – AES-Masinloc Power Partners Co., Ltd. (AES-MPPCL)
17 September 2009 – Present

ENGR. RALPH T. CRISOLOGO
Member, Generator
Vice President/Chief Market Officer – SN Aboitiz Power (SNAP)
17 September 2009 – Present

ATTY. LIBERTY Z. DUMLAO
Member, Generator
Corporate Legal Counsel – Power Sector Assets and Liabilities Management Corp. (PSALM)
17 September 2009 – Present

MS. CYNTHIA R. ENCARNACION
Member, Generator
OIC, Accounts Management Department – National Power Corporation (NPC)
28 October 2009 – Present

ENGR. CIPRINILO C. MENESES
Member, Distribution
Senior Manager & Acting Head, Energy Sourcing Office – Manila Electric Company (MERALCO)
17 September 2009 – Present

ENGR. AUGUSTO D. SARMIENTO
Member, Distribution
Network Operations Manager – Dagupan Electric Corporation (DECORP)
14 January 2010 – Present

ENGR. JOSE P. SANTOS
Member, Distribution
Energy Trading Manager – Ilocos Norte Electric Cooperative, Inc. (INEC)
17 September 2009 – Present

MR. SULPICIO C. LAGARDE, JR.
Member, Distribution
General Manager – Central Negros Electric Cooperative, Inc. (CENECO)
1 September 2011 – Present

ENGR. CONRADO D. PECJO
Member, Supplier
Manager, Operations & Business Development – Angeles Power, Inc.
28 October 2009 – Present

ENGR. RAUL JOSEPH G. SELUDO
Member, Systems Operator
Department Manager, Luzon Systems Operation – National Grid Corporation of the Philippines (NGCP)
17 September 2009 – Present

ENGR. ROBINSON P. DESCANZO
Member, Market Operator
Vice President, Corporate Planning and Communications Dept. – Philippine Electricity Market Corporation (PEMC)
17 September 2009 – Present

Technical Committee

ENGR. MELEUSIPO E. FONOLLERA, SR.
Chairperson
Director – Westrade International Trading Co., Inc.
27 April 2007 – Present

ENGR. JAIME V. MENDOZA
Member
Chairman – Distribution Management Committee (DMC)
Member – Board of Electrical Engineering
24 June 2010 – Present

ENGR. SANTIAGO A. DIMALIWAT IV
Member
Deputy Assistant, Chief Technical Officer – NGCP
15 March 2011 – Present

ENGR. JOSEPH ALLAN C. BALTAZAR
Member
Member – Grid Management Committee (GMC)
Sr. Manager and Head Network Asset Planning – MERALCO
1 August 2011 – Present

ENGR. EDGAR GRACIOLO F. ALCAZAR
Member (resigned)
Director, Technical Support Group – Ayala Property Management Corp. (APMC)
27 April 2007 – 26 April 2012

PEM Audit Committee

DR. FELIXBERTO U. BUSTOS, JR.
Chairperson/PEM Auditor
Adjunct Professor – Asian Institute of Management (AIM)
27 April 2007 – Present

MR. CHRISTIAN M. ORIAS
Member
Associate Management Consultant – Neville Clarke Philippines and Digileaf Philippines
1 September 2011 – Present

MR. EDUARDO ALEJANDRO O. SANTOS
Member
Director, Case Management Service – Office of the Solicitor General (OSG)
1 September 2011 – Present

ATTY. GLORIA VICTORIA Y. TARUC
Member (resigned)
Assistant Solicitor General – OSG
27 April 2007 – 25 August 2011
Resigned in view of appointment as Commissioner of the Energy Regulatory Commission

Philippine Electricity Market Corporation

Corporate Report
January - December 2011

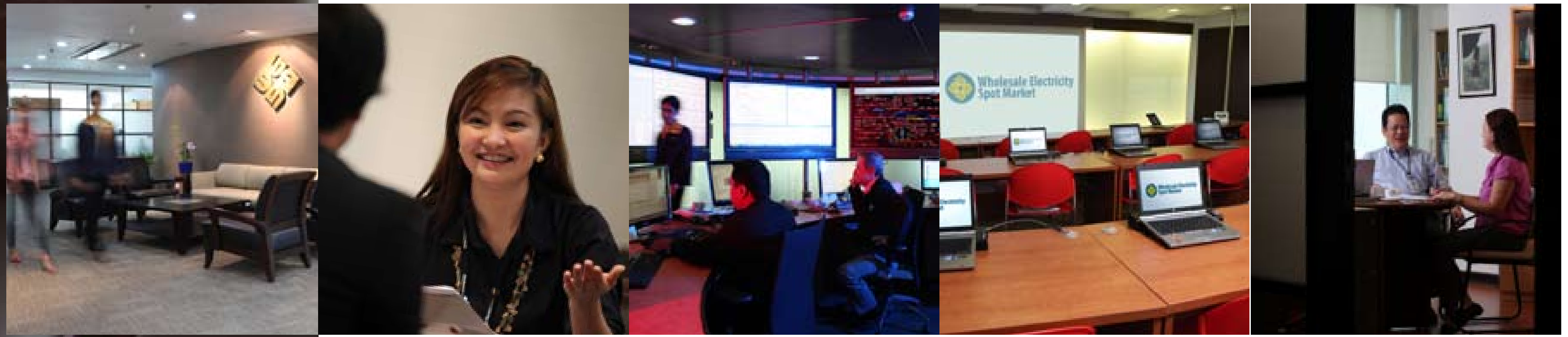
PEMC MISSION

- We provide a fair and transparent trading environment responsive to the needs of the electricity industry stakeholders.
- We promote the sustainability of the industry by fostering healthy competition contributing to the economic development of the country.
- We will do this by maintaining professionalism, integrity and dedication to excellence.

PEMC VISION

To achieve the highest standard of self-governance and market operations in the competitive electricity market.

PEMC CORPORATE VALUES



Excellence in Professionalism
We adhere to corporate business ethics and a deep sense of dedication to efficiency, quality consciousness and achievement-orientation

Excellence in Integrity
We value honesty, trustworthiness and steadfastness to our principles

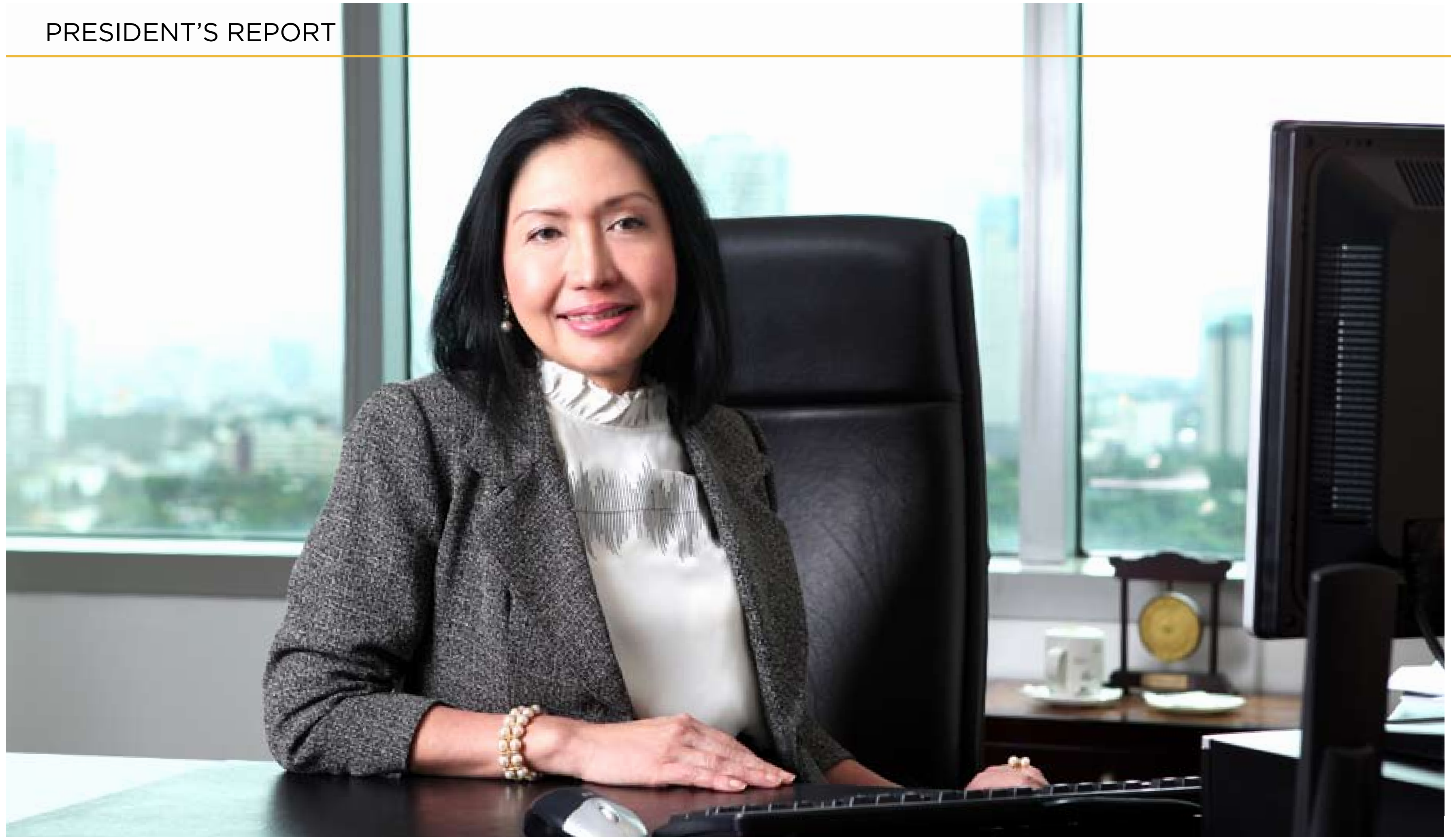
Excellence in Fairness
We demonstrate evenhandedness and fair judgment in relating with our colleagues and stakeholders

Excellence in Teamwork
We believe in selflessness and cooperation to achieve our corporate goals

Excellence in Service
We tailor our efforts and solutions to identify and exceed the demands and needs of our internal and external customers

Excellence in Innovation
We strive to be creative and to "think out of the box" to deliver cutting edge solutions

CONTENTS



Each year, the Philippine Electricity Market Corporation (PEMC) selects a theme for the annual Wholesale Electricity Spot Market (WESM) and PEMC reports to encapsulate in one word or phrase how PEMC envisioned the role that WESM played in the past year and the role it will play in the following year.

It started with the ***One Spark*** (2006-2007) which conveyed the vision that the *One Spark* that is WESM can bring progress to a nation, bring life to communities and bring hope for a better future. This then became the ***Catalyst*** (2008) expressing the view that one spark can start a revolution; that the WESM as the country's first competitive electricity market effectively revolutionized the power industry in the Philippines and became a change agent that has made the dream of cost-efficient power relevant. It also expressed the commitment to strengthen the market through continuous innovation and investments in technology. ***Renewed Energy*** (2009) characterized WESM's transformational presence in the Philippine power industry, being a key player in ensuring energy sufficiency facing the future with renewed energy, confident and firmly committed not just to the industries we serve, but to the broader base of consumers who depend on electricity to power their lives. ***Coalescence*** (2010) conveyed that, as the power industry moves closer to full open access, WESM has made possible the coming together of the major players in the industry working as one in order to ensure efficient, transparent and reliable supply of electricity to fuel the country's growth.

This year we adopted the theme ***Ablaze*** to express the vision of the WESM setting the power industry ablaze by paving the way for continuous market growth and industry development. We find this a fitting theme as the market now moves towards retail competition and open access.

All these express in different ways PEMC's vision of the WESM as an instrument, an agent to facilitate the power industry's efforts to realize the goal of ensuring reliable and cost-efficient supply of electricity.

MELINDA L. OCAMPO
President

Review of 2011

Towards this vision, PEMC continued in 2011 as it did in previous years with its efforts in improving efficiency of the operations of the WESM and of PEMC, even as it also firmly focused on making the WESM a tool for power industry policy and regulatory development.

The integration of the Visayas in the WESM has commenced and this has provided opportunities for further improving operations and governance of the WESM. Amidst the challenge of operating in the Visayas for the first time, PEMC also commenced its preparations for the eventual implementation of retail competition and open access and the renewable energy market. It also took time to further improve corporate operations by working for the ISO/IEC 27001:2005 certification for PEMC's Information Security and Management System.

Efficient and reliable spot market

The learning curve for operating the WESM in the Visayas was rather sharp, and challenged PEMC to introduce enhancements to the operations of the market to respond to issues posed by the integration. Among the significant enhancements implemented within a few months of the integration resulted in a more efficient pricing and scheduling process marked by a significant reduction of pricing errors particularly in the Visayas. Transparency in the WESM billing and settlement process is further achieved by segregating and reflecting the components of the line rental trading amounts in the WESM bills.

Market-Based Scheduling of the Leyte-Luzon HVDC export-import. Prior to the integration of the Visayas grid into the WESM, the schedules and limits of the export and import of power through the Leyte-Luzon high voltage direct current (HVDC) link were set and managed by the System Operator. This arrangement continued after the integration of the Visayas in order to minimize disruptions that the integration may bring to the WESM pricing and scheduling processes. On 29 April 2011, after about four months of operations in the Visayas and with close coordination with the System Operator, PEMC implemented the "market-based scheduling" of the Leyte-Luzon HVDC flow such that the export and import schedules are now determined through the WESM bidding processes. The implementation was quite uneventful and no disruptions in the market processes occurred. It also had the added benefit of reducing significantly the occurrence of pricing errors caused by not meeting the HVDC power flow target schedule.

Regional Application of Price Substitutions. On 29 May 2011, five months after integration, PEMC began implementing the regional application of the declaration of pricing errors and corresponding price substitution, as well as the regional application of the Price Substitution Methodology and the Administered Price Determination Methodology. Implementation began after approval by the Energy Regulatory Commission (ERC) of PEMC's proposed refinements to these price substitution rules and methodologies.[1]

[1] Approval by the ERC of the regional application of the various price substitution methodologies was made in its Order dated 11 February 2011 in ERC Case No. 2010-120 RC – In the Matter of the Establishment of the Wholesale Electricity Spot Market in the Visayas Grid.

With regional application, pricing errors and market intervention affecting only one grid will not affect the other as the price substitution will only be applied to the grid where the pricing error or market intervention occurred. This has resulted in a reduction by about 89% in the occurrence of ex-ante pricing errors in the Visayas grid as it is no longer affected by pricing errors that are caused by events affecting Luzon only.

Reduction of Ex-Post Pricing Errors. Another related enhancement, implemented shortly before and in preparation for the integration of the Visayas, was the exclusion of the contingency list submitted by the System Operator as an input in the ex-post market runs. This is to address the frequent occurrence of constraint violation coefficients and pricing errors arising because of contingency constraints imposed by the System Operator. This is consistent with the WESM Rule to reflect actual conditions in the ex-post market run. As a significant number of pricing errors particularly in Luzon were caused by violation of contingency requirements set by the System Operator, this enhancement reduced the occurrence of ex-post pricing errors significantly.[2]

Segregation of the Components of the Line Rental Trading Amounts. To achieve further transparency in the WESM billing and settlements processes, the segregation of the components of the line rental trading amounts, i.e., cost of losses and cost of congestion, was implemented in 2011. The methodology for calculating these components is contained in the WESM Manual on Segregation of Line Rental Trading Amounts proposed by PEMC and approved by the PEM Board on 25 August 2011. The Manual documents the manner by which line rental is computed in the WESM, as well as sets the methodology for segregating line rental amounts into cost of losses and congestion.

Efficient operations

PEMC President Melinda L. Ocampo receives the ISO/IEC 27001 certificate from Mr. Jen Wen Chia, TÜV SÜD PSB Philippines General Manager

Information Security Management System

PEMC obtained an ISO/IEC 27001:2005 certificate for Information Security Management System (ISMS).[3] This certification marks PEMC's establishment and application of an Information Security Management System that is applicable and appropriate for its operations as Market Operator of the Philippine WESM. The certification covers the WESM offices and back-up sites in Metro Manila and Cebu. With ISMS standards in place, PEMC can better ensure continuity in delivery of services, regularity of access to important market information and reliability of market information to better guard against threats to information security, such as unauthorized access, tampering of information, etc. This will not restrict but will, in fact, enhance PEMC's ability to ensure transparency in the market processes.

ISMS Policies. PEMC defined and adopted six mandatory policies to ensure that the organization is compliant with the ISMS standards at all times.

[2] The exclusion of the WESM Dispatch Protocol Manual and WESM Manual Procedure for Determining Ex-Post (RTX) Nodal Energy Prices. Originally approved as an urgent amendment in November 2010, the final amendments were approved on 28 April 2011.

[3] While the certification was released on 27 February 2012, the ISMS audit process was completed in 2011.

PEM Board Chairman and DOE Secretary Jose Rene D. Almendras leads the ceremonial toast

The PEMC ISMS Teams with PEMC President Melinda L. Ocampo, Chairman of the PEM Board and DOE Secretary Jose Rene D. Almendras and Management Representative Carlito C. Claudio

Logical Access Management defines the PEMC's electronic security and access control requirements for its information facilities (hardware and software) in order to ensure confidentiality, integrity and availability of all information it handles. Access control and responsibilities of all users within the company with regard to password use and corresponding access privileges are also defined.

Information Classification. Information assets will have differing values depending on the risk they carry for the company. For consistency and efficiency, a classification standard is established defining the risk levels associated with various categories of information and the corresponding protection that is required. Along with laws and regulations that govern some types of information, the confidentiality, integrity and availability requirements as set forth in the WESM Rules and market manuals are also considered in the classification scheme.

Clear Desk, Clear Screen ensures that all printed materials, data storage media and other forms of media that contain restricted or confidential information are always stored securely and are not left unattended. All computers located at the work stations of PEMC employees are always secured.

Acceptable Use of Removable Media. All removable storage media issued and used by employees, particularly those that contain restricted or confidential information, are secured using acceptable logical access controls such as encryption and/or password. Handling and disposal of removable storage media is controlled.

Physical Asset Security. Equipment, such as computers, brought into the office premises by PEMC employees, external parties and visitors shall be inspected and logged by the guard upon entry and exit. Meanwhile, Office Area Security is achieved as the access to PEMC office areas is limited to PEMC employees to avoid unauthorized access.

Business Continuity Plan. PEMC has also formally adopted and tested its Business Continuity Plan. The plan complements the disaster recovery and switchover procedures adopted by PEMC for the Market Management System and other infrastructure used by PEMC in the operations of the WESM.

ISMS Organization. One of the first steps taken in building PEMC's information security management system was the establishment of a formal ISMS structure within the organization to ensure the smooth implementation of information security, as well as guarantee compliance with the established policies and standards of the ISO/IEC 27001. The ISMS Organization reports directly to the PEMC president and is headed by an ISMS Adviser. It is composed of the ISMS Committee, Core Team, Document Control Team and Internal Audit.

The ISMS Organization, under the guidance of the ISMS Adviser, led PEMC in establishing the information security governance framework, preparation of essential ISMS documentation, initiating the necessary security processes, asset and facility management, computer operations, incident management, IT infrastructure support, change management, disaster recovery and business continuity plan.

Enhancements in operations

As it continuously seeks to improve its systems and processes, PEMC has been able to introduce measures that enhanced efficiency of its day-to-day operations.

Prudential Requirements Monitoring. Compliance with prudential requirements is a nagging issue in the operations of the WESM. Thus, PEMC has taken steps to implement strict compliance through regular assessment of the trading participants' market exposure and issuance of margin calls to participants with inadequate or expiring securities.

Market Network Model Management. Among PEMC's daily challenges is ensuring that the WESM Market Network Model is always a fair and consistent representation of the actual conditions of the power system. Improvements in the protocol between PEMC and the National Grid Corporation of the Philippines (NGCP) have been made in which NGCP ensures that network developments are relayed to PEMC in a timely manner. Thus far, all significant network developments are promptly reflected in the Market Network Model and no disruptions in the market processes have been experienced as a result of inconsistencies of the Model with actual power system topology.

Market Management System Enhancements. Enhancements to the Load Predictor (LDP) and Day Ahead Projection (DAP) functionalities of the Market Management System (MMS) were introduced. The improvements to the LDP functionality minimized the time of LDP execution and allowed the manual setting of a lag time for Real-Time Dispatch (RTD) workflow to start. This enhancement avoids overlap of RTD-LDP runtime causing work flow stoppages that result in the inability of the MMS to generate a feasible dispatch schedule. With this enhancement, market intervention because of work flow stoppage is minimized.

With the enhancement of the DAP functionality, the DAP run is able to use the latest generator breaker status for a pre-defined number of intervals. As a result, a generating unit will be considered in the DAP scheduling process if it has a valid offer, is not in the outage schedule and has closed controlling breakers. With this enhancement, the DAP results now provide valuable and fairly reliable information for purposes of demand forecasting.

Wholesale Billing and Settlement System Enhancements. The regional application of pricing error and price substitution rules and methodologies was incorporated in the Wholesale Billing and Settlement System (WBSS) immediately upon implementation of the revised methodologies in May 2011. In August 2011, PEMC started working on the Accounts Management System (AMS) to support the functionalities related to collection and payments, including (a) collection notice preparation, (b) collection and payment allocation, (c) reporting and (d) monitoring. The AMS module is expected to be completed and launched in the last quarter of 2012.

Effective governance

WESM Dispute Resolution. PEMC initiated changes in the dispute resolution framework in the WESM through the creation of a pool of mediators and arbitrators outside of the WESM in order to ensure their independence. This is a significant departure from the previous framework where the mediators/arbitrators are members of the Dispute Resolution Group which is a committee under the PEM Board and whose members are appointed by the same.

Further, a Dispute Management Protocol (DMP) was also introduced where disputes between the WESM members and PEMC, as Market Operator, are managed prior to a formal mediation or arbitration proceeding. DMP focal persons were likewise identified for each participant who will play a significant part in the established DMP.

Enforcement and Compliance. PEMC recognizes that enforcement and compliance in the WESM can only be as effective as the process for investigation of breach by WESM members is effective. Thus, efforts have been taken to strengthen the capability of the PEMC Enforcement and Compliance Office so that the conduct of investigations can be expedited and cases submitted for investigation are resolved within reasonable time frames.

Market Audit. Regular conduct of independent operational audits of market systems and processes is relevant if market efficiency and transparency are to be continuously enhanced. Not only does the audit point to where corrective or remedial measures need to be implemented,

Digital Graphic Design Contest

The Digital Graphic Design Contest created an opportunity for the PEMC employees to contribute their ideas and display their artistic talents in coming up with a cover design for the WESM and PEMC annual reports.

Luis Angelo T. Canicon's entry entitled "Ablaze" won over several entries. Shown here are the works of the contest finalists.

Becoming World Class

Katrina A. Garcia-Amuyot

Breezin' Thru Fusion

Priscillano Jesus G. de la Cruz, Jr.

Center Stage

Vida Joan G. Gumera

but it also brings out recommendations for best practices. Thus, PEMC worked towards institutionalizing independent operational audits not only of market operations processes and systems, but of metering arrangements and systems operations, as well.

PEMC laid the ground work for the conduct of the audit of metering arrangements and this will commence in 2012 to cover performance of wholesale metering services by PEMC and the National Grid Corporation of the Philippines (NGCP). An operational audit of systems operations is also being considered and this is expected to be implemented in the near future.

Meanwhile, PEMC underwent a second independent operational audit of its market operations systems and processes. Also covered are the Market Assessment System which is being administered by the Market Assessment Group (MAG), and interfaces with the System Operator, Metering Services Providers, WESM Participants, Department of Energy (DOE) and Energy Regulatory Commission (ERC).

The independent auditor, PA Consulting Group Ltd., found that the operations of the WESM are generally compliant with the obligations set out in the WESM Rules. In respect to market software, it was certified that, except for the Market Settlement Software which was for replacement at the time of the audit, the software used in the WESM, Market Network Model, Load Forecasting Software, Market Clearing Software and the Market Assessment System, generally comply with the industry standards and with their specified formulations. The auditor did note that there is still room for improvement in each of the five software areas in order to take advantage of new and better methodologies and technologies.

The audit covered four major areas. **Market Software Testing** covered the compliance and accuracy of key algorithms and calculations within the suite of market software. **Operational Procedure Review** assessed whether the Market Operator and the Market Assessment manuals and procedures are aligned with WESM Rules and meet best practice standards as assessed by the auditor using its procedure evaluation framework. **Operational Process Review** assessed whether selected Market Operator and Market Assessment processes are in compliance with the WESM Rules and consistent with best practice standards defined by the auditor's process evaluation framework. **IT Systems Review** provided an assessment against international best practice standards with respect to software management, operations and security. It also provided software validation for selected interfaces and systems beyond those included in the Market Software Testing.

Recommendations have been put forward by the auditor to PEMC to improve the efficiency of the operations of the WESM. PEMC formulated a detailed Action Plan to address the said findings and recommendations. The progress of the implementation of the said action plans is being regularly monitored by the PEM Audit Committee. The audit reports are published in the WESM website. The majority of the recommendations that were made by previous audits have been implemented or are in the process of being implemented.

Continuing improvements. From the last two operational audits that it underwent, PEMC has learned valuable lessons, particularly from the auditors' recommendations of best practices. For this reason, PEMC has entered into a framework agreement with an expert consultant to provide continuing services aimed at market improvement, including market operations audit, integration of retail competition and open access, operations of the reserve market and the renewable energy market.

Strengthened coordination

Coordination with the National Grid Corporation of the Philippines (NGCP) is an indispensable component of PEMC's day-to-day operations of the WESM. Previously, operational issues that arose between PEMC and NGCP were resolved through meetings – both formal and informal – between relevant staff and officers of both organizations. Thus, PEMC and NGCP regularly conduct coordination meetings between the Market Operations and System Operations personnel, as well as between the NGCP Metering Services and PEMC's Billing, Settlements and Metering staff.

But beyond dealing with day-to-day operations, strong bilateral cooperation between NGCP and PEMC is needed in meeting the objectives of the WESM to comply with the policies and directives of the Department of Energy (DOE) and Energy Regulatory Commission (ERC) and the requirements of the Philippine Grid Code. For this reason, PEMC and NGCP initiated discussions on the signing of a Memorandum of Understanding for increased cooperation between the Market Operator and the System Operator and the revival of the PEMC-NGCP Working Group that is working on compliances with ERC regulatory directives.

Contributing to policy and market growth

Making the WESM a tool for policy and regulatory development is among the objectives that PEMC set for itself in its strategic plan. This is towards achieving the corporate goal of providing "support to energy sector programs towards achievement of the objectives of the Electric Power Industry Reform Act (EPIRA) and other relevant laws."

We have endeavored to raise consciousness, within PEMC and with its stakeholders, on the role of WESM in the electric power industry. By including this as one of PEMC's goals, PEMC employees are made aware of their important role in making the electricity market work by strict compliance with and enforcement of the market rules and by providing valuable inputs to policy makers and regulators as they make significant decisions that will contribute to the growth of the market.

Digital Graphic Design Contest Entries

Co-development
Clares Loren C. Jalocon

Development Through Diversity
Edward I. Olmedo

Life
Fernando G. Dizon

Flux
Ma. Victoria B. Que

Support through timely reporting of market information and discussion of market developments. PEMC strengthened its coordination with the Department of Energy (DOE) and Energy Regulatory Commission (ERC) through regular reporting of market results and analysis of significant market events. A generation monitoring system was put in place for the DOE to enable timely monitoring of available generation and anticipation of possible generation shortfall.

Market studies to support policy development and planning. A working group within PEMC was organized to perform various market studies aimed at making policy and regulatory proposals. Specific studies included, among other topics, assessment of a feasible market design for Mindanao and treatment of generation assets in the region, triggers for investigation of anti-competitive behavior and incentives for self-reporting of non-compliances.

Further, PEMC has readily provided the DOE with analysis of market results to support recommendations for means to deal with issues confronting the power industry. For instance, although PEMC has no operations in Mindanao, it has been a constant presence in consultations on the Mindanao power supply issue, and it has supported the DOE through conduct of relevant market studies.

Market development. PEMC is an active participant in market development initiatives, particularly of the DOE.

PEMC is a member of the Retail Competition and Open Access (RCOA) Steering Committee created by the DOE; and through its membership, it actively participated in the discussions and consultations on the impending implementation of retail competition and open access. To support the DOE's formulation of the appropriate policy framework for RCOA implementation, PEMC, in coordination with the DOE and the ERC, developed the RCOA design including the work plan and framework. In the RCOA design, the RCOA will be implemented such that the operations of the WESM will be extended to the contestable customers. Further, the key feature of this market design is the freedom of the contestable customers to choose their suppliers of electricity.

Initial preparations are also now underway for the establishment of the renewable energy (RE) market, which PEMC is mandated by law to operate, and for the establishment of a renewable energy certificates registrar. PEMC has developed a high level RE market design and conceptual framework which includes assessment of the impact of the requirements of the Renewable Energy Law to the WESM operations. Preliminary work was undertaken in 2011 for the inception report in coordination with the DOE. PEMC is also represented in the National Renewable Energy Board (NREB) and is an active participant in all the activities of the NREB.

From left to right: Phillip C. Adviento, Robert J. Supnet, Mark Anthony C. Andrada, Marie Emmanuelle T. Delarmente, PEMC VP Carlito C. Claudio, John Mark S. Catriz and Cyril Recto S. Calub at the International Conference on Power Markets in New Delhi, India

PEMC VP Carlito C. Claudio presenting the WESM Status Update at the 4th APEx APAC Meet in New Delhi, India

PEMC Manager for Corporate Planning, Zigfred Niño C. Viray (center), was one of the panellists at the APEx Convention 2011 in Rio de Janeiro, Brazil

Motivating employees

Continuous Staff Development and International Linkages

As part of PEMC's commitment to continuous staff development and to maintaining linkages with other electricity markets, PEMC maintained its membership in the Association of Power Exchanges (APEx) and in the Energy Intermarket Surveillance Group (EISG).

Delegations composed of selected PEMC officers and staff attended the APEx International Convention in Sao Paolo, Brazil on 23-26 October 2011 and the APEx Asia Pacific Conference (APAC) in New Delhi, India on 6-8 March 2011. Both events are annual meetings of market operators and serve as a venue for sharing of experiences, developments and ideas for improvement of the market in their respective countries and jurisdictions.

In both meetings, reports on the developments in the WESM and in the Philippine power industry were included in the meeting agenda, and presentations on these were made by the PEMC delegates. The delegates also had an opportunity to listen to presentations on other electricity markets thereby gaining insight on current practices and developments. In the 2011 APEx International Conference held in Brazil, the Philippine market was considered as one of the forefront in the development of electricity markets in the Asia-Pacific region. As such, PEMC was tasked to report on its experience in operating the electricity market together with an independent System Operator. PEMC's Zigfred Niño C. Viray, Manager for Corporate Planning, gave a presentation entitled, "Electricity Market Response to Transmission Issues: The Philippine Experience."

PEMC delegates, together with representatives from the Department of Energy (DOE), also participated in the 23rd

Digital Graphic Design Contest Entries

Market Expansion
Arthur P. Pintado

Meliorating
Jocelyn Q. Sabile

Spectrum
Orlando C. Ninon

The Light
Juan Carlo L. Panopio

23rd Spring EISG Meeting delegates with PEMC, ERC and DOE participants in New Orleans, Louisiana, USA

24th EISG Meeting delegates with PEMC and DOE participants in Austin, Texas, USA

and 24th Meetings of the Energy Intermarket Surveillance Group (EISG). The bi-annual EISG Meetings serve as venues for member-organizations to come together and discuss issues, techniques, procedures and other matters in regard to their responsibility in monitoring the competitiveness of wholesale electricity markets. The Market Monitoring Unit of the Southwest Power Pool (SPP) hosted the 23rd Meeting held on 10-12 April 2011 in New Orleans, Louisiana, USA. The 24th Meeting was held on 25-27 September 2011 in Austin, Texas, USA and was hosted by the Public Utility Commission of Texas (PUCT).

For the 23rd Meeting, the agenda focused on market power mitigation practices and other potential solutions, real-time price projection and its implications, treatment of intermittent resources in capacity markets, demand response measurement and verification and other special topics. Also presented and discussed in the meeting were case studies from various jurisdictions. Following the EISG meeting, PEMC, together with delegates from the DOE, held a coordination meeting with the SPP at their office in Little Rock, Arkansas 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.

In the 24th Meeting, the delegates focused on the conduct of market monitoring and benchmarking, market power issues, load resource deployment and performance measurement, among others. Additionally, the DOE and PEMC delegates took the opportunity to meet with the PUCT officials in Austin, Texas on 28 September 2011. The said officials discussed their experiences and lessons learned in the implementation of the renewable energy market. On 29 September 2011, the delegates also visited the Xtreme Power (XP) headquarter in Kyle, Texas. XP conducted a lecture on the features and application of the energy storage, called Dynamic Power Resources (DPR).

PEMC has been a member of the APEx since 2007 and the EISG since 2006.

Fostering Volunteerism among Employees

PEMC also took time during the year to look inwards to provide venues to promote social involvement among the PEMC employees. As PEMC does not have the resources to engage in large-scale corporate social responsibility (CSR) programs, volunteerism among employees is encouraged through various activities in which the employees volunteer their services as well as through skills training programs designed to equip the employees with skills that they can use for community service.

The PEMC employees volunteered in tree-planting and other eco-activities in Jala-Jala, Rizal on 19 August 2011 which was designed to raise environmental awareness among the employees. Also in line with the thrust to raise environmental awareness, PEMC employees attended a seminar on solid waste management conducted by the National Solid Waste Management Council. In partnership with the Philippine National Red Cross, PEMC employees participated in a blood-letting drive and certification training on basic life support and first aid. PEMC employees also had an opportunity to share their blessings through gift-giving with children cancer patients supported by the Kythe Foundation and orphans housed at the Children's Joy Foundation.

Forward to 2012 and Beyond

Glimpse into 2012

For the year ahead, PEMC has set for itself three major corporate goals, as follows:

- Provide an efficient, competitive, transparent and reliable spot market
- Achieve organizational excellence
- Support energy sector programs towards the achievement of the Electric Power Industry Reform Act (EPIRA) and other energy/relevant laws

A strategic plan for the achievement of these goals is embodied in the PEMC's Goals, Objectives, Strategies and Measures (GOSM) Strategic Plan for 2012. Conceptualized with wide participation from all PEMC officers and employees, the PEMC-GOSM spells out in concrete detail the activities that PEMC will undertake in 2012 and beyond to achieve the set corporate goals.

Specific measures of performance are also set out and regular monitoring of corporate and market operator performance has now been institutionalized. In compliance with the WESM Rules, the Philippine Electricity Market Board (PEM Board) of Directors approved the Market Operator Performance Standards (MOPS) that is intended to measure all relevant market operator processes, including registration and participant support, scheduling and pricing, market infrastructure availability and billing and settlements. The MOPS were already submitted to the Department of Energy (DOE) for final approval. But even pending its final approval, the standards will already be implemented in 2012. Corporate-wide, the PEM Board has also approved the Corporate Performance Measures (CPM) incorporated in the 2012 Strategic Plan. Monitoring of performance is to be done on a quarterly basis.

Future Directions

After having successfully integrated the Visayas to the operations of the WESM, PEMC as with the rest of the power industry, is looking forward to the further evolution of the electricity market in the Philippines.

Integration of Retail Competition in the WESM and Assumption by PEMC of the Central Registration Body Functions. It is envisioned that at the initial phase involving customers with average demand of one MW, retail competition will be integrated in the WESM. With this, PEMC looks forward to expanded participation in the WESM, as well as to playing a crucial role in the implementation and operations of the retail competition as the Central Registration Body (CRB).

Trading of Reserves. PEMC looks forward to expanding the operations of the spot market to include the trading of reserves. Currently, PEMC continues to work with the National Grid Corporation of the Philippines (NGCP) for the compliances required by the Energy Regulatory Commission (ERC) pertinent to the approval of the pricing and cost recovery mechanism for the trading of reserves in the WESM.

Renewable Energy Market. Also in the near horizon is the establishment of the renewable energy (RE) market and the registry of renewable energy certificates, which are to be operated by PEMC pursuant to express mandate under the Renewable Energy Act of 2008.

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

Strengthening partnerships with other electricity markets. PEMC's memberships in the Association of Power Exchanges (APEx) and the Energy Intermarket Surveillance Group (EISG) will be jump-off points for the organization to interact with other electricity markets to achieve greater learning and increased competence. At present, PEMC has conducted various briefings and trainings for guests from other countries such as Vietnam, Saudi Arabia, Singapore and Thailand. PEMC intends to continue with its international relations and has, in fact, received various requests from other electricity spot markets for briefings and trainings.

All of these are expected to bring significant changes to the electricity market in the Philippines. It is hoped that PEMC has laid the ground work to enable it to face these challenges and continue to ensure the relevance of the WESM. Thus, what started as one spark would indeed set the power industry ablaze towards achieving the goal of efficient, affordable and reliable electricity to fuel the country's growth.

Know the PEMC Staff

With the aim of ensuring a stronger and more resilient organization by maximizing its human capital requirements thereby warranting effective market governance and proficient operations of the WESM, PEMC initiated and implemented changes in its organizational structure in 2010.

With this, the organization was able to successfully align the updated corporate constitution to realize PEMC's key mandate of a fair, transparent, efficient and reliable operation of an electricity spot market.

EXECUTIVE COMMITTEE

Seated from left to right: Pres. Melinda L. Ocampo, Claudette G. Ubaldo-Dema, Medardo T. Nuñez

Standing from left to right: Sheila P. Ingco, Chrysanthus S. Heruela, Criselda S. Martin-Funelas, Robinson P. Descanzo, Carlito C. Claudio, Maria Nerissa A. Cordoba, Jesusito H. Sulit

PEMC OFFICERS

Top

Seated from left to right: Criselda S. Martin-Funelas, Rachel Angela P. Anosan, Medardo T. Nuñez

Standing from left to right: Elaine D. Gonzales, Carlito C. Claudio, Pres. Melinda L. Ocampo, Aldwin Aris C. Gregorio, Edwin N. Mosa, Millan H. Libongco, Patrick S. Fernandez

Bottom

Seated from left to right: Sheila P. Ingco, Chrysanthus S. Heruela, Caryl Miriam Y. Lopez-Mateo, Zigfred Niño C. Viray

Standing from left to right: Jesusito H. Sulit, Maria Nerissa A. Cordoba, Robinson P. Descanzo, Claudette G. Ubaldo-Dema, Isidro E. Cacho Jr., Celina R. Encarnacion, Marissa P. Gandia

OFFICE OF THE PRESIDENT
Melinda L. Ocampo, President

OFFICE OF THE CORPORATE SECRETARY
Claudette G. Ubaldo-Dema, Corporate Secretary

LEGAL
Criselda S. Martin-Funelas, Vice President

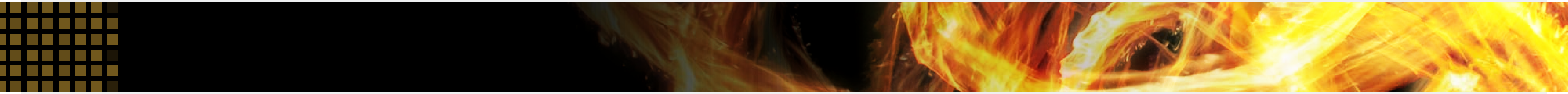
MARKET ASSESSMENT
Chrysanthus S. Heruela, Vice President

Office of the President
The Office of the President runs the over-all management, operation and administration of PEMC and its integral units through the effective execution and implementation of plans, programs, policies and procedures approved by the PEM Board.

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

Market Assessment
The Market Assessment Group (MAG) monitors and evaluates the performance of the WESM and the activities of the market participants, Market Operator and System Operator ensuring the effective function and overall efficiency of the electricity market. MAG also serves as the primary support unit of the various governance committees.

Legal
The Legal Department provides over-all legal consultations and assistance to various PEMC internal business units and stakeholders.



ENFORCEMENT AND COMPLIANCE OFFICE
Sheila P. Ingco, Vice President

INTERNAL AUDIT
Maria Nerissa A. Cordoba, Vice President

INFORMATION SYSTEMS AND TECHNOLOGY
Carlito C. Claudio, Vice President

CORPORATE PLANNING AND COMMUNICATIONS
Robinson P. Descanzo, Vice President

Enforcement and Compliance Office

The Enforcement and Compliance Office leads in fostering a culture of compliance in the trading practices of the electricity spot market participants through the conduct of investigations of possible breaches in the WESM Rules and WESM Manuals under the direction of the PEM Board.

Internal Audit

The Internal Audit Department audits PEMC's financial, operational and support functions and processes ensuring the adequacy of internal control systems, reliability and integrity of market data, compliance with policies, safeguarding of assets, economical and efficient use of resources and implementation of resolutions and recommendations.

Corporate Planning and Communications

The Corporate Planning and Communications (CPC) Department develops, manages and monitors the over-all business and annual operational plans of PEMC, ensuring synergy across the corporation's performance measures and alignment of corporate goals and activities with regulatory compliance and government agency policies. The CPC also manages over-all participant and market-related trainings and the corporate communications plan.

Information Systems and Technology

The Information Systems and Technology Department develops and manages the overall Information Systems and Information Technology (IS/IT) business goals and objectives and determines the appropriate strategies both for the Market Management System (MMS) IS/IT infrastructure-related operations and the corporate network.

CORPORATE SERVICES
Medardo T. Nuñez, Vice President

OFFICE OF THE CORPORATE TREASURER
Medardo T. Nuñez, Corporate Treasurer

TRADING OPERATIONS
Jesusito H. Sulit, Vice President

Corporate Services

The Corporate Services Department provides administrative support and guidance, as well as implements programs at the corporate level in the areas of Finance, Human Resources and Administration and Billing, Settlements and Metering through development of policies and ensuring consistent implementation across different units within the organization.

Office of the Corporate Treasurer

The Office of the Corporate Treasurer is the custodian of company funds and manages projection of expenses and ensuring the availability of alternatives for obtaining supplemental funding for corporate undertakings.

Trading Operations

The Trading Operations Department (TOD) develops the market operating systems and all operations-related undertakings such as market documentation, market forecast and projections, dispatch scheduling and pricing. The TOD directly interfaces with the System Operator to ensure proper 24/7 management of the real-time operations of the WESM, and directs and coordinates 24 hours a day and 7 days a week the real-time operations of the WESM.

ISMS COMMITTEE

ISMS INTERNAL AUDITORS

ISMS CORE TEAM

DOCUMENT CONTROL TEAM

Report of Independent Auditors

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 statements of financial position as at December 31, 2011 and 2010, and the statements of comprehensive income, statements of changes in fund balance and statements of cash flows for the years 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 .

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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, 2011 and 2010, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

Our audits were 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, 2011 required by the Bureau of Internal Revenue as disclosed in Note 22 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: Christopher M. Ferareza
Partner

CPA Reg. No. 0097462
TIN 184-595-975
PTR No. 3174792, January 2, 2012, Makati City
SEC Group A Accreditation
Partner - No. 1185-A (until Jan. 18, 2015)
Firm - No. 0002-FR-3 (until Jan. 18, 2015)
BIR AN 08-002511-34-2011 (until Sept. 21, 2014)
Firm's BOA/PRC Cert. of Reg. No. 0002 (until Dec. 31, 2012)

March 29, 2012

Statements of Financial Position

December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

	Notes	2011	2010
A S S E T S			
CURRENT ASSETS			
Cash and cash equivalents	5	**P 701,321,469**	P 722,737,512
Funds held for WESM trading participants	6	**444,153,098**	395,202,030
Market fees and other receivables	7	**201,068,129**	84,078,923
Prepayments and other current assets	8	**39,769,358**	19,207,124
Total Current Assets		**1,386,312,054**	1,221,225,589
NON-CURRENT ASSETS			
Property and equipment - net	9	**39,205,421**	53,151,940
Intangible assets - net	10	**245,184,883**	349,868,345
Retirement benefit asset	15	**1,032,035**	-
Other non-current assets	18	**9,850,293**	15,190,522
Total Non-current Assets		**295,272,632**	418,210,807
TOTAL ASSETS		**P 1,681,584,686**	P 1,639,436,396
LIABILITIES AND FUND BALANCE			
CURRENT LIABILITIES			
Interest-bearing loans and borrowings	12	**P 216,121,151**	P 207,950,816
Accounts and other payables	11	**199,422,926**	70,319,041
Due to WESM trading participants	6	**444,153,098**	395,202,030
Total Current Liabilities		**859,697,175**	673,471,887
NON-CURRENT LIABILITIES			
Interest-bearing loans and borrowings	12	**736,625,907**	728,557,962
Retirement benefit obligation	15	**-**	16,652,603
Total Non-current Liabilities		**736,625,907**	745,210,565
Total Liabilities		**1,596,323,082**	1,418,682,452
FUND BALANCE	18	**85,261,604**	220,753,944
TOTAL LIABILITIES AND FUND BALANCE		**P 1,681,584,686**	P 1,639,436,396

See Notes to Financial Statements.

Statements of Comprehensive Income

For the Years Ended December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

	Notes	2011	2010
REVENUES			
Market fees	13	**P 688,736,157**	P 769,757,648
Less prior year unutilized market fees	13	**252,565,325**	-
		436,170,832	769,757,648
Fair value gain	12	**30,573,854**	-
Interest	5	**19,529,670**	16,951,656
Others	14	**3,442,524**	10,721,535
		489,716,880	797,430,839
EXPENSES			
Salaries and employee benefits	15	**230,320,890**	207,080,649
Depreciation and amortization	9, 10	**136,610,358**	140,595,676
Interest	12	**55,602,101**	64,278,653
Outside services		**42,482,654**	41,497,678
Repairs and maintenance		**24,539,279**	21,391,087
Rental	18	**24,292,507**	23,490,521
Honorarium and allowances		**23,225,000**	23,284,000
Transportation and travel		**19,468,362**	14,590,282
Utilities		**18,991,959**	17,089,022
Supplies		**10,310,566**	9,241,012
Impairment loss	18	**3,311,126**	-
Other expenses	16	**36,054,418**	25,058,710
		625,209,220	587,597,290
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES		**(135,492,340)**	209,833,549
OTHER COMPREHENSIVE INCOME		**-**	-
TOTAL COMPREHENSIVE INCOME (LOSS)		**(P 135,492,340)**	P 209,833,549

See Notes to Financial Statements.

Statements of Changes in Fund Balance

For the Years Ended December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

	Notes	2011	2010
CONTRIBUTED CAPITAL	3	**P 10,000**	P 10,000
ACCUMULATED EXCESS OF REVENUES OVER EXPENSES	3		
Balance at beginning of year		**220,743,944**	10,910,395
Excess (deficiency) of revenues over expenses during the year		**(135,492,340)**	209,833,549
Balance at end of year		**85,251,604**	220,743,944
TOTAL FUND BALANCE		**P 85,261,604**	P 220,753,944

See Notes to Financial Statements.

Statements of Cash Flows

For the Years Ended December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

	Notes	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Excess (deficiency) of revenues over expenses		(P 135,492,340)	P 209,833,549
Adjustments for:			
Depreciation and amortization	9, 10	136,610,358	140,595,676
Interest expense	12	55,602,101	64,278,653
Fair value gain	12	(30,573,855)	-
Interest income	5	(19,529,670)	(16,951,656)
Noncash expenses included in interest-bearing loans and borrowings		-	5,505,593
Excess of revenues over expenses before working capital changes		6,616,594	403,261,815
Increase in accounts and other payables		120,313,919	165,246
Decrease (increase) in market fees and other receivables		(116,960,014)	46,235,803
Increase in due to WESM trading participants		48,951,068	135,094,798
Increase in funds held for WESM trading participants		(48,951,068)	(135,094,798)
Increase in prepayments and other current assets		(20,562,234)	(8,612,239)
Decrease (increase) in prepaid income taxes		5,340,229	(6,816,272)
Increase in retirement benefit asset		(1,032,035)	-
Decrease in retirement benefit obligation		(16,652,603)	(24,656,246)
Net Cash From (Used in) Operating Activities		(22,936,144)	409,578,107
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisitions of property and equipment	9	(16,763,700)	(31,264,742)
Interest received		19,500,478	15,164,647
Acquisitions of intangible assets	10	(1,216,677)	(1,034,587)
Net Cash From (Used in) Investing Activities		1,520,101	(17,134,682)
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of interest-bearing loans and borrowings		-	(58,599,461)
Interest paid		-	(13,778,420)
Net Cash Used in Financing Activities		-	(72,377,881)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		(21,416,043)	320,065,544
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		722,737,512	402,671,968
CASH AND CASH EQUIVALENTS AT END OF YEAR		P 701,321,469	P 722,737,512

Supplemental Information on Noncash Operating, Investing and Financing Activities

1) In 2011, the Company recognized fair value gain amounting to P30.6 million as a result of measuring the non-current interest-bearing loans and borrowings at amortized cost. Interest expense recognized from this loan amounted to P38.6 million in 2010 (see Note 12).

2) As of December 31, 2011 and 2010, accrued interest expense amounting to P19.5 million and P1.5 million, respectively were included as part of interest-bearing loans and borrowings (see Note 12).

See Notes to Financial Statements.

Notes to Financial Statements

December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

1. CORPORATE MATTERS

1.01 Incorporation and Operations

Philippine Electricity Market Corporation (the Company or PEMC) 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 in the Philippines 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 only as a pass-through entity (see Note 2). However, cash received and held by the Company for the WESM (see Note 6) 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 Notes 4.01(b) and 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 formally started.

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 (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.

Notes to Financial Statements

December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

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. The DOE has engaged the services of consultants to study the possible structure and manner of selection or appointment of the IMO. In 2011, the DOE formally presented the creation of the IMO. The Company will be restructured and its by-laws will be amended, converting the Company to become the IMO. An independent transition board (ITB) will be formed chaired by the DOE Secretary. The ITB will be tasked to oversee the orderly transition to the IMO Board which will come into being once all the necessary preparatory steps to fully establish it are completed. As of December 31, 2011, the creation of the IMO as well as the determination of its structure is still subject to deliberations by the Joint Congressional Power Commission (JCPC).

Consistent with the provisions 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 being appointed by the Secretary of the DOE, until such time that the IMO has been finally designated.

1.04 Designation as Central Registration Body (CRB) and the Retail Competition and Open Access (RCOA)

Section 31 of the EPIRA provides that RCOA shall be implemented no later than three (3) years upon the effectivity of the EPIRA, subject to fulfillment of certain pre-conditions. Through the Energy Regulatory Commission (ERC) Resolution No. 10 Series of 2011, dated June 6, 2011 and pursuant to Section 31 of the EPIRA and Section 3, Rule 12 of its Implementing Rules and Regulations, the ERC has declared fulfillment of the pre-conditions prescribed for the initial implementation of the RCOA.

Retail Competition is the provision of electricity to a contestable market by suppliers through Open Access, which is defined as the system of allowing any qualified person of the use of transmission and/or distribution systems and associated facilities, subject to the payment of transmission and/or distribution retail wheeling rates duly approved by the ERC.

The RCOA Steering Committee (RCOA SC) which was created through the DOE Circular No. DC 2011-06-0006 dated June 17, 2011, recommended policies to enhance and ensure the readiness of the industry participants in the implementation of the RCOA and the deferment of its implementation from December 26, 2011 to a later date. On October 24, 2011 the ERC approved and declared the deferment of implementation of the RCOA in Luzon and Visayas, as recommended by the RCOA SC, while all rules, systems, preparations and infrastructures required have not yet been put in place.

On February 24, 2012, the Company was designated by the DOE through DOE Circular No. DC 2012-02-0002 as the CRB assigned to undertake the development and management of the required systems and processes and information technology system that will be capable of handling customer switching and information exchange among retail electricity market participants, as well as the settlement of their transactions in the WESM.

For purposes of implementing the functions of the CRB under the RCOA regime and under the supervision of the DOE, the Company is directed to undertake the following duties and responsibilities:

(a) Review of WESM Rules and Manuals;
(b) Develop market infrastructure, systems and processes;
(c) Conduct training for the electric power industry participants;
(d) Comply with DOE directives;
(e) Coordinate with relevant stakeholders and other government agencies; and
(f) Perform such other related functions as may be necessary in the effective and efficient implementation of the RCOA.

1.05 Approval of the Financial Statements

The financial statements of the Company as of and for the year ended December 31, 2011(including the comparatives for the year ended December 31, 2010) were authorized for issue by the PEM Board on March 29, 2012.

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.

Majority of the registered WESM trading participants delivered Letters of Credit serving as their prudential security requirement. 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 which is assumed to be attributable as economic rentals arising from other binding constraints. 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 contribution on the total NSS 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, 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 both in Luzon and Visayas, and will take effect 15 days following its publication in a newspaper of general circulation and will continue until otherwise directed by the ERC.

Notes to Financial Statements

December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

2.03 Unutilized Market Fees

The market fees charged by the Company to trading participants have to be approved by the ERC (see also Note 13).

ERC Case No. 2007-124 RC issued by the ERC on January30, 2008 defined unutilized market fees as the excess market fees collected over the approved market fees by the ERC (see also Note 13). Also, pursuant to the same ERC case, any excess in the market fees in the previous year will be carried over to the succeeding year. Thus, any unutilized market fee in any preceding year shall be considered in the determination of the adjusted market fees for the current year in case the Company's actual collection in that preceding year is more than the approved revenue for that year.

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, *Presentation of Financial Statements*. The Company presents all items of income 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.

(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.

(d) *Reclassification of Accounts*

Certain accounts in the 2010 financial statements were reclassified to conform with the 2011 financial statements classification and presentation (see Notes 11 and 12.01).

3.02 Adoption of New and Amended PFRS

(a) *Effective in 2011 that are Relevant to the Company*

In 2011, the Company adopted the following amendments, interpretation and annual improvements to PFRS that are relevant to the Company and effective for financial statements for the annual period beginning on or after July 1, 2010 or January 1, 2011:

PAS 24 (Amendment)	:	Related Party Disclosures
Philippine Interpretation International Financial Reporting Interpretations Committee (IFRIC) 14 (Amendment)	:	Prepayment of a Minimum Funding Requirement
Various Standards	:	2010 Annual Improvements to PFRS

Discussed below are relevant information about these new and amended standards.

(i) PAS 24 (Amendment), *Related Party Disclosures* (effective from January 1, 2011). The amendment simplifies and clarifies the definition of a related party by eliminating inconsistencies in determining related party relationships. The amendment also provides partial exemption from the disclosure requirements for government-related entities to disclose details of all transactions with the government and other government-related entities. The adoption of this amendment did not result in any significant change in the Company's disclosures of related parties on its financial statements.

(ii) Philippine Interpretation IFRIC 14 (Amendment), *Prepayment of a Minimum Funding Requirement* (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 surplus for defined benefit plans based on PAS 19, *Employee Benefits*, that are subject to a minimum funding requirement. The Company is not subject to minimum funding requirements, hence, the adoption of the revised standard has no material effect on its financial statements.

(iii) 2010 Annual Improvements to PFRS. Most of these amendments became effective for annual periods beginning on or after July 1, 2010 or January 1, 2011. Among those improvements, only the following amendments were identified to be relevant to the Company's financial statements but which did not have any material impact on its financial statements:

- PAS 1 (Amendment), *Presentation of Financial Statements: Clarification of Statement of Changes in Equity* (effective from July 1, 2010). The amendment clarifies that, for each component of equity, an entity may present an analysis of other comprehensive income either in the statement of changes in equity or in the notes to the financial statements. The Company has no transactions that would affect other comprehensive income.

- PFRS 7 (Amendment)*, Financial Instruments: Clarification of Disclosures* (effective from January 1, 2011). The amendment clarifies the disclosure requirements which emphasize the interaction between quantitative and qualitative disclosures about the nature and extent of risks arising from financial instruments. It also amends the required disclosure of financial assets including the financial effect of collateral held as security. This amendment has no significant effect on the financial statements since the Company already provides adequate information in its financial statements in compliance with the disclosure requirements.

Notes to Financial Statements

December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

(b) *Effective in 2011 that are not Relevant to the Company*

The following amendments and improvements to PFRS are mandatory for accounting periods beginning on or after January 1, 2011 but are not relevant to the Company's financial statements:

PAS 32 (Amendment)	:	Financial Instruments: Presentation – Classification of Rights Issues
PFRS 1 (Amendment)	:	First-time Adoption of PFRS – Limited Exemption from PFRS 7 Comparative Disclosures
IFRIC 19	:	Extinguishing Financial Liabilities with Equity Instruments
2010 Annual Improvements		
PAS 28 (Amendment)	:	Investments in Associates
PAS 31 (Amendment)	:	Interests in Joint Ventures
PAS 34 (Amendment)	:	Interim Financial Reporting
PFRS 1 (Amendment)	:	First Time Adoption of PFRS Financial Instrument Disclosures
PFRS 3 (Amendment)	:	Business Combinations
IFRIC 13(Amendment)	:	Customer Loyalty Programmes – Fair Value of Awards Credits

(c) *Effective Subsequent to 2011 but not Adopted Early*

There are new PFRS, amendments, annual improvements and interpretations to existing standards that are effective for periods subsequent to 2011. 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) PFRS 7 (Amendment), *Financial Instruments: Disclosures – Transfers of Financial Assets* (effective from July 1, 2011). The amendment requires additional disclosures that will allow users of financial statements to understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and, to evaluate the nature of, and risk associated with any continuing involvement of the reporting entity in financial assets that are derecognized in their entirety. The Company does not usually enter into this type of arrangement with regard to transfer of financial asset, hence, the amendment may not significantly change the Company's disclosures in its financial statements.

(ii) PAS 1 (Amendment), *Financial Statements Presentation – Presentation of Items of Other Comprehensive Income* (effective from July 1, 2012). The amendment requires an entity to group items presented in Other Comprehensive Income into those that, in accordance with other PFRS: (a) will not be reclassified subsequently to profit or loss and (b) will be reclassified subsequently to profit or loss when specific conditions are met. The Company's management expects that this will not affect the presentation of items in other comprehensive income, since the Company has no transactions which affect other comprehensive income.

(iii) PAS 19 (Amendment), *Employee Benefits* (effective from January 1, 2013). The amendment made a number of changes as part of the improvements throughout the standard. The main changes relate to defined benefit plans as follows:

- eliminates the corridor approach under the existing guidance of PAS 19 and requires an entity to recognize all gains and losses arising in the reporting period;
- streamlines the presentation of changes in plan assets and liabilities resulting in the disaggregation of changes into three main components of service costs, net interest on net defined benefit obligation or asset, and remeasurement; and,
- enhances disclosure requirements, including information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in them.

Currently, the Company is using the corridor approach and its unrecognized actuarial losses as of December 31, 2011 amounting to about P13.2 million (see Note 15.02) will be retrospectively recognized as losses in other comprehensive income in 2013.

(iv) PFRS 13, *Fair Value Measurement* (effective from January 1, 2013). This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across PFRS. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards. The Company is yet to assess the impact of this new standard.

(v) PFRS 9, *Financial Instruments: Classification and Measurement* (effective from January 1, 2015). This is the first part of a new standard on classification and measurement of financial assets and financial liabilities that will replace PAS 39 in its entirety. This chapter deals with two measurement categories for financial assets: amortized cost and fair value. All equity instruments will be measured at fair value while debt instruments will be measured at amortized cost only if the entity is holding it to collect contractual cash flows which represent payment of principal and interest. The accounting for embedded derivatives in host contracts that are financial assets is simplified by removing the requirement to consider whether or not they are closely related, and, in most arrangement, does not require separation from the host contract.

For liabilities, the standard retains most of the PAS 39 requirements which include amortized-cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change is that, in case where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than in profit or loss, unless this creates an accounting mismatch.

To date, other chapters of PFRS 9 dealing with impairment methodology and hedge accounting are still being completed.

The Company does not expect to implement and adopt PFRS 9 until its effective date or until all chapters of this new standard have been published. In addition, management is currently assessing the impact of PFRS 9 on the financial statements of the Company and is committed to conduct a comprehensive study of the potential impact of this standard before its adoption in 2015 to assess the impact of all changes.

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 (FVTPL), 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 FVTPL 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 apart of Prepayments and Other Current Assets, with respect to certain guaranty deposits which are refundable, in the statement of financial position. Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments with original maturities of three months or less, 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, discounted at the effective interest rate.

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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, amortization 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, accumulated amortization and any accumulated 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 interest-bearing loans and borrowings, accounts and other tax-related liabilities other payables [except other tax-related liabilities accounts and output value-added tax (VAT) component], and due to WESM trading participants.

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 and other payables and amounts due to WESM trading participants are initially recognized at their fair value and amounts are subsequently measured at amortized cost using the effective interest method for maturities beyond one year, less settlement payments.

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 classified as current liabilities if payment is due to be settled within one year or less after the end of the reporting period (or in the normal operating cycle of the business, if longer), or the Company does not have an unconditional right to defer settlement of the liability for at least twelve months after the end of the reporting period. Otherwise, these are presented as non-current liabilities.

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. The increase in the provision due to passage of time is recognized as interest expense. 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 fees are recognized when services are rendered and are based on market fee filings as approved by the ERC.

(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 goods and 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.

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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 (net of any incentive received from lessor) 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 flows. In determining value in use, management estimates the expected future cash flows from each cash-generating unit and determines the suitable interest rate in order to calculate the present value of those cash flows. 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 Benefit

Post-employment benefit is 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, non contributory and administered by a trustee.

The liability (asset) 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 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

For financial reporting purposes, 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.

For income tax purposes, interest and other borrowing costs are recognized as expense when incurred.

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

Fund balance 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.

3.16 Events after the Reporting Period

Any post-year-end event that provides additional information about the Company's financial position at the end of the reporting period (adjusting event) is reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

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

As mentioned in Note 6,the Company recognizes 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. Management believes that the Company's obligation to remit these collections to the WESM trading participants should be given accounting recognition.

(c) Exemption from Income Taxation

As discussed in Note 18.03, management took a position that the Company, being a nonstock, nonprofit corporation and as intended under the EPIRA, 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, 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.

(d) 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.

(e) Provisions and Contingencies

Judgment is exercised by management to distinguish between provisions and contingencies. Accounting policies on recognition and disclosure of provision and contingencies are discussed in Note 3.07 and relevant disclosure on present commitments and contingencies are presented in Note 18.

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 based on management's assessment.

(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 2011 and 2010.

(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 2011 and 2010 based on management's evaluation.

(d) Amortized Cost of Loan Payable to Power Sector Assets and Liabilities Management Corporation (PSALM)

As discussed in Note 12.02, the terms of the loan payable to PSALM have not yet been finalized as of December 31, 2011 and such terms, particularly the start of the loan amortization (principal and interest), will also have to be approved by the ERC. As a result, the Company, pending the finalization of the terms of the loan measured it at amortized cost, using effective interest method in 2011, based on certain assumptions.

Those assumptions used in measuring the Loan payable to PSALM as described in Note 12.02 include, among others, effective interest rate and expected date when the principal payment will commence and when the nominal interest will be due on the loan. Management estimates are made in light of the Company's past experience with the ERC with respect to the average time the ERC takes to issue their directives to the Company. Though management believes that the assumptions used in the estimation of fair value and amortized cost of the Loan payable to PSALM as reflected in the financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of the loan's carrying value and generally affect the amounts to be recognized as expense in future periods.

(e) 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.

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The amounts of retirement benefit obligation (asset) and expense and an analysis of the movements in the estimated present value of retirement benefit obligation and fair value of plan assets including the relevant assumptions used are presented in Note 15.02.

5. CASH AND CASH EQUIVALENTS

Details of the Cash and Cash Equivalents account follows:

	2011	2010
Cash on hand and in banks	**P 20,144,467**	P 9,379,996
Short-term placements	**681,177,002**	713,357,516
	P 701,321,469	P 722,737,512

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 4.25% to 4.75% in 2011 and 3.50% to 4.50% in 2010.

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, except for appropriate retentions and portions representing prudential security deposits, to such participants to whom these are due within two to three months from the date of market settlements. These funds are deposited in bank accounts in the name of the Company and whose signatories are officers of the Company. Accordingly, the Company recognizes the corresponding asset and related obligation to the WESM participants, which 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 April 8, 2009, under ERC Resolution No. 06, Series of 2009. Consequently, the Company only started in 2009 the distribution of the accumulated amount of NSS in prior years. As of December 31, 2011 and 2010, NSS amounting to P47.3 million and P95.5 million, respectively, and prudential security deposits amounting to P317.1 million and P142.8 million, respectively, are presented as part of the Due to WESM Trading Participants account.

The Funds Held for WESM Trading Participants account also includes the related interest income earned from these funds. The interest is also subsequently remitted to the WESM trading participants and as such, it does not also flow through the Company's results of operations.

7. MARKET FEES AND OTHER RECEIVABLES

This account is composed of the following receivables:

	Note	2011	2010
Market fees	13	**P 196,904,260**	P 79,345,449
Interest		**1,995,220**	2,189,781
Others		**2,168,649**	2,543,693
		P 201,068,129	P 84,078,923

Market fees receivables pertain to amounts due from the imposition of market fees on the power generation companies (see Note 13). In 2011, the Company recognized market fees receivable from WESM Visayas trading participants amounting to P123.3 million pursuant to ERC Case No. 2011-085 RC (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. However, as allowed under Section 3.14.11 of the WESM Rules, interest, which is calculated from the time when the receivable became due and demandable until the payment date, is charged on overdue accounts.

Others include training fees due from third parties and advances to employees that are subject to liquidation. These advances are liquidated within 15 days from the time the advances were granted.

Any excess between the advances and the total liquidated business expenses by the employee is settled either through salary deduction or direct payment by the employee.

All of the Company's market fees and other receivables have been reviewed for indications of impairment. In 2011 and 2010, 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:

	Notes	2011	2010
Claims for tax credit		**P 12,421,371**	P -
Input VAT – net	22.01(b)	**10,056,363**	-
Guaranty deposits	18.01	**6,243,962**	6,168,166
Prepaid rent	18.01	**4,233,142**	4,068,673
Withholding VAT		**2,626,446**	2,599,772
Prepaid maintenance		**1,827,890**	1,773,968
Prepaid insurance		**1,153,586**	1,167,704
Expanded withholding tax receivable		**252,031**	2,734,096
Others		**954,567**	694,745
		P 39,769,358	P 19,207,124

Claims for tax credit refer to creditable withholding taxes evidenced by tax certificates that will be used by the Company as payment for any income taxes due.

Guaranty deposits and prepaid rent are related to various 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 (see also Note 12.01) at the beginning and end of 2011 and 2010 are shown below.

	Office Equipment	System Equipment	Leasehold Improvements	Transportation Equipment	Furniture and Fixtures	Total
December 31, 2011						
Cost	P 92,412,165	P 58,802,570	P 48,901,925	P 18,139,498	P 11,344,371	P 229,600,529
Accumulated depreciation and amortization	(81,244,143)	(41,458,233)	(45,583,809)	(10,905,525)	(11,203,398)	(190,395,108)
Net carrying amount	P 11,168,022	P 17,344,337	P 3,318,116	P 7,233,973	P 140,973	P 39,205,421

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	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
January 1, 2010						
Cost	P 81,715,760	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

Fully depreciated property and equipment with a total cost of P97.9 million and P88.9 million as of December 31, 2011 and December 31, 2010, respectively, are still being used in operations and have not yet been derecognized.

A reconciliation of the carrying amounts of property and equipment at the beginning and end of 2011 and 2010 is shown below.

	Office Equipment	System Equipment	Leasehold Improvements	Transportation Equipment	Furniture and Fixtures	Total
Balance at January 1, 2011, net of accumulated depreciation and amortization	P 14,601,391	P 25,050,432	P 6,945,913	P 6,182,101	P 372,103	P 53,151,940
Additions	5,670,652	7,913,584	-	3,163,393	16,071	16,763,700
Depreciation and amortization charges for the year	(9,104,021)	(15,619,679)	(3,627,797)	(2,111,521)	(247,201)	(30,710,219)
Balance at December 31, 2011, net of accumulated depreciation and amortization	P 11,168,022	P 17,344,337	P 3,318,116	P 7,233,973	P 140,973	P 39,205,421
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	5,102,737	18,463,819	3,551,045	3,991,963	155,178	31,264,742
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 14,601,391	P 25,050,432	P 6,945,913	P 6,182,101	P 372,103	P 53,151,940

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 at the beginning and end of 2011 and 2010 are shown below.

	Market Management System	Other System Software	Total
December 31, 2011			
Cost	P 681,264,499	P 38,400,384	P 719,664,883
Accumulated amortization	(442,519,206)	(31,960,794)	(474,480,000)
Net carrying amount	P 238,745,293	P 6,439,590	P 245,184,883
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
January 1, 2010			
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

A reconciliation of the carrying amounts at the beginning and end of 2011 and 2010 is shown below.

	Market Management System	Other System Software	Total
Balance at January 1, 2011, net of accumulated amortization	P 334,243,410	P 15,624,935	P 349,868,345
Additions	-	1,216,677	1,216,677
Amortization charges for the year	(95,498,117)	(10,402,022)	(105,900,139)
Balance at December 31, 2011, net of accumulated amortization	P 238,745,293	P 6,439,590	P 245,184,883
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

No impairment losses were recognized in 2011 and 2010 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 (see Note 12.02).

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11. ACCOUNTS AND OTHER PAYABLES

This account consists of:

	Notes	2011	2010
Accounts payable	13	**P 141,299,647**	P 19,346,829
Accrued expenses		**22,849,560**	19,906,367
Withholding taxes payable		**16,465,995**	15,619,264
Deferred output VAT	22.01(a)	**9,643,863**	8,607,281
Accrued interest	13	**8,789,966**	-
Output VAT	22.01(a)	**-**	6,449,117
Others		**373,895**	390,183
		P 199,422,926	P 70,319,041

In 2011, the Company recognized accounts payable to WESM Luzon trading participants amounting to P108.1 million pursuant to ERC Case No. 2011-085 RC (see Note 13). Accounts payable also includes market fees amounting to P14.1million that was ordered to be returned by the ERC to trading participants but which remained unpaid by the Company as of December 31, 2011. (see Note 13). Accrued interest pertains to the interest on unutilized market fees that the ERC ordered to return to trading participants (see Note 13).

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.

The amount of deferred input VAT in 2010 amounting to P6.8 million presented as part of Deferred output VAT and Output VAT was reclassified to Other Non-current assets account to conform with the 2011 financial statement classification and presentation.

12. INTEREST-BEARING LOANS AND BORROWINGS

The interest-bearing loans and borrowings, represent short-term loans from the National Transmission Company (Transco) and long-term loans from Power Sector Assets and Liabilities Management Corporation (PSALM), are presented as follows:

	2011	2010
Loan from Transco	**P 216,121,151**	P 207,950,816
Loan from PSALM	**736,625,907**	728,557,962
	P 952,747,058	P 936,508,778

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 (see Note 9) at the time of transfer which was included as part of the loan. Based on the agreement between Transco and the Company, quarterly amortization amounting to P36.1 million inclusive of interest will be made. 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 was scheduled to be fully settled in November 2011.

In August and 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. Since the Company can not determine, without a court order, who between Transco and the Municipality is entitled to the loan repayment, the Company did not deliver the payment to the Municipality and also stopped the quarterly principal loan payment to Transco starting August 2010 (see Note 18.02).However, it continued to accrue interest based on the schedule of amortization of the loan.

As of December 31, 2011, the Company has already accrued interest amounting to P19.5 million, net of withholding taxes, since August 2010 when the warrant of distraint was issued [see Note 18.02(a)]. This accrued interest is also recognized as part of the carrying amount of the loan. Interest expense recognized with respect to this loan amounted to P8.2 million in 2011 and P22.5 million in 2010 (2010 includes amount paid up to July 2010 of P11.2 million). Though the Company has not yet paid the corresponding interest from August 2010 up to November 2011, the Company has already remitted the corresponding withholding taxes on the interest expense recognized for those inclusive periods. As the loan was scheduled to be fully settled in November 2011 and the Company was merely constrained not to pay because by the matter described above, the Company did not no longer recognized interest expense for the last month of 2011.

Management anticipates that the matter described above will be resolved anytime. Accordingly, the balance of the loan is classified as part of Current Liabilities in the statements of financial position.

The amount of accrued interest on this loan amounting to P1.3 million previously presented as part of Accounts and Other Payables account in the 2010 statement of financial position was reclassified to Interest-bearing Loans and Borrowings account to conform with the classification and presentation in the 2011 financial statements.

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 the 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.

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The MMS cost recovery and loan repayment were 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 the subject of a separate application with the agreement that there should be established recovery arrangements between NPC, Transco, PSALM and the Company.

In 2010, the Company and PSALM agreed on the final amount of the loan at P728.6 million. However the MOA between PSALM and the Company covering, the terms of the loan such as maturity date, interest rate (though the nominal rate of 12% per annum has already been determined) and principal payment terms as at December 31, 2011 has not yet been approved by the ERC. Moreover, the date when the principal payment will commence and when the nominal interest will start accruing on the loan, are also yet to be determined.

The Company estimates that the MOA may be finalized no later than 2012 as it is already approved by PSALM and Transco and is just waiting for the approval of the Company and NPC. Once all the parties have approved the MOA, the document will be submitted to the ERC for its approval.

Management estimates that it will most likely receive the ERC order setting the date when the principal payment will commence and when the nominal interest will start accruing on the loan, by the first quarter of 2013 and will be effective by July of that same year. This is based on the Company's experience with the ERC with respect to the timeline and duration for application and approval processes of its market fees, prayers and motions for reconsiderations of other matters to the ERC. As such, the Company presented the whole amount of the loan as part of Non-current Liabilities in the statements of financial position as of December 31, 2011 and 2010.

The fair value of the loan payable to PSALM is determined by calculating the present value anticipated on the loan payments until the end of 2016 using the effective interest rate of 5.4% per annum. As the loan does not have an active market, the interest rate was determined with reference to market interest rate of comparable instruments plus a spread that is indicative of the Company's borrowing capacity. As a result of measuring the loan at fair value, the Company recognized P30.6 million reduction in the carrying amount of the loan which is presented as Fair Value Gain in the 2011 statement of comprehensive income.

Interest expense from the amortization of fair value gain by way of unwinding of the discount (which will continue until the loan is fully paid) amounted to P38.6 million in 2011 and is presented as part of Interest Expense in the 2011 statement of comprehensive income.

13. MARKET FEES

This account consists of:

	2011	2010
Market transaction fees	**P 688,288,757**	P 768,809,098
Market registration fees	**447,400**	948,550
	P 688,736,157	P 769,757,648

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 members, provided that such market fees are approved by the ERC.

In ERC Order dated July 19, 2010,a motion for additional market transaction fee (AMF) of P0.075/kWh that is intended to finance MMS Migration was granted with modification. ERC allowed the Company to collect the P331.5 million budgeted capital expenditures that will be spread over a period of5 years with an annual rate of P0.0015/kWh.

On February 4, 2011, the Company filed a Manifestation and Motion where it was manifested that it has terminated its negotiations with ABB, Inc. relative to the MMS Migration. Nonetheless, the Company requested for the continued collection of the approved budget to fund the purchase of the new MMS. The request was denied in the absence of a concrete basis to justify the same and considering that the acquisition of a new MMS has yet to be approved by the ERC. Relative to this, The Company was directed to refund turn to paying market participants unutilized market fees the amounting tot of P268.2 million to the market participants. In compliance with this directive by the ERC and ERC Case No. 2010-079 RC, the Company returned to the trading WESM participants the sum of P238.4 million representing portion of prior years' unutilized market transaction fees, as defined in that ERC order (see Note 2.03). The remaining amount of unutilized market fees amounting to P14.1 million that remained unreturned as of December 31, 2011 was accrued as part of Accounts Payables (see Note 11) and recognized as part of Unutilized Market Fees in the 2011 statement of comprehensive income. The related interest expense which is computed as the excess of Manila Reference Rate plus 3% over the actual interest earned on the unutilized market fees, related interest expense on the other hand, is presented as Accrued Interest under the Accounts and Other Payables account in the statement of financial position and as part of Interest Expense in the 2011 statement of comprehensive income (see Note11).

The prospective amount to be recovered by the Company for calendar year 2011 shall be the total approved revenue requirement for calendar year 2011less the sum of:

(a) actual market fees collected from Luzon stakeholders at the rate of P0.0144/kWh in 2011; and

(b) any unutilized market transaction fees in calendar year 2010 intended for MMS Migration.

Based on ERC Case No. 2010-079 RC, the approved maximum market transaction fees for calendar year 2011 was P661.3 million. However, on February 28, 2012, ERC Case No. 2011-085 RC was issued by the ERC granting the Company the right to collect additional market transaction fees from WESM trading participants amounting to P26.4 million, which effectively set and increased the limit of market transaction fees to P687.7 million, for 2011, excluding market registration fees. As of December 31, 2011, the Company has a pending motion for reconsideration with respect to ERC Case No. 2010-079 RC.

Prior to these ERC directives, the Company has collected market transaction fees solely from the WESM Luzon trading participants basing from the volume of kWh traded in the WESM, which included transactions in the Visayas region, at a rate of P0.0144/kWh. In 2011, as ordered by the ERC, the Company determined the amount of market fees that should have been collected from the WESM Visayas trading participants as well as the amount that was initially collected from the WESM Luzon trading participants and the amount that should be refunded to them.

As of December 31, 2011, market fees amounting to P108.1 million, including VAT, are due for refund to the Luzon trading participants. This amount is presented as part of Accounts Payable under the Accounts and Other Payables account in the 2011 statement of financial position (see Note 11).

Corollary to the recognition of payables to WESM Luzon trading participants, the Company also recorded receivables amounting to P123.3 million, including VAT, as market fees due from the WESM Visayas trading participants. This amount is presented as part of Market Fees under Market Fees and Other Receivables in the 2011 statement of financial position (see Note 7).

14. OTHER REVENUES

Other revenues of the Company consist of:

	Note	**2011**	2010
Excess of standard over actual input VAT	16	**P 2,073,237**	P 10,309,612
Miscellaneous income		**1,369,287**	411,923
		P 3,442,524	P 10,721,535

The excess of standard over actual input VAT is the difference between 12% VAT and the 5% final VAT deducted and withheld by government-owned and controlled corporations from collections.

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15. EMPLOYEE BENEFITS

15.01 Salaries and Employee Benefits

Details of salaries and employee benefits are presented below (see also Note 17).

	Note	2011	2010
Short-term employee benefits		**P 205,259,739**	P 188,922,961
Post-employment defined benefit	15.02	**25,061,151**	18,157,688
		P 230,320,890	P 207,080,649

15.02 Post-employment Benefit

The Company maintains a 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 retirement benefit obligation (asset), recognized in the statements of financial position follows:

	Note	2011	2010
Present value of the obligation		**P 107,245,735**	P 89,069,555
Fair value of plan assets		**(85,309,759)**	(40,638,959)
Unfunded obligation		**21,935,976**	48,430,596
Unrecognized actuarial losses	3.02(c)	**(13,242,040)**	(18,810,032)
Unrecognized past service cost		**(9,725,971)**	(12,967,961)
		(P 1,032,035)	P 16,652,603

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

	2011	2010
Balance at beginning of year	**P 89,069,555**	P 46,225,786
Current service cost	**17,246,073**	10,190,219
Interest cost	**7,223,541**	5,015,498
Actuarial losses (gains)	**(6,293,434)**	30,963,995
Benefits paid by the plan	**-**	(3,257,798)
Benefits paid from book reserve	**-**	(68,145)
Balance at end of year	**P 107,245,735**	P 89,069,555

The movements in the fair value of plan assets are presented below.

	2011	2010
Balance at beginning of year	**P 40,638,959**	P -
Contributions paid into the plan	**42,745,789**	42,745,789
Expected return on plan assets	**3,100,593**	-
Actuarial gains (losses)	**(1,175,582)**	1,150,968
Benefits paid by the plan	**-**	(3,257,798)
Balance at end of year	**P 85,309,759**	P 40,638,959

The plan asset consists of the following:

	2011	2010
Time deposits	**P 46,693,867**	P -
Government securities	**29,711,303**	33,015,091
Unit investment trust funds	**8,847,283**	6,866,193
Mutual funds	**57,120**	757,318
Cash	**186**	357
	P 85,309,759	P 40,638,959

Actual return on plan assets was P1.9 million and P1.2 million in 2011 and 2010, respectively.

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.

	2011	2010	2009	2008	2007
Present value of the obligation	**P 107,246**	P 89,070	P 46,226	P 11,244	P 17,571
Fair value of the plan assets	**85,310**	40,639	-	-	-
Deficit in the plan/ Unfunded obligation	**P 21,936**	P 48,431	P 46,226	P 11,244	P 17,571
Experience adjustments arising on plan liabilities	**P -**	P 2,413	P 4,560	(P 15,074)	(P 7,414)
Experience adjustments arising on plan assets	**(P 1,176)**	P 1,151	P -	P -	P -

The post-employment benefit expense recognized in the statements of comprehensive income follows:

	2011	2010
Current service cost	**P 17,246,073**	P 10,190,219
Interest cost	**7,223,541**	5,015,498
Net actuarial gains recognized during the year	**450,140**	(290,019)
Past service cost – non-vested benefits	**3,241,990**	3,241,990
Expected return on plan assets	**(3,100,593)**	-
	P 25,061,151	P 18,157,688

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

	2011	2010
Discount rate	**6.22%**	8.11%
Expected rate of return on plan assets	**4.00%**	5.00%
Expected rate of salary increases	**10.00%**	10.00%

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16. OTHER EXPENSES

This account consists of:

	Notes	2011	2010
Insurance		**P 10,881,314**	P 7,379,025
Conference		**8,590,397**	4,569,340
Training and education		**5,353,691**	3,031,835
Litigations		**4,946,969**	1,647,540
Membership and association dues		**2,416,743**	2,227,129
Advertising and promotions		**1,621,210**	1,922,111
Tax expense	14	**1,032,757**	3,199,819
Miscellaneous	22.01(f)	**1,211,337**	1,081,911
		P 36,054,418	P 25,058,710

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).

17. RELATED PARTY TRANSACTIONS

The Company's transactions with related parties include only providing compensation to its key management personnel. The compensation of key management personnel included in salaries and employee benefits (see Note 15.01) is broken down as follows:

	2011	2010
Short-term benefits	**P 19,998,855**	P 20,496,064
Post-employment defined benefit	**1,352,889**	1,248,639
	P 21,351,744	P 21,744,703

18. COMMITMENTS AND CONTINGENCIES

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

18.01 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%. As a guaranty to the faithful compliance of the lease agreements, the Company made security deposits which will be refunded to the Company at the end of the lease terms (see Note 8). The future minimum rentals payable under these non-cancellable operating leases are as follows as of December 31:

	2011	2010
Within one year	**P 18,134,480**	P 14,802,046
After one year but not more than five years	**60,984**	12,394,566
	P 18,195,464	P 27,196,612

Total rental expense from these operating leases amounting to P24.3million in 2011 and P23.5 million in 2010 is presented as part of Rental in the statements of comprehensive income.

18.02 Legal Claims

(a) Garnishment of Transco Loan Payments

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

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

The complaint was subsequently dismissed by the RTC for failure to state cause of action. The Municipality filed for a petition for Review on Certiorari with the Supreme Court (SC) to challenge the dismissal of its complaint. On December 14, 2011, the SC dismissed the petition for failure to show any reversible error in the RTC decision. The Municipality was given 15 days from receipt of Notice of the Resolution to file a motion for reconsideration with the SC.

The Company's legal counsel believes that, in the remote event that the SC grants the motion for reconsideration, 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 Note 12.01). Hence, no further obligation needs to be recorded should a ruling in favor of the Municipality be rendered.

(b) Possible 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.

In an Order dated September 12, 2011, the ERC exonerated the Company from any administrative sanction and/or criminal liability in connection with this case.

(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 in 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.

On June 17, 2011, a Special Payment Arrangement has been executed wherein the principal amount of obligation was determined to be P963.0million and which bear an interest of 2.7% per annum. Repayments will be made in 3years commencing September 30, 2011 with 1st monthly amortization of P30.0million and P28.0 million thereafter. On November 14, 2011, ALECO, was temporarily suspended to participate in the WESM. In a notice made and effective November 21, 2011, the temporary suspension was lifted and made ALECO eligible to participate in the WESM. Subsequently, on March 6, 2012, ALECO was issued a notice of disconnection for failure to pay the amount of P112.6 million, exclusive of VAT and default interest, for outstanding amounts due to the WESM for billing periods November 26, 2011 up to January 25, 2012. This amount is part of the amount payable by ALECO pursuant to the Special Payment Agreement executed by it with National Electrification Administration, PEMC, Therma Luzon Inc., Masinloc Power Partners Co., Ltd., Panasia Energy Holdings Inc., San Miguel Energy Corporation and Strategic Power Development Corporation.

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As of December 31, 2011 and 2010, the total outstanding obligation of ALECO to the WESM participants amounted to P1.06billion and P996.0million, respectively, exclusive of VAT and default interest.

Because the Company is not a party to the disputed amounts, management believes that it will not be held liable in case ALECO fails to pay all its obligations to the WESM participants.

18.03 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(c)]. 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 in the previous paragraph) 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, 2011, the balance of the unutilized withholding taxes amounted toP8.4 million. However, the Company determined that the claims for cash refund pertaining to taxable years 2007 and 2008 amounting to P3.3 million may be doubtful of recovery since the proper time for which the Company should have exhausted its options in claiming for cash refund has already expired in accordance with the National Internal Revenue Code of 1997. The net amount of claims for cash refund after recording impairment loss, amounts to P5.1 million. These are classified as part of Other Non-Current Assets in the statements of financial position while the expense recognized in 2011 due to impairment is presented as Impairment Loss in the 2011 statement of comprehensive income.

18.04 Others

There are other commitments, guarantees, litigations and contingent liabilities that may arise in the normal course of the Company's operations which are not reflected in the 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.

19. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company is exposed to certain 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 PEM Board 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 in the succeeding paragraphs.

19.01 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 and good corporate governance. 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. WESM Rules 3.14.7 provides that if total payments actually received or drawn from prudential security by the market operator is insufficient to pay for the total amounts payable to WESM members, then the total payments received and drawn shall be distributed and paid pro rata.

19.02 Market Risk

The Company is exposed to market risk through its use of financial instruments and specifically to foreign 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. In 2011, the PEM Board approved the drafting of a MOA that will be executed with PSALM and for submission to the ERC, whereby among others, both parties agreed that the amount of loan together with its interest will be in Philippine pesos. 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. Long-term borrowings are therefore usually at fixed rates. At December 31, 2011 and 2010, 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 (deficiency) of revenues over expenses and fund balance to a reasonably possible change in interest rates in+/- 1.11% in 2011 and +/- 0.89% in 2010. 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
2011(+/-1.11%)	**P 18,564,340**	**(P 18,564,340)**
2010 (+/- 0.89%)	P 19,439,747	(P 19,439,747)

19.03 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	2011	2010
Cash and cash equivalents	5	**P 701,321,469**	P 722,737,512
Funds held for WESM trading participants	6	**444,153,098**	395,202,030
Market fees and other receivables	7	**201,068,129**	84,078,923
Guaranty deposits	8	**6,243,962**	6,168,166
		P 1,352,786,658	P 1,208,186,631

The information provided 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.

Notes to Financial Statements

December 31, 2011 and 2010 *(Amounts in Philippine Pesos)*

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.

19.04 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.

As at December 31, 2011, the Company's financial liabilities have contractual maturities which are summarized below and further compared with financial liabilities as of December 31, 2010.

	Notes	Current		Non-current	
		Within 6 Months	6 to 12 Months	1 to 5 Years	Later than 5 Years
2011					
Accounts and other payables	11	P 173,313,069	P -	P -	P -
Interest-bearing loans and borrowings	12	216,121,151	-	863,341,185	-
Due to WESM trading participants	6	444,153,098	-	-	-
		P 833,587,318	**P -**	**P 863,341,185**	**P -**

	Notes	Current		Non-current	
		Within 6 Months	6 to 12 Months	1 to 5 Years	Later than 5 Years
2010					
Accounts and other payables	11	P 39,643,379	P -	P -	P -
Interest-bearing loans and borrowings	12	137,435,713	70,515,103	863,341,185	-
Due to WESM trading participants	6	395,202,030	-	-	-
		P 572,281,122	P 70,515,103	P 863,341,185	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.

20. FUND MANAGEMENT OBJECTIVES, POLICIES AND PROCEDURES

The Company aims to manage operational and strategic objectives.

The PEM Board 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 approvals of the ERC and the risk characteristics of the underlying assets.

The Company monitors the fund balance on the basis of debt-to-fund balance ratio, which is calculated as total debt divided by fund balance. Fund balances for the reporting periods December 31, 2011 and 2010aresummarized as follows (in thousands of Philippine pesos):

	2011	2010
Total liabilities	**P 1,596,323**	P 1,418,682
Total fund balance	**85,261**	220,754

21. OTHER MATTERS

21.01 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.

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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.

The second operational audit of the Company's market operations was completed in August 2011. The audit was conducted by independent auditors from PA Consulting Group Ltd. 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.

21.02 International Organization for Standardization (ISO)/International Electrotechnical Commission (IEC) 27001:2005 Certification

The Company has established an Information Security Management System (ISMS) which is a set of policies concerned with information security management as the Company aims to establish, maintain, operate and govern an efficient, competitive, transparent and reliable market for wholesale purchase of electricity and ancillary services in the Philippines in accordance with applicable laws, rules and regulations.

An audit of the ISMS has been performed in which Report No. 70785938 proved that the requirements according to ISO/IEC27001:2005 were complied with by the Company. As such, on November 16, 2011, the Company has been awarded with Certification No. 12-130-42589 TMS which is valid until February 14, 2015.

21.03 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. Following the results of investigations of alleged anti-competitive behavior, 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. The petition is still pending resolution with the Supreme Court as at December 31, 2011.

21.04 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. In a Compliance filed on May 13, 2009, PEMC manifested that the adjusted settlement amounts have already been computed and that the same will be collected and paid in seven equal monthly installments beginning June 2009.

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22. SUPPLEMENTARY INFORMATION REQUIRED BY THE BIR

Presented below is the supplementary information which is required by the BIR under its existing revenue regulations to be disclosed as part of the notes to financial statements. This supplementary information is not a required disclosure under PFRS.

22.01 Requirements under Revenue Regulations (RR) 15-2010

The information on taxes, duties and license fees paid or accrued during the taxable year required under RR 15-2010 issued on November 25, 2010 are as follows:

(a) Output VAT

In 2011, the Company declared output VAT as follows:

	Tax Base	Output VAT
Market fees	P 696,297,412	P 83,555,689
Other revenues	1,202,140	144,257
	P 697,499,552	P 83,699,946

The Company has no Zero-rated and VAT exempt receipts for 2011.

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 presented in the 2011 statement of comprehensive income. The VAT related to accruals amounting to P9.6million is recognized as deferred output VAT (see Note 11).

The output VAT was fully paid in 2011 as follows:

Output VAT	P 83,699,946
Payments:	
Cash	(44,344,046)
Input VAT applied	(37,410,840)
Creditable tax certificates applied	(1,945,060)
	P -

(b) Input VAT

The movements in creditable input VAT in 2011 is summarized below.

Balance at beginning of year	P -
Effect of unutilized market fees returned	29,792,746
Services lodged under other accounts	10,673,729
Capital goods subject to amortization	3,666,301
Input tax on sale to government	1,840,675
Goods other than for resale or manufacture	1,191,918
Capital goods not subject to amortization	301,834
Applied against output VAT	(37,410,840)
Balance at end of year	P 10,056,363

The outstanding input VAT is presented as Input VAT under the Prepayments and Other Current Assets account in the 2011 statement of financial position (see Note 8).

(c) Taxes on Importation

The Company does not have taxes on importation in 2011 since it did not have any importations for 2011.

(d) Excise Tax

The Company does not have excise tax in 2011 since it does not have any transactions which are subject to excise tax.

(e) Documentary Stamp Tax (DST)

The Company did not incur any DST in 2011, since the counterparties of the Company usually shoulders and pays for the DST.

(f) Taxes and Licenses

Taxes and licenses are broken down as follows for the year ended December 31, 2011:

Licenses and business tax	P 230,339
Fringe benefit tax	146,176
Community tax	10,500
Miscellaneous	61,807
	P 448,822

Taxes and licenses is presented as part of Miscellaneous Expenses in the 2011 statement of comprehensive income (see Note 16).

(g) Withholding Taxes

The details of total withholding taxes for the year ended December 31, 2011 are shown below.

Compensation and benefits	P 52,474,479
Expanded withholding tax	6,762,603
	P 59,237,082

The Company has no income payments which are subject to final withholding tax.

(h) Deficiency Tax Assessment and Tax Cases

As of December 31, 2011, the Company does not have any final deficiency tax assessments from the BIR nor does it have tax cases outstanding or pending in courts or bodies outside of the BIR in any of the open taxable years.

22.02 Requirements under RR 19-2011

On December 9, 2011, the BIR issued RR 19-2011 which prescribes the new form that will be used for income tax filing covering and starting with periods ending December 31, 2011 and onwards. This recent RR requires schedules of taxable revenues and other non-operating income, costs of sales and services, and itemized deductions, to be disclosed in the notes to financial statements.

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The amounts of taxable revenues and income, and deductible costs and expenses presented below are based on relevant tax regulations issued by the BIR, hence, may not be the same as the amounts reflected in the 2011 statement of comprehensive income.

(a) *Taxable Revenues*

Management believes that the Company's net market transaction fees for the year ended December 31, 2011 amounting to P436,170,832 million (see Note 13) is not subject to income tax because the Company is a nonstock, nonprofit entity, accordingly presented these revenues under the exempt classification (see also Note 18.03).

(b) *Deductible Cost of Services*

The Company has no deductible cost of services in 2011 considering the Company's position with respect to the taxability of its market transaction fees.

(c) *Taxable Non-operating and Other Income*

The details of taxable non-operating and other income in 2011 which are subject to regular tax rate are shown below.

	Note		
Excess of standard over actual input VAT	14	P	2,073,237
Other income			1,369,287
		P	3,442,524

(d) *Itemized Deductions*

The amounts of itemized deductions which are presented under the exempt classification for the year ended December 31, 2011 are as follows:

Salaries and employee benefits	P	210,415,310
Amortization of intangibles		105,900,139
Management and consultancy fees		31,676,719
Depreciation		30,710,220
Repairs and maintenance		24,539,279
Rental		23,777,574
Honorarium and allowances		23,225,000
Utilities		18,991,959
Transportation and travel		17,841,960
Insurance		10,881,314
Supplies		10,310,566
Conference		8,590,397
Interest		8,170,335
Janitorial Services		5,521,734
Training and education		5,353,691
Security services		4,966,438
Amortization of past service cost		4,227,274
SSS, GSIS, Philhealth, HDMF and other contributions		2,220,942
Fuel and oil		1,626,402
Advertising and promotions		1,621,210
Representation and entertainment		516,288
Taxes and licenses		448,822
Professional fees		317,764
Miscellaneous		7,907,089
	P	559,758,426

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