

POWER SECTOR ASSETS AND LIABILITIES MANAGEMENT CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
(In Philippine Peso)

1. GENERAL INFORMATION

The need for reforms in the entire power industry became evident when the power crisis started in 1989 and continued well into the 1990s. Series of laws were then enacted that instituted reforms in the industry. The latest law, and one that embodies the most extensive reforms, was Republic Act No. 9136, known as the Electric Power Industry Reform Act of 2001 or "EPIRA", enacted on 26 June 2001. The major aspects of the reforms embodied in the EPIRA include: 1) restructuring of the entire power industry to introduce competition in the generation sector; 2) change from government to private ownership; and 3) introduction of a stable regulatory framework for the electricity sector.

National Power Corporation (NPC)

From NPC's creation in 1936 up to the late 1980's the generation of power and its transmission through the nationwide transmission grid (the Grid) in the country was vertically integrated, centrally controlled and managed, and wholly-owned by the NPC. Created as a non-stock government corporation, NPC was tasked to undertake the development of hydraulic power and the production of power, subject to existing rights, from Philippine water resources reserved for its use and all other sources, to meet the needs of industrial development and of rural electrification. Subsequently, NPC was granted an authorized capital stock of P50 billion corresponding to 500 million shares of stock at P100 par value, of which 270,488,708 shares were issued equivalent to P27,048,870,789.

In 1971, NPC's operations were decentralized to its regional centers in Luzon, Visayas and Mindanao. In 1988 and under its Small Island Grid Power Development Program, NPC took over the operation of generating facilities formerly managed by rural electric cooperatives in small islands and installed additional generation plants to make power rates affordable in these remote rural areas. In 1992, the Small Power Utilities and Barge Management Group was formed to handle this operation. This group later became the Small Power Utilities Group (SPUG). A subsequent reorganization was implemented in 1993 brought on by the enactment of the Electric Power Crisis Act of 1993. Five (5) regional profit centers were devolved and functional groups were created in preparation for the planned privatization of the corporation. The said law also liberalized the power industry by allowing more private sector participation in the generation of electricity. NPC, however, retained exclusive ownership and operation of

the Grid and continued to own and operate its existing plants and develop new plants.

Independent Power Producers (IPPs)

In 1987, President Corazon Aquino promulgated Executive Order No. 215 to authorize private sector participation in electricity generation to augment the country's power capacity. This resulted in the first investments by IPPs in generation plants. The Electric Power Crisis Act of 1993, brought on by the power crisis that began in 1989, encouraged increased private capital infusion to power generation, and authorized the increase in the return on rate base from 8% to 12%. Due to the incentives under this statute, more private capital was invested on the construction of IPPs, undertaken in partnership with NPC. These undertakings were formed under different BOT (Build-Operate-Transfer) schemes such as:

IPP-Owned

1. Build-Operate-Transfer (BOT)

Under this contract, the private sector will build a power plant and operate it for a specified cooperation period (to recover capital/operating cost with reasonable return on investment) and, thereafter, transfer ownership to NPC. In return, NPC commits to pay fixed capacity, operation and maintenance (O&M) and variable energy fees.

2. Build-Operate-Own (BOO)

A project proponent is authorized to finance, construct, own, operate and maintain the power plant as well as recover its investment and operating and maintenance cost plus a reasonable return thereon.

3. Energy Conversion Agreement (ECA)

Under this agreement, NPC shall provide fuel supply during the cooperation period.

4. Power Purchase Agreement (PPA) or Electric Power Supply Agreement (EPSA)

The power plant is built, owned and operated by an IPP. NPC enters into a contract to purchase the power generated by the plant at a guaranteed price for a certain period. These are also known as "Insurance capacity plants," which were encouraged by NPC during the years the country is under power crisis to guarantee availability of power in case some of NPC's base load plants break down.

5. Gas Sale and Purchase Agreement (GSPA)

Under this scheme, NPC commits to purchase the natural gas output of the plant. This contractual arrangement is unique to the Ilijan Natural Gas Plant.

IPP contracts may also be classified as BOT–ECA, BOT-PPA, BOO-ECA or BOO-PPA, BOT-EPISA, etc.

NPC-Owned

6. Build-Transfer-Operate (BTO)

Under this scheme, NPC obtains a loan for the project and for the private contractor builder, which builds the power plant on a turnkey basis. The private contractor builder turns over the plant to NPC, the owner, upon completion of the project and operates the power plant under an operation and maintenance (O&M) contract with NPC. NPC guarantees purchase of power generated by the plant for the duration of the cooperation period. NPC enters into BTO contracts if it does not want to expand its operation in a particular place, or when the technology for running the plant is new and is better left to the private sector.

7. Rehabilitate-Operate-Maintain-Manage (ROMM)

The scheme applies to existing NPC-owned plants that require massive rehabilitation to be able to operate at its rated capacity. NPC enters into a ROMM agreement with a private company, which puts in the needed investment to either replace or repair aging or inefficient equipment, and thereafter operate and maintain the power plant for a certain period. In turn, NPC purchases the power generated by the power plant. The Operate-Manage-Repair (OMR) scheme is a similar contractual arrangement.

8. Build-Rehabilitate-Operate-Transfer (BROT)

This scheme is a combination of BOT and ROM where the proponent builds additional power plants and conducts massive rehabilitation of existing NPC power plants. At the end of the cooperation period, the project proponent will transfer the ownership of the power plants to NPC.

9. Electricity Supply, Operation and Maintenance (ESOM)

This is a combination of the EPISA scheme and an operation and maintenance agreement with the proponent.

As of December 2009, the existing IPPs are

Plant Name	Contract Type
<i>NPC-owned</i>	
Caliraya	BROT-PPA
Botocan	BROT-PPA
Kalayaan 1-2 Units	BROT-PPA
Malaya TPP 1 & 2	ROM-ECA
Limay Combined Cycle "A" & "B" ^{1/}	BTO-OMR
Naga Coal I & II (CTPP/Salcon)	ROMM-ECA
Naga Diesel (CDPP 1/Salcon)	ROMM-ECA
Naga GT Land-based (LBGT/Salcon) ^{1/}	ROMM-ECA
Power Barge 117 ^{1/}	BTO-ESOM
Power Barge 118 ^{1/}	BTO-ESOM
<i>IPP-owned</i>	
Hydro Electric Dev't Corp (HEDCOR) ^{3/}	BOO-EPSPA
Northern Mini Hydro Corp. (HEDCOR) ^{3/}	BOO-EPSPA
Bakun A/C HEP (HEDCOR) ^{3/}	BOT-PPA
Casecnan (NIA)	BOT-PPA
Kalayaan 3 & 4 Units	BROT-PPA
San Roque Multi-Purpose ^{3/}	BOT-PPA
Bauang La Union	BOT-ECA
Pagbilao Coal Units 1 & 2 ^{2/}	BOT-ECA
Sual Coal FTTP ^{2/}	BOT-ECA
Ilijan Nat Gas	BOT-ECA, GSPA
Leyte A & B	BOO-PPA
Zamboanga Diesel	BOO-ECA
General Santos Diesel	BOO-ECA
Mt. Apo GPP I & II	BOO-PPA
Mindanao Coal (Steag)	BOT

^{1/} Successfully privatized in 2009. For turnover to the new owners upon completion by PSALM and the winning bidders of deliverables under their respective Asset Purchase Agreements (APAs).

^{2/} Management and control of the total energy production of these plants under contract with NPC were turned over to Independent Power Producer Administrators (IPPAs) that won the biddings for their contracted capacities in 2009.

^{3/} For turnover to IPPAs that won the biddings held in 2009 for their contracted capacities.

Restructuring of the Electric Power Industry

The EPIRA restructured the power industry by organizing it into four (4) sectors: generation, transmission, distribution and supply. The structural reforms resulted in the following:

- a) Two government-owned and controlled corporations (GOCCs), Power Sector Assets and Liabilities Management Corporation (PSALM) and National Transmission Corporation (TransCo) were created. PSALM takes over and privatizes the generation and other disposable assets of NPC and manages the latter's financial obligations, while TransCo takes over the transmission functions of NPC;
- b) NPC was retained as a GOCC performing the missionary electrification function through the SPUG;
- c) The distribution and supply sectors were separated to promote retail competition and open access was introduced;
- d) The sale of sub-transmission assets to distribution utilities (DUs) was mandated;
- e) A wholesale trading market for electricity was established;
- f) The end-user rates and retail distribution rates were unbundled according to specific electricity services provided by industry participants;
- g) A universal charge was imposed as part of electricity tariffs for the recovery of stranded debts and stranded contract costs resulting from the restructuring;
- h) The Department of Energy (DOE) was given the added role of supervising the restructuring of the electricity industry;
- i) The Energy Regulatory Board (ERB) was abolished and the Energy Regulatory Commission (ERC) was created in its stead;
- j) The National Electrification Administration (NEA) was given the additional mandate of preparing electric cooperatives to operate and compete under a deregulated electricity market;
- k) Electric cooperatives (ECs) were given the option to convert into either a stock cooperative under the Cooperatives Development Act or a stock corporation under the Corporation Code; and
- l) The Joint Congressional Power Commission (JCPC) was created to monitor and ensure the proper implementation of the EPIRA, determine inherent weaknesses in the law and recommend necessary remedial legislation or executive measures.

Power Sector Assets and Liabilities Management Corporation (PSALM)

PSALM was created under the EPIRA to take ownership of all the existing generation assets, independent power producer (IPP) contracts, real estate and all other disposable assets, and to assume all liabilities and obligations

of NPC. The principal purpose of PSALM is to manage the orderly sale, disposition and privatization of NPC's assets with the objective of liquidating in an optimal manner all of NPC's financial obligations and stranded contract costs. To strengthen the financial viability of electric cooperatives, PSALM was also tasked to assume all outstanding financial obligations of electric cooperatives to NEA and other government agencies incurred for the purpose of financing the Rural Electrification Program.

PSALM shall exist for a period of twenty-five (25) years from the effectivity of the EPIRA, unless otherwise provided by law, and all assets and liabilities of the Corporation outstanding upon the expiration of its term of existence shall revert to and be assumed by the National Government.

Included in PSALM's mandate is the collection, administration and application of NPC's portion of the universal charge. The universal charge refers to the charge, if any, imposed on all electricity end-users for the following purposes:

- a) Recovery of the stranded debts and stranded contract costs of NPC as well as the qualified stranded contract costs of distribution utilities resulting from the restructuring of the industry. The *stranded debts* of NPC refer to any unpaid obligations which have not been liquidated by the proceeds from the sales and privatization of its assets. *Stranded contract costs* of NPC or distribution utility is the excess of the contracted cost of electricity under eligible contracts over the actual selling price of the contracted energy output of such contracts in the market. Such contracts should have been approved by the Energy Regulatory Board as of December 31, 2000;
- b) Missionary electrification, which refers to the provision by NPC-SPUG of power generation and its associated power delivery systems in areas that are not connected to the transmission system;
- c) Equalization of taxes and royalties applied to indigenous or renewable sources of energy vis-à-vis imported energy fuels;
- d) An environmental charge equivalent to one-fourth of one centavo per kilowatt-hour (~~₱~~0.0025k/Wh), which shall accrue to an environmental fund to be used solely for watershed rehabilitation and management. Said fund shall be managed by NPC; and
- e) A charge to account for all forms of cross-subsidies for a period not exceeding three (3) years.

The universal charge (UC) is a non-bypassable charge which is passed on and collected from all end-users on a monthly basis by the distribution

utilities. The collections by the distribution utilities and TransCo in any given month shall be remitted to PSALM on or before the fifteenth (15th) of the succeeding month. Any end-user or self-generating entity not connected to a distribution utility shall remit its corresponding UC directly to TransCo.

Asset – Debt Accounts Transfer/Separation of Books

2008

The transfer of NPC's assets and liabilities was not immediately implemented due primarily to the difficulty of immediately obtaining universal consent of NPC creditors to the transfer and the long process of completing the conditions precedent to the transfer. Without creditors' consent, transfers cannot be effectively made without violating the provisions of loan covenants that prohibit the conveyance of the assets financed through the loans.

Notwithstanding this impediment, PSALM began the privatization process by seeking specific consents from creditors for each plant that is to be privatized. Pending the completion of the conditions precedent to transfer, PSALM recognized an obligation to NPC corresponding to the proceeds of the assets sold. Likewise, PSALM began servicing the foreign obligations of NPC from the proceeds of the assets sold and booked it as a receivable from NPC.

The asset transfer from NPC to PSALM began in 2007 with the transfer of the 360 MW Magat Hydro Electric Power Plant, having obtained the specific consent of the creditors and backed by the Deed of Transfer and the Transfer Certificate of Title for the plant.

Bases

To carry out the mandate of ownership of assets and assumption of obligations of NPC by PSALM and the separation of books of NPC and TransCo, the Deeds of Transfer between NPC and PSALM, and between NPC and TransCo, were executed in December 2001. Both Deeds provide that the assignment, transfer and conveyance of the assets and obligations of the executing parties shall become effective upon the fulfillment of certain conditions precedent or the waiver thereof by the appropriate party(ies).

To make the Deeds effective, the respective Boards of PSALM and NPC approved and confirmed the waiver of the conditions precedent under PSALM Board Resolution No. 07-80 dated 14 November 2007 and NPC Board Resolution No. 2007-66 of even date, while the TransCo Board approved and confirmed the waiver of the conditions precedent per Board Resolution No. TC 2008-013 dated 09 May 2008.

The Implementing Guidelines for the Asset-Debt Accounts Transfer and Separation of NPC/TransCo Books of Accounts drafted by PSALM/NPC/TransCo were approved for implementation by the PSALM Board on 20 June 2008 per PSALM Board Resolution No. 2008-0620-007 and by the joint PSALM/NPC Boards on 19 July 2008 as stated in PSALM/NPC Board Resolution No. 2008-0719-004.

The legality of the asset-debt transfer was affirmed with the issuance by the Office of the Government Corporate Counsel of Opinion No. 247, Series of 2008, dated 21 October 2008, which states that the clear intent of the EPIRA is the transfer of ownership of the assets of NPC to PSALM.

Scope and Limitations

The asset-debt accounts transfer covers the transfer to PSALM of the balances of the asset and debt accounts of NPC (except those pertaining to the Small Power Utilities Group) as of 31 December 2008 to PSALM, and the recording in TransCo's own separate books of its asset and debt accounts, except the long-term loans which were assumed by PSALM.

The account balances transferred were the amounts as reflected in NPC books and did not consider thorough analyses and substantiation. As such, the account balances added to PSALM's books may not be entirely correct. Some accounts, particularly the reciprocal transactions, may have not been fully eliminated.

The tasks of validation, confirmation, and accounts' disposition will form the succeeding phase of the asset-debt accounts transfer. Meanwhile, to the extent that resources (time, personnel, availability of documents) allowed, PSALM made some initial account validations which resulted in some ₱19.535 billion various account balances as of 31 December 2008 (excluding those of TransCo) being retained in NPC books for validation/confirmation. Pending the formation of an inter-agency group to work on the reconciliation/validation of accounts, which is being hindered by resource limitations on the part of PSALM, PSALM has been conducting its own reconciliation of certain accounts, as in the case of the GL 417 – *Due to Other GOCCs* account and GL 137 - *Due from GOCCs* and the subsidiary ledger accounts such as the *Gain/(Loss on Forex (SL 306)*, *Reimbursement of Insurance Premium (SL 313)*, and *Priva Proceeds (SL 302)*. This resulted in the elimination of the SL accounts 306 and 313 and the adjustment of the GL accounts 137 and 417 and the SL account 302. These accounts will be further adjusted upon receipt of the relevant data from NPC.

Process

Technical Working Groups (TWGs) from the three agencies drafted the Implementing Guidelines for the Asset-Debt Accounts Transfer and Separation of NPC/TransCo Books of Accounts. These guidelines were approved by the PSALM Board on 20 June 2008 per PSALM Board Resolution No. 2008-0620-007 and the joint PSALM/NPC Boards on 19 July 2008 per PSALM/NPC Board Resolution No. 2008-0719-004. The TWGs, likewise, addressed issues specific to the process, and set the cut-off date for the transfer of NPC's accounts to both PSALM and TransCo at 30 September 2008. This date set the cut-off for the following:

- Close-out of all January to September 2008 nominal accounts of NPC (except those for the Small Power Utilities Group or SPUG) to its Retained Earnings.
- Transfer by NPC and receipt/recording by TransCo of TransCo's real accounts in its own set of books (excluding some ₱1.848 billion accounts retained in NPC books for validation/confirmation). The difference between the amounts of the assets and the liabilities was closed by NPC to its reciprocal account with TransCo, and by TransCo to its Equity from PSALM account. PSALM, on the other hand, recognized TransCo as its subsidiary and set up an Investment in TransCo account with a credit to the Capital from Asset-Debt Transfer account.
- Transfer by NPC and receipt/recording by PSALM of the generation-related real accounts in PSALM's books (excluding the ₱19.535 billion accounts retained in NPC books for validation/confirmation). The difference between the amounts of the assets and the liabilities was closed by NPC to its Retained Earnings account and by PSALM to its Capital from Asset-Debt Transfer account.

October to December 2008 Transactions

While the cut-off date was set at 30 September 2008 and the implementation was done in October 2008, full implementation of the asset-debt accounts transfer was effected on 31 December 2008.

The October to December 2008 main grid operations were still processed and recorded in NPC and reflected in its income statement. The 4th quarter nominal accounts were then closed to NPC Retained Earnings, with the net effect of the transactions, in both the asset and liability accounts, taken up as adjustment to the Capital from Asset-Debt Transfer account.

December 31, 2008 Balances Transferred

Summary of the transferred balances as of 31 December 2008 follows:

Assets transferred to PSALM	
Electric plants under capital lease, net	456,777,856,390
Current assets	101,008,390,595
Utility plants, net	77,103,244,049
Investments and other assets	64,081,241,964
Deferred charges	16,350,152,971
Net assets transferred to TransCo	<u>115,693,280,923</u>
Total assets	<u>831,014,166,892</u>
Liabilities assumed by PSALM	
Lease obligation	451,694,256,752
Long-term debts, net of current portion	280,930,814,340
Current liabilities	150,873,950,481
Deferred credits	<u>21,356,158,403</u>
Total liabilities	<u>904,855,179,975</u>
Capital from asset-debt transfer	<u>(73,841,013,083)</u>

With the transfer of the account balances, NPC was left with the SPUG and some generation and transmission-related accounts which were retained for further validation/confirmation. As of 31 December 2008, SPUG has an asset base of ₱12.081 billion, while the retained accounts total ₱21.383 billion.

Trust Accounts

Part of the accounts retained in NPC books is the inventory (₱16.132 billion as of 31 December 2008) which, for proper accountability, was established as trust account together with the December 31 cash balances (₱6.523 billion) and net receivables from NPC officers and employees (₱62 million). PSALM treats the trust account as an asset and by NPC as a liability.

Separate TransCo Books from NPC

The October to December 2008 transmission operations were recorded in TransCo's own books. Full year 2008 operations were, however, reported by TransCo. Also, with the separation of TransCo from NPC and the recognition of PSALM's equity in TransCo, the parent-subsidary relationship of PSALM and TransCo is effected beginning 01 October 2008. PSALM's Investment in TransCo is accounted for at cost.

Transferred Generation Assets

Generation assets transferred by NPC to PSALM included the following:

Lands

Angat HEPP
Mak-Ban GPP

Botocan HEPP (CBK-IMPISA)
Ilijan Gas Pipeline

Mak-Ban GPP Ormat
 Tiwi GPP
 Masinloc CFTPP
 Batangas CFTPP
 Panay DPP
 Bohol DPP
 Agus HEPP 1,2,4,5,6,7
 Pulangui HEPP 4
 Sual CFTPP
 Bauang First Private Power Corp
 San Roque Power Corp
 Luzon HEPP (Bakun 1)
 ABB Bataan Combined Cycle 1 & 2
 Malaya TPP 1 - Land
 Kalayaan HEPP (CBK-IMPISA)
 Caliraya HEPP (CBK-IMPISA)

Naga CTPP 1 (Cebu CTPP)
 Power Barge 117 (Nasipit)
 Upper Agno HEPP
 Pantabangan-Masiway HEPP
 Barit-Cauayan HEPP
 Loboc HEPP
 Talomo HEPP
 Agusan HEPP
 Manila TPP 1 & 2
 Sucat TPP 1,2,3,4
 Bataan TPP 1 & 2
 Bataan GT
 Malaya GT
 Talavera DPP (Cebu DPP 2)
 Aplaya DPP
 Gen. Santos DPP

Generation Plants

Operating

Angat HEPP
 Amlan HEPP
 Mak-Ban GPP 1,2,3,4,5,6, Ormat,
 7,8,9,10
 Tiwi GPP 1,2,3,4,5,6
 Bac-Man GPP 1
 Bac-Man GPP 2 (Cauayan)
 Bac-Man GPP 2 (Botong)
 Tongonan (Leyte) GPP
 Palinpinon GPP 1
 Palinpinon GPP 2 (Nasuji)
 Palinpinon GPP 2 (Okoy)
 Palinpinon GPP 2 (Sogongon)
 Batangas CFTPP 1
 Batangas CFTPP 2

Panay DPP 1
 Panay DPP 3
 Bohol DPP
 Power Barge 101 *
 Power Barge 102 *
 Power Barge 103 *
 Power Barge 104 *
 Agus HEPP 1,2,4,5,6,7 **
 Pulangui HEPP 4 **
 Iligan DPP 1
 Talomo HEPP
 Agusan HEPP
 Upper Agno HEPP
 Masinloc CFTPP

Decommissioned

Manila TPP 1 & 2
 Sucat TPP 1,2,3,4
 Sucat LBGT
 Bataan TPP 1 & 2
 Bataan GT
 Malaya GT

Cebu DPP 2
 Aplaya DPP
 Gen. Santos DPP
 Iligan DPP 2
 Navotas DPP 1 (Energy) U1, U2, U3
 Navotas DPP 2 (Tileman)

Independent Power Producers (IPPs)

Bataan CC DPP 1 & 2	Naga GT LB 1
Malaya TPP 1 & 2	Naga GT LB 2
Kalayaan HEPP	Naga CFTPP 1 & 2
Caliraya HEPP	Power Barge 117
Botocan HEPP	Power Barge 118
Naga DPP 1	

- For transfer to NPC-SPUG. The PSALM Board approved on 15 December 2009 NPC's request to exclude Power Barges 101 to 104 and other related facilities from the assets transferred to PSALM. The four power barges will be used by NPC to augment power supply in Panay and in other off-grid operations of SPUG. In addition, the transfer of the power barges will relieve PSALM from operating losses and result in some savings on borrowing costs for the remaining life of the plants.
- ** Pursuant to the EPIRA, the Agus and Pulangui complexes may not be privatized before 2011, or within 10 years from the date when the EPIRA became effective.

2009

Validation of accounts

The account balances transferred in 2008 were the amounts as reflected in NPC books. PSALM began the process of validating these account balances in 2009.

One of the tasks undertaken is the conduct of a joint PSALM/NPC year-end inventory-taking of general plant equipment (GPE) and materials, supplies, and equipment (MSE) for CY 2009.

Reconciliation of their respective lists was done by NPC and PSALM prior to the finalization and signing of the official inventory reports for CY 2009. The inventory was completed on 05 February 2010. However, the official inventory reports have yet to be signed by both parties pending resolution of certain issues that arose during the inventory.

PSALM also undertook the validation of the other assets transferred from NPC thru an Asset Revaluation Project that was approved by the PSALM Board on 27 November 2009 under Board Resolution No. 2009-1127-007. As envisioned, this project will provide the following benefits to PSALM:

1. The values of all remaining assets transferred from NPC will be updated with reference to price movements, technological advances,

currency exchange rate movements, and other factors in accordance with sound and generally accepted methods of valuation.

2. PSALM will be compliant with the provisions of the PFRS (IAS 16), which require that *“revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.”*
3. PSALM will be compliant with the requirements of the ERC in line with the on-going tariff hearings on Basic Generation Charge jointly applied for by PSALM and NPC.
4. Declared values of the assets for various insurance covers will be brought up-to-date.
5. The updated values will be useful for taxation and financial reporting purposes.

As approved by the Board, an Independent Asset Appraiser composed of a team of engineers, appraisers and financial analysts from an ERC-accredited appraisal firm with requisite expertise in asset valuation of power utilities was hired under the Asset Revaluation Project through competitive bidding. The contract of service was awarded to Royal Asia Appraisal Corporation, which started its revaluation activity upon acceptance of the Notice to Proceed on 08 February 2010. The project will have a duration of three (3) months.

Transfer of Titles to PSALM

As of February 2010, PSALM already completed the registration of the corresponding titles over the following plants/properties to PSALM's name:

Plant/Property Name	No. of Titles	Location	Date Registered in PSALM's Name
Magat Hydroelectric Power Plant	1	Northern Luzon	Titled in PSALM's name on 10/09/2007 and transferred to S.N. Aboitiz Power Corp. (SNAP) on 12/04/2007
Masinloc Coal-Fired Thermal Power Plant	145	Central Luzon	Already in PSALM's name on 02/28/2008
Batangas Coal-Fired Thermal Power Plant	20	Southern Luzon	Already in PSALM's name on 12/02/2008
NPC Head Office	1	Metro	Already in PSALM's name on

		Manila	02/04/2009
Bohol Diesel Power Plant	8	Visayas	Already in PSALM's name on 07/31/2009
Bataan Combined-Cycle Power Plant	57	Central Luzon	Already in PSALM's name and obtained owner's copy on 02/18/2010

PSALM is in the process of completing the requirements for the transfer of titles of the following plants/properties, namely:

Plant/Property Name	No. of Titles	Location	Date Registered in PSALM's Name
Pantabangan Hydro-Electric Power Plant	2	Central Luzon	Completing required documents for transfer to PSALM's name
Tiwi Geothermal Power Plant	103 + 511 unregistered lots covered by the Land Lease Agreement	Bicol Region	Completing required documents for transfer to PSALM's name
Mak-Ban Geothermal Power Plant	119 + 366 unregistered lots covered by the Land Lease Agreement	Bicol Region	Completing required documents for transfer to PSALM's name

PSALM is already safekeeping the Original Owner's Duplicate Copy of Title of the foregoing NPC assets:

Plant Name	No. of Titles	Location	Date Acquired
Ambuklao Hydro-Electric Power Plant	3	Northern Luzon	04/15/2009
Barit Hydro-Electric Power Plant	15	Bicol Region	04/15/2009
Bauang Diesel Power Plant	4	Northern Luzon	04/15/2009
Cawayan Hydro-Electric Power Plant	10	Bicol Region	04/15/2009
Cebu Diesel Power Plant	6	Visayas	04/15/2009
Manila Thermal Power Plant	4	Metro Manila	04/15/2009
Panay Diesel Power Plant	3	Visayas	06/11/2009
Abandoned Sub-Station in Concepcion, Pequeña	1	Bicol Region	09/08/2009
Agus 4 Hydro-Electric Power Plant	28	Mindanao	09/08/2009
Agus 5 Hydro-Electric Power Plant	24	Mindanao	09/08/2009
Agus 6 & 7 Hydro-Electric Power Plant	4	Mindanao	09/08/2009

Agusan Hydro-Electric Power Plant	2	Mindanao	09/08/2009
Defunct Laoag Diesel Electric Plant	1	Northern Luzon	09/08/2009
Former Camalaniugan Sub-Station	1	Northern Luzon	09/08/2009
Pulangi Hydro-Electric Power Plant	162	Mindanao	09/08/2009

Operation and Maintenance Agreement (OMA)

Pursuant to the Implementing Rules and Regulations (IRR) of the EPIRA, PSALM has the power to operate the generation assets, directly or through NPC, prior to privatization of such assets.

The Operation and Maintenance Agreement signed on 17 February 2009 between PSALM and NPC provides for the continued orderly operation and maintenance of the transferred generation and other disposable assets and the provision of necessary corporate services from transfer date until the turn-over of such assets to buyers. NPC shall also provide preservation services to all decommissioned plants and mothballed plants in accordance with the agreed performance standards to prevent the deterioration of serviceable equipment and systems prior to disposal. Furthermore, NPC shall continue to discharge its duties and contractual obligations under existing IPP contracts such as the supply of fuel, payment of capacity, energy and other fees, purchase of power generated, etc. NPC shall turn over the IPP plants under IPP contracts to PSALM after the termination/expiration of the IPP contracts, with PSALM having the option to include these plants in the OMA.

NPC shall prepare the budget it needs annually to perform its obligations under the OMA and submit the O&M Budget to PSALM for review and approval. Upon approval, PSALM shall release the funding in accordance with the O&M Budget subject to existing accounting and auditing rules and regulations. NPC shall regularly submit to PSALM reports on the performance of the generation and other assets and the use of the funds.

Using the privatization proceeds and income from the operation of the generation and other assets, PSALM shall be responsible in servicing outstanding financial obligations of NPC arising from: (1) loans, issuances of bonds, securities and other instruments of indebtedness; and (2) IPP contracts.

IPP Administrator (IPPA)

PSALM was mandated under the EPIRA to competitively select and appoint qualified independent entities called Independent Power Producer Administrators (IPPAs) to administer and manage the contracted energy output of NPC/PSALM IPP contracts. The IPPAs are qualified private sector independent entities with whom PSALM will enter into “back to back” contracts referred to as “Administration Agreements,” with NPC as a

concurring party and the respective IPPs as counterparties. These Administration Agreements mirror applicable provisions of the Energy Conversion Agreements (ECAs)/Power Purchase Agreements (PPAs) that NPC entered into with the IPPs, in effect transferring the rights and obligations of NPC under these contracts to the IPPAs. The IPPAs will be appointed through public biddings to be conducted by PSALM.

A major responsibility that has been transferred to the IPPA under the Sual and Pagbilao Administration Agreements is the management of fuel (coal) procurement. A number of risks associated with the ECAs of these plants were also transferred under the Administration Agreements but PSALM will continue to bear risks that the IPPA cannot manage, such as Government, Force Majeure and extended outage risks. In return, the IPPA will have the unfettered opportunity to manage and trade the contracted capacities of these plants in the Wholesale Electricity Spot Market (WESM) and through bilateral contracts. For thermal plants, revenues for the first few years are guaranteed to the IPPA through the assignment of Transition Supply Contracts (TSCs).

The IPPA process gives successful bidders a way to enter the WESM for a very low capital outlay. The Sual and Pagbilao structure, for example, enables bidders to pay the fixed monthly fees and the pass through energy fees of the IPPs out of cash flows. Thus, no upfront financing is required.

This is a unique way to enter the WESM. The assets are relatively new, high quality plants that were built and are well maintained by some of the best IPP developers in the world. The IPPAs will have most of the benefits of being owners of generating stations, such as controlling the fuel and its dispatch, trading, and contracting of the plant, but without maintenance cost or capital upgrades. Also, many of the risks of owning a plant are explicitly managed through the contract. If there is an extended outage, for example, there is up to a 90% discount on the monthly fees.

Wholesale Electricity Spot Market (WESM)

The commercial operation of the WESM (26 June 2006) is one of the pre-conditions to retail competition and open access. Other conditions as required in the Implementing Rules and Regulations (IRR) of the EPIRA are the: (i) approval of the unbundling of the transmission and distribution charges; (ii) initial implementation of the Cross Subsidy Removal System; (iii) privatization of 70% of the total capacity of NPC plants in Luzon and the Visayas; and (iv) transfer of the management and control of at least 70% of the total energy output of power plants under contract with IPPs.

The WESM is initially a market for energy. Eventually, with the approval of the ERC, there will be a market for ancillary services for regulation, contingency reserve and dispatchable reserves.

Electricity is offered and traded in a 24 hour by 7 days market. There are hourly prices published and used as basis for settlements. Prices in the spot market are volatile ranging from zero prices during off peak hours to as high as twelve pesos during peak hours. Distribution Utilities (DUs), Electric Cooperatives (ECs) and Suppliers/Aggregators can source their electricity requirements from the spot market or through Transition Supply Contracts (TSCs) with NPC. There is a provision in the EPIRA where DUs must source at least 10% of their requirements from the spot market.

In parallel to the spot market, DUs, ECs and Suppliers can enter into Transition Supply Contracts (TSCs) with NPC. These contracts can have predetermined rates such as the NPC Grid Rate or Time of Use (TOU) rates (plus other charges as approved by the ERC) that eliminate the volatility if one will source from the spot market.

On the demand side of the spot market, MERALCO is the biggest customer of the WESM. There are electric cooperatives such as the Camarines Sur Electric Cooperative (CASURECO) and the Ilocos Norte Electric Cooperative (INEC) which have registered as market participants in the WESM.

Since 2006, when the WESM commenced its operations, PSALM has been effectively acting as the interim IPPA by bidding the NPC/PSALM IPPs' energy output into the WESM on a day-to-day basis. The total MW capacity of PSALM's two trading teams will be limited to around 56% of the total contracted capacities upon the completion of the second wave of appointments of IPPAs, which will leave the following IPPs in their portfolio: Ilijan Natural Gas-Fired Combined Cycle Power Plant, Casecnan Multi Purpose Hydroelectric Power Plant, Bauang Diesel Power Plant, CBK Pumped Storage Hydroelectric Power Plant, Malaya Thermal Power Plant and Leyte B Geothermal Power Plant.

Operation and Maintenance Service Contract (OMSC)

Pursuant to its privatization mandate, PSALM schedules the selling of the plants thru open and competitive bidding on dates such that the date of turn-over to the winning bidder/new owner would correspond with the termination of the plants' operation and maintenance agreements with third parties. In some instances, the biddings would not proceed as planned due to various constraints, delaying the turn-over of the plants to the new owners. Pending these plants' privatization and still continue the operation of the plants, prevent their deterioration, and service the power

requirements of the public, PSALM entered into Operation and Maintenance Service Contracts with the following third parties:

Plant	3 rd Party Operator	Contract Amount (estimated) *	Effective Date
Naga Land-Based Geothermal Turbine	SPC Power Corp.	₱ 38.2 million	30 May 2009
Limay Combined Cycle Power Plant	Alstom	₱ 1,028 million	19 April 2009
Power Barge 117	Burmeister & Wain Scandinavian Contractor	₱ 318.12 million	01 May 2009
Power Barge 118	Burmeister & Wain Scandinavian Contractor	₱ 332.78 million	06 August 2009

* Estimated cost of original OMSC (excludes cost of contract extension, if any)

National Transmission Corporation (TransCo)

TransCo started operations as a functional unit in charge of the transmission functions of NPC. TransCo started independent operations in March 2003, although its operations continued to be carried in NPC's books of accounts. On 31 December 2008, TransCo's books were separated from the books of NPC and TransCo ceased as one of NPC's functional units.

The creation of TransCo under the EPIRA as a GOCC that will assume the transmission function of NPC and the responsibility for the planning, construction and centralized operation and maintenance of its high voltage transmission facilities (the Grid), including grid interconnections and ancillary services, was meant to separate the power transmission system from the power generation system. TransCo was also mandated to privatize sub-transmission assets transferred from NPC by selling these assets to qualified distribution utilities.

As provided in the EPIRA, TransCo is wholly-owned by PSALM and its transmission function is also subject to privatization. Based on the government's Privatization Plan, PSALM privatized the transmission assets by way of an award of a Concession to a qualified bidder in an open and competitive bidding process. The concession contract was awarded to the consortium of Monte Oro Grid Corporation, Inc. as the winning bidder in the fourth round of bidding for the TransCo concession contract held on 12 December 2007. The consortium, composed of Monte Oro Grid Resources Corp., Calaca High Power Corp. and State Grid Corp. of China, won with their bid price of US\$3.95 billion. The consortium established the National Grid Corporation of the Philippines (NGCP) as the "Concessionaire."

On 28 February 2008, the Concession Agreement became effective. Republic Act No. 9511 (The TransCo Franchise Law) was enacted on 01 December 2008 and became effective on 20 December 2008. The operation and management of the transmission business by NGCP commenced on 15 January 2009, upon receipt by PSALM of 25% of the concession fee as upfront payment (Commencement Fee). The balance of the concession fee will be paid by the Concessionaire with interest in semi-annual installments for 20 years.

KEY ACCOMPLISHMENTS

PSALM's notable accomplishments in the pursuit of its mandate won the Company international recognition. Late in 2009, PSALM received three awards from the renowned Asset Magazine in recognition of PSALM's effective and diligent implementation of its power privatization and liability management programs.

The honor was bestowed by the publication's 2009 Triple A Regional Awards, an annual event that recognizes institutions and individuals that have made a significant contribution to the development of the finance industry in Asia. The Triple A Regional Awards is considered the most prestigious in the financial sector because of its rigorous assessment process. PSALM bagged awards in the Best Deals and Best Issuers categories.

In the Best Deals division, PSALM's USD1-billion debut bond offering in the international credit market in May 2009 was acclaimed as "Best New Bond." Six times oversubscribed, the offering attracted around USD5.7 billion in demand, with 208 foreign investors participating in the transaction. An estimated 55% of the bonds were allocated to Asia, 18% went to Europe, while 27% were booked in the US.

Under the same category, PSALM received the "Best Privatization" award for its sale of the 25-year concession contract to manage and operate the country's transmission grid through the National Grid Corporation of the Philippines (NGCP) on 12 December 2007.

The achievements of PSALM in 2009 are detailed below:

I. Asset Management

Privatization of Generation Assets

As of December 2009, PSALM has successfully bid out twenty-four (24) generating power facilities and five (5) decommissioned plants. Eighteen (18) of these operating plants, with a total rated capacity of 3,072.23 MW,

account for 81.3% of the total rated capacity of 3,778.23 MW of the generating assets in the Luzon and Visayas grids.

Privatization of Operating Generation Plants

Late in January 2009, the winning bidder for the 600 MW Calaca Coal-Fired Thermal Power Plant, Emerald Energy Corporation, terminated the Asset Purchase Agreement for the plant due to what it observed as the “deterioration” of the plant’s condition since the bid date. The bidding was held last 6 October 2007 on an “as is, where is” basis. Despite this turn of events, PSALM remained committed to achieving its goal of 100% privatization of the generation assets. Thus, on 8 July 2009, the Calaca Plant was again successfully bid out through negotiations with DMCI Holdings, Inc. as the highest bidder at US\$361.709 million.

On 31 July 2009, the 100 MW Power Barge 117 was sold to Therma Mobile Inc. for US\$16 million and the 100 MW Power Barge 118 to Therma Marine Inc. for US\$14 million through a negotiated bidding. The 620 MW Limay Combined Cycle Power Plant was sold for US\$13.5 million to San Miguel Energy Corporation via a negotiated sale last 26 August 2009. The packaged 192.5 MW Palinpinon and 112.5 MW Tongonan Geothermal Power Plants were acquired by Green Core Geothermal Inc. for US\$220 million in the bidding held on 02 September 2009. Finally, the 55 MW Naga Land-Based Gas Turbine Power Plant was sold via a negotiated sale to SPC Power Corporation on 16 October 2009 for US\$1.008 million.

The privatization of the six plants generated US\$626.227 million in expected proceeds, bringing the total bid price of the twenty-four (24) generation plants and four (4) decommissioned plants sold as of 31 December 2009 with a total capacity of 3,952.33 MW to US\$3.03 billion.

In the second quarter of 2009, PSALM turned over the remaining three plant portfolios to the winning bidders in the biddings held in 2008: the 146.5 MW Panay I & III and 22 MW Bohol Diesel Power Plant package; the 289 MW Tiwi and 458.52 MW MakBan Geothermal Plant package; and the 0.8 MW Amlan Hydroelectric Power Plant. The Palinpinon and Tongonan Geothermal Power Plants were turned over to Green Core on 22 October 2009 while the Calaca Power Plant was turned over to DMCI on 03 December 2009.

As of end December 2009, four generating plants have yet to be turned over to the new owners pending completion of deliverables by both PSALM and the respective winning bidders, consistent with the Asset Purchase Agreements (APAs): Power Barges 117 & 118, Limay Combined Cycle and Naga LBGT. In the meantime, these plants were placed under OMSCs to ensure uninterrupted operations and delivery of power.

With the successful privatization of the above plants, the remaining unsold generation plants are the Angat, Agus and Pulangui Hydroelectric Power Plants and the Bacon-Manito (BacMan) Geothermal Power Plants. Only the Angat and Bacman Power Plants are scheduled for privatization in 2010. The privatization process for the BacMan Geothermal Plants was began on 17 March 2010 with the publication of an Invitation to Bid. On 28 April 2010, Korea Water Resources Development Corporation (K-Water) won the bidding for Angat HEPP.

Privatization of Decommissioned Generation Plants

Taifu Metal Exchange Corporation completed negotiations with PSALM on 22 January 2009, agreeing to pay US\$460,000 for the plant equipment, components, auxiliaries and accessories of the 54 MW Cebu II Diesel Power Plant, excluding the land. The decommissioned facility was officially turned over to Taifu on 25 May 2009 after remittance of the full payment on 20 April 2009.

PSALM also turned over the retired Manila Thermal Power Plant to winning bidder Gagasan Steel Inc. on 13 April 2009 after receiving the full payment for the plant on 20 February 2009. Gagasan bought the plant for US\$2.5 million in a negotiated sale completed on 25 April 2008.

After three unsuccessful rounds of bidding, the decommissioned Bataan Thermal Power Plant was sold through negotiation to lone bidder Rubenori Inc. on 16 April 2009 for US\$2.859 million. This plant has not been turned over to Rubenori pending completion of deliverables under the APA.

PSALM met its privatization schedule for the decommissioned plants this year with the sale of the packaged Aplaya and General Santos diesel facilities to TEC Industries Inc. on 25 May 2009. TEC agreed to match the government's reserve price of US\$1.488 million. The plants were turned over to TEC on 02 October 2009.

The sale of the four decommissioned plants generated a total of US\$7.32 million expected privatization proceeds.

As of end December 2009, the remaining unsold decommissioned plants are the Sucat Thermal Power Plants 1 to 4 and Land- Based Gas Turbine Plant, the Navotas Diesel Power Plants 1 & 2 and the Bataan Gas Turbine Plant. The Navotas and Sucat Plants are slated for privatization in 2010.

Privatization of IPPs

The first wave of the appointment of IPPAs covers the management and control of contracted energy of the Sual and Pagbilao Coal-Fired Thermal Power Plants, as approved by the Joint PSALM-NPC Boards on 07 November 2008. The choice of the Sual and Pagbilao plants was based on their having the least complex ECAs, which will result in relieving the government of the burden of procuring fuel (coal and oil) using the ownership approach. This should bring private sector efficiency in procurement activities resulting in lower fuel costs for the IPP plants.

The combined contracted capacities of the Sual and Pagbilao plants is 1,700 MW, constituting around 40% of the required contracted capacities that need to be privatized.

On 28 August 2009, the Sual and Pagbilao plants were successfully privatized through competitive bidding with the appointment of the winning bidders as Administrators. In October 2009, the management of the contracted capacity of the Pagbilao plant was formally turned-over to Therma Luzon, Inc., while the administration of the contracted capacity of the Sual plant was formally turned-over to San Miguel Energy Corporation in November 2009.

PSALM was, likewise, successful in implementing the second wave of IPPA appointments, utilizing the same commercial and legal structure in privatizing the IPP contracts. In the bidding held on 15 December 2009, Strategic Power Development Corporation won the bid for the contracted capacity of the 345 MW Pangasinan-based San Roque Multipurpose Hydroelectric Power Plant while the Amlan Power Holdings Corporation consortium bagged the 100 MW capacity Bakun-Benguet package. The appointment of these two IPPAs brought the total privatized contracted capacity of IPP plants to 43.75%. This is still below the 70% contracted capacity threshold required under the EPIRA. The appointment of the four IPPAs generated expected privatization proceeds of US\$2.36 billion.

Because the WESM is only being implemented in Luzon, only the ECAs/PPAs of IPPs in Luzon were programmed for privatization through the IPPA approach. The projected third wave, however, will cover the ECAs of the 1200 MW Ilijan Gas-Fired Combined Cycle Power Plant and the Malaya Thermal Power Plant and the PPA of the Unified Leyte A and B Geothermal Power Plants in Leyte that supply power to the Luzon Grid.

As of end December 2009, fourteen IPPs remain to be privatized, with the third wave of IPPA appointments scheduled for 2010. On 16 April 2010, the San Miguel Corporation won the bidding as IPPA for Ilijan Power Plant.

The privatization process for the Malaya Thermal Power Plant also began with the issuance of an Invitation to Bid in April 2010.

Privatization of Transmission Assets

The transmission assets were privatized by way of the award of a Concession Contract to the National Grid Corporation of the Philippines. The Concession commenced on 15 January 2009, upon payment of US\$987.5 million or 25% of the Concession Fee of US\$3.95 billion as Commencement Fee. The balance of US\$2.96 billion of the Concession Fee will be paid by the Concessionaire with interest in semi-annual installments falling on the 15th day of January and July of each year for 20 years.

Proposed Amendments to EPIRA

Amendments to the EPIRA have been proposed under various House and Senate bills beginning the First Regular Session of the Fourteenth Congress of the Philippines. These proposed amendments deal with the manner or mode of privatization of TransCo, the lowering of the requisite 70% thresholds for total rated capacity of privatized generating assets and total contracted capacity of privatized IPPs prior to open access and retail competition and the limitation or removal of the Universal Charge.

Some of these proposed amendments have been overtaken by PSALM's accomplishments on the privatization of TransCo through the award of a concession contract and the privatization of the various generating assets with a combined rated capacity of 3,072 MW or 81.3% of the total rated capacity of 3,778.23 MW of the generating assets in the Luzon and Visayas grids. Thus, only the proposed lowering of threshold for the total contracted capacity of IPPs remains pending in Congress as of end 2009. Should PSALM be successful in implementing the third wave of the IPPA privatization program, the 70% threshold for total privatized contracted capacity would be greatly exceeded and the proposed amendment would be moot and academic.

II. Liability Management

Liability Management Program Phase I (LMP-I)

On 20 June 2007, PSALM secured Board approval of the Liability Management Program Phase-1(LMP-1). The LMP-1 aims to refinance US\$2.45 billion of NPC debt to achieve the following objectives: (i) liquidate debt from the privatization proceeds; (ii) manage liquidity risks and improve the debt service coverage ratio (DSCR) for the years 2009-2011; (iii) reduce foreign currency exposure of NPC debt from 90.75% to at least 50%; and,

(iv) realize foreign exchange mark-to-market gains from 2004 to 2007. In the last quarter of 2007, with upfront cash provided by the success in the privatization of the various generation assets, PSALM started a program of prepayment (a component of LMP-I) as a means to efficiently manage its cash and comply with its mandate to optimally liquidate its debt. This resulted in the utilization of US\$1.3 billion of the approved program to liquidate the more volatile Yen obligations equivalent to US\$1.17 billion and Dollar debt of US\$126 million related to privatized assets.

The Yen prepayments paid off as the Yen strengthened against the dollar. Present value savings on this program is at US\$376.1 million, inclusive of US\$184.33 million in interest savings and US\$191.77 million in FX mark-to-market savings. In addition, the currency mix profile of PSALM's debt improved with the increase of its Peso component and the corresponding reduction of the Yen component from 36% to 22%.

However, towards the last quarter of 2008, PSALM decided to terminate the prepayment program under LMP-1 and reserved the cash in light of the credit crisis. Additionally, the Peso-linked Dollar bond financing under LMP-I did not push through. PSALM also had to accommodate bidders' requests to change payment currency to Peso as well as requests for adjustments in deferred interest payments. Furthermore, NPC's cash position posted a shortfall in the last quarter of 2008, requiring PSALM to utilize privatization proceeds for NPC regular debt service and IPP obligations. NPC's shortfall also prompted PSALM to avail of a six-month ₱20 billion loan facility on 11 December 2008 with the Land Bank of the Philippines and the Development Bank of the Philippines. These developments marked a turning point in the management of PSALM's debt, as without any adjustment in tariff or corresponding reduction in costs, cash flow projections indicated more shortfalls in the operations of the generating assets.

On the US\$300 million principal-only-swap (POS) transaction executed in July 2007, a US\$100 million replacement swap with a prepayment option executable on 15 November 2009 was successfully bid out, with UBS A.G. as the winning bidder. The prepayment option released PSALM from paying the Peso leg at maturity in 2028. PSALM executed the prepayment option on 16 November 2009, paying US\$1.0 million.

In May 2009, PSALM successfully issued an inaugural US\$1.0 billion 10-year global bond. With a spread of 97 bps over the ROP, this issue established a benchmark for future PSALM financing that may be necessary to cover the huge funding requirements in 2010 and 2011. For PSALM, it was a good way to close LMP-I as all transactions undertaken helped attain its objectives of reducing cost of debt, rebalancing the currency mix and addressing liquidity issues, albeit connected with NPC operations.

On 14 December 2009, PSALM also prepaid the outstanding amount of EUR 3,519,859.87, with applicable interest, of the export credit facility with Erste Bank der Oesterreichischen Sparkassen AG (EBOS). Present value savings on the prepayment is at US\$180,400 inclusive of US\$132,170 in interest savings and US\$101,270 in guarantee fee savings.

Liability Management Program Phase II (LMP-II)

Liquidity issues continue to be PSALM's paramount concern in the medium term. This is due to the fact that 34.61% of PSALM's principal payments are set to mature in 2009, 2010 and 2011, while operations of PSALM IPPs and generating assets continue to need funding. Given that financial markets locally and internationally have an appetite for PSALM credit, it was advisable to implement/fast track any liability management program to address these concerns in 2010.

PSALM's LMP-II contemplated six financial products/structures with the following objectives:

- Manage liquidity risks in 2009-2011
- Match privatization cashflows with maturity of debt obligations
- Reduce debt volatility by increasing Peso component of debt mix
- Reduce cashflow volatility arising from foreign currency obligations
- Reduce cashflow volatility arising from interest rate

The financial structures under the LMP-II are as follows:

- i. Securitization Program of the TransCo Concession Fee Deferred Payments
- ii. Proposed Peso Bonds/Credit Facility with an aggregate amount of up to ₱50 Billion
- iii. Proposed Bond Exchange of up to US\$1.34 Billion inclusive of new money component of between US\$450-700 Million
- iv. Proposed Financial Derivatives Transaction: Forwards, Swaps, and Options
- v. Proposed US\$ Bond Issuance of up to US\$1.0 Billion

The Securitization Program, as approved by the Board on 31 July 2009, ensures that TransCo privatization proceeds are locked-in to liquidate debt but more importantly, ensures that the debt maturities in 2010 and 2011 are adequately covered (matched).

The ₱33.0 Billion of retail treasury bonds (RTB) that matured in July 2009 provided an opportunity to tap funds that prefer government paper. Additionally, with rates at an all time low and exchange rates fairly stable,

issuing a Peso note will afford PSALM to issue at a low cost and improve its debt currency mix while addressing liquidity issues in 2010.

The implementation of the securitization in the 1st half of 2010 (US\$1.0 billion) and the issuance of Peso bonds (P50 billion) will not be enough to cover the projected shortfall of both privatization/debt proceeds and generating assets/IPP operations in 2010. A bond exchange, another LMP structure, is expected to compliment the proposed liability management options available to PSALM. -

PSALM intends to issue an exchange of three bond obligations (the “Old Bonds”):

- US\$500 million 9.875% Notes due on 16 March 2010,
- US\$700 million Zero Coupon Bonds due on 12 July 2010, and
- US\$400 Million Floating Rate Notes (FRN) maturing on 23 August 2011.

This translates to approximately US\$400-640 Million in debt that may be extended for another 5, 7, or 10 years.

The Old Bonds were exchanged for PSALM’s newly issued U.S. Dollar Denominated Guaranteed Global Bonds due 2024 and a reopened U.S. Dollar Denominated Guaranteed Global Bonds due 2019 (together with the 2024 Bonds, the “New Global Bonds.”

A dollar bond issuance is an important and practical alternative in PSALM’s LMP. The dollar bond market is well-established, liquidity is present, and pricing is very transparent. The issuance process is, likewise, clear and simple and provides PSALM access over a broad range of investors.

To institutionalize the process of closing short-term hedging transactions, PSALM is considering opening a line with DBP, a government financial institution (“GFI”), to ensure any upside or downside within the government. Further, PSALM has started talks with the BSP to discuss the process and to consider policy/rule changes (if necessary).

The only long-term hedge PSALM has entered into is the Principal-Only-Swap (POS) with an in-the-money mark-to-market of US\$22.3 Million as of end December 2009. PSALM is considering closing another swap, similar to the last Principal-Only-Swap (POS) to hedge the US\$ and Yen liabilities. Under this structure, PSALM effectively pays a premium to pay the future principal exchange into Peso with an option to prepay the final principal a year after closing the transaction.

The LMP-II was approved by the PSALM Board on 26 August 2009 under Board Resolution No. 2009-0826-001.

Liability Management Program Phase III (LMP-III)

To complement LMP-II, the PSALM Board approved in November 2009 the LMP-III, which consists of various long-term hedging structures. Given current market conditions and the preference to close hedges that will minimally impact the peso-dollar market, PSALM Management decided on the Currency Cap (or a “Call Spread Transaction”) option as an initial transaction to partially protect the company from anticipated long-term Peso depreciation. However, execution of this option is on hold pending compliance with the requirements of the BSP.

Management of Privatization Proceeds

PSALM started receiving privatization proceeds from the sale of NPC generating plants in January 2005. As of 31 December 2009, actual privatization proceeds collected amounted to US\$3.89 billion.

On 20 June 2007, the joint Boards of PSALM and NPC, under Board Resolution No. 07-29, approved the utilization of the privatization proceeds to liquidate principal and interest obligations of NPC as they fall due. This was amended on 4 October 2007 by Board Resolution No. 07-61, which granted authority to PSALM Management to utilize the privatization proceeds to:

- Prepay NPC’s principal obligations;
- Settle NPC’s principal and interest obligations as they become due only after NPC shows deficit in its cash flow after utilization of its own internally generated cash;
- Manage NPC’s liabilities with the objectives of reducing interest cost and liquidity risk in 2009-2011 and hedging foreign exchange risks at terms and conditions advantageous to the government; and
- Pay other financial obligations of NPC.

From 22 August 2007 to 31 December 2009, a total of US\$2.34 billion dollar proceeds and ₱52.33 billion peso proceeds were utilized to cover mostly the financial obligations of NPC such as the maturing obligations, IPP obligations and the prepayment of the more expensive Yen-denominated obligations of NPC, as well as other privatization-related expenditures. A total of US\$76.12 million dollar proceeds were also utilized for peso swaps for debt service and other privatization-related expenses.

As of end December 2009, the balance of dollar proceeds is US\$6.24 million, while the balance of the peso proceeds amounts to ₱20.44 billion.

III. Universal Charge Administration

PSALM complemented the LMP financing activities by filing petitions with the ERC for the recovery of the CY 2008 Stranded Contract Costs (SCC) and the CY 2009-2029 Projected Stranded Debts (SD) portions of the Universal Charge (UC). The UC-SCC petition seeks approval for PSALM/NPC to recover the shortfall incurred in operating the eligible IPPs in the Luzon Grid in the amount of P22.26 billion over a period of five (5) years. On the other hand, in order to stabilize and mitigate increases in the level of NPC's SD, PSALM seeks approval to recover over a 17-year period a levelized UC-SD amounting to P470.86 billion. The calculated levelized SD is the estimated shortfall of NPC in paying its financial obligations. The petitions for UC-SCC and UC-SD have undergone hearings, the latest was in November 2009.

To further improve the administration of the Universal Charge funds, the following projects were undertaken by PSALM in 2009:

1. To facilitate their submission of the billing, collection and remittance reports and keep PSALM records current and updated, the Universal Levy Administration System (ULAS), a web-based information system, was developed by PSALM for use by the collecting entities (CEs).
2. To facilitate the implementation of the ULAS, series of seminar/workshops were conducted in the Mindanao and Visayas CEs in 2009. The series of workshops for the Luzon CEs were completed in February 2010.
3. To be consistent with Section 34 (e) of the EPIRA, PSALM is currently working on the proposal to amend PSALM Circular No. 2004-005 dated 17 February 2004 entitled "Universal Charge Transaction Guidelines and Procedures" to shift the set-up of UC receivables from UC billed to UC actually collected by CEs from end-users.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Preparation of Financial Statements

The financial statements are prepared on a historical cost basis and transactions are recorded using the accrual basis of accounting. The assets transferred from NPC were recorded at their carrying amounts (balances as reflected in NPC books) as of the transfer date of 31 December 2008.

The preparation of the financial statements in accordance with Philippine Accounting Standards require the Company to make estimates and

assumptions that affect the reported amounts of resources, liabilities, income and expenses and the disclosures of contingent resources and liabilities. Future events may occur which can cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the financial statements as they become reasonably probable.

Estimates and judgments are continually evaluated and are based on historical experiences and other factors including expectations of future events that are believed to be reasonable under the circumstances.

Cash Equivalents

Cash equivalents consist of short-term placements/time deposits which are highly liquid investments with a maturity of three months or less from the date of acquisition and which are subject to insignificant risk of changes in value.

Receivables and Allowance for Bad Debts

Receivables are initially measured at fair value and subsequently at amortized cost. Impairment loss is recognised using an allowance account. A 10% impairment allowance is recognised for accounts past due for more than one to two years while accounts overdue for three years are provided a 30% allowance for impairment. Dormant accounts are provided 100% impairment allowance.

Inventories

Inventories are valued at cost using the moving-average method and consist only of office supplies.

Assets Held for Sale

Assets held for sale consist of generation plants in service and decommissioned plants that are scheduled for privatization in 2010. These also include those plants that have been previously bid out but whose sale were not consummated by end of 2009, either because the bidding was declared a failure or because the winning bidder failed to close the sale, but which are still intended to be sold in 2010.

Under Philippine Financial Reporting Standards (PFRS) 5, "Non-current Assets Held for Sale", a non-current asset is classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate

sale in its present condition. Management must be committed to the sale that should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell, the carrying amount being the amount reflected in the NPC books at the date of transfer.

Build-Operate-Transfer (BOT) Plants

Total capacity fees for the duration of the cooperation period are capitalized and recognized as asset under BOT Electric Plants under Capital Lease account. A liability corresponding to the unpaid portion of the capital recovery fees is set up under BOT Lease Obligation. BOT assets are amortized over 20 years, except for Hopewell Pagbilao which is amortized over 29 years.

Upon turnover of the privatized BOT plant to the appointed IPPA, the asset is derecognized from the books of PSALM in conformity with IAS/PAS 17 (Leases).

IPPA Receivable

As structured, the contract (Administration Agreement) between the IPPA and PSALM can be classified as a finance lease because it substantially transfers the risks and rewards incidental to ownership to the IPPA.

Based on IAS/PAS 17, the contract between the IPPA and PSALM may be classified as a finance lease because, in substance, the contract contains the following indicators of a finance lease:

- a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
- b) the lease term is for the major part of the economic life of the asset even if title is not transferred; and
- c) the leased assets are of such a specialized nature that only the lessee can use them without major modifications.

The IPPA structure provides that:

- a) full ownership of the generating plant and the right to use the land transfers to the IPPA at the end of the contract period;
- b) the contract is for a period of fifteen (15) years, which is for the most part of the economic life of the asset given that, on the average, the

estimated economic life of the transferred generating plants is thirty (30) to forty (40) years, based on their last revaluation in 1996;

- c) the leased generating plant is of a specialized nature and size that operating this asset and managing its output require highly technical expertise and considerable financial capability that only qualified entities such as the IPPAs can bid for administration of their contracted capacity and eventually own and operate them.

The IPP asset under a finance lease is presented as a lease receivable from the IPPA in the amount equal to the aggregate of the monthly payments to be made by the winning bidder throughout the contract period. The schedule of monthly payments was part of the Financial Bid of the IPPA and is made part of the Administration Agreement as Annex 1 to Schedule I.

Property, Plant and Equipment and Depreciation

NPC-transferred assets

Property, plant, and equipment transferred from NPC include electrification, power and energy structures and referred to as utility plants. The last external revaluation of these plants was of the 1996 asset prices. These structures are recognized in PSALM's books at their carrying amounts as stated in NPC books as of the transfer date of 31 December 2008. While these assets were carried in NPC books, regular annual maintenance, repairs and minor replacements were charged to expense as they were incurred, whereas major maintenance, which was done on periodic three-to five-year intervals, was deferred, amortized and charged to operations over the number of years interval. Rehabilitation expenditures that would result in improvement of the plant's efficiency beyond five years were capitalized and transferred to plant cost upon completion of work orders.

Depreciation was charged from the date of acquisition of the fixed assets or after the completion of work orders and computed on a straight-line basis. Depreciating the asset based on the sound value over its remaining useful life will result in amortizing the remaining cost of the assets reflective of its true physical state. The average remaining useful life was determined by subtracting the age of the asset from the estimated standard economic life. Depletion, which shows the periodic provision for the depletion of extractable natural resources such as steam, natural gas, etc. was also computed on a straight-line basis.

The same NPC depreciation policies were adopted by PSALM on the transferred assets, including the estimated standard economic life as ascertained by the last independent appraiser of NPC, as follows:

<u>Type of Plant</u>	<u>Economic Life</u>
1. Thermal Production	
a. Oil-fired	
b. Coal-fired	35 yrs
2. Hydraulic Production	40 yrs
3. Geothermal Production	30 yrs
4. Other Production	
a. Combined-cyle	
b. Diesel Plants and Barges	
c. Gas Turbine	20 yrs

PSALM-acquired

Property and equipment consisting of computers, office furniture and fixtures, vehicles and communication equipment are stated at cost less accumulated depreciation and any impairment in value. The stated cost comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Generally, tangible assets that are expected to be used for more than one year are considered as capital assets. Expenditures for repairs and maintenance are charged to expense as incurred.

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

Furniture, fixtures and equipment	5 – 10 years
Transportation equipment	7 years
Computers and accessories	5 years

Residual value equivalent to ten percent (10%) of the acquisition cost is deducted before dividing the same by the estimated useful life.

The carrying values of property and equipment are reviewed for impairment when changes in circumstances indicate that the carrying value may not be recoverable or may have diminished. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount and impairment losses are recognized in the statement of income and expenses.

On 09 January 2009, PSALM filed with the ERC its petition for the adoption of proposed asset valuation guidelines using an indexation method to revalue NPC's assets to its current cost level in lieu of the conduct of an appraisal by an external appraiser.

The public consultation on the petition was held on 23 February 2009, whereupon ERC directed PSALM to revise the Asset Valuation Guidelines based on comments from interested parties.

Assumed REP Loans

Electric cooperatives (ECs) loans from National Electrification Administration (NEA) and from other government agencies (OGA) and local government units (LGUs), which were incurred for the purpose of financing the Rural Electrification Program and which were assumed by PSALM, were previously recorded under the deferred asset account "Assumed Rural Electrification Program Loans" that was subjected to amortization. The amortization expense for this account was computed based on a straight-line, 10-year amortization of the total assumed NEA loans and a straight-line amortization of the OGA and LGU loans over the remaining balance of the 10-year period, beginning from the year the OGA and LGU loans were assumed. The related liability account was set up in the books of PSALM.

On 30 September 2009, the deferred asset account and its corresponding *Allowance for Amortization* account were closed to the *Capital from Asset-Debt Transfer* account upon the recommendation by COA in its 2008 Annual Audit Report on PSALM. With this adjustment, only the related liability accounts for the current and long-term portion of the assumed debts remained in the books.

Taxes

Taxes for current and prior periods are, to the extent unpaid, recognized as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess payment is recognized as an asset.

Unlike the NPC whose Charter provides that NPC shall be exempt from direct and indirect taxes, the EPIRA (the law that created PSALM) does not contain a provision that exempts PSALM, as an entity, from taxation.

While PSALM as an entity is not per se tax-free, there are certain transactions of PSALM which are exempt from taxation. The tax treatment of PSALM's transactions is set forth in BIR Ruling No. 020-02 dated 13 May 2002, the pertinent provisions of which are summarized as follows:

1. Income of PSALM arises from the exercise of essential government function and, thus, exempt from tax.

Under Section 32(B)(7)(b) of the Tax Code of 1997, income derived from the exercise of any essential government function accruing to the Government of the Philippines is excluded from gross income. The defined activities of PSALM under Section 50 of EPIRA are essentially governmental functions.

2. Gain from the sale by PSALM of the generation facilities to qualified buyers is not subject to income tax.

Such income is considered income from exercise of essential government function and thus, exempt from income tax pursuant to Sec. 32(B)(7)(b) of the Tax Code.

3. Privatization of assets by PSALM is not subject to VAT.

The sale or disposition by PSALM of NPC assets is completely not related with the original business of NPC as a power generation company, which function is now being assumed by PSALM, and neither is it incidental thereto. Moreover, the disposition or sale of NPC assets are isolated transactions, therefore, not subject to VAT (BIR Ruling No. 113-98 dated 23 July 1998).

4. The collection of universal charge by PSALM will not be considered as taxable income nor will it form part of its gross receipts for VAT purposes.

The universal charge received by PSALM is not subject to income tax since it is not in the nature of income as defined in Sec. 32(A) of the Tax Code and Section 36, Revenue Regulations No. 2, otherwise known as the Income Tax Regulations.

5. "The loans, credits and indebtedness contracted under this subsection and the payment of the principal, interest and other charges thereon, as well as the importation of machinery, equipment, materials and supplies by the Corporation, paid from the proceeds of any loan, credit or indebtedness incurred under this Act, shall also be exempt from all taxes, fees, imposts, other charges and restrictions, including import restrictions, by the Republic of the Philippines, or any of its agencies and political subdivisions." – Sec. 8. *Authority to Incur Indebtedness and Issue Bonds; Their Conditions, Privileges and Exemptions; Sinking funds; Guarantee*, Subsection (b) Foreign Loans, RA No. 6395 (NPC Charter).
6. Income derived by foreign governments, financing institutions owned, controlled or enjoying refinancing from foreign governments, and international or regional financial institutions established by foreign governments, from loans to PSALM shall be tax exempt, (Sec. 32(B)(7) (a), 1997 Tax Code).
7. Interest income arising from foreign commercial loans is exempt from income tax pursuant to any of the tax treaties that the Philippines has with other country.

Under certain tax treaties, interest income arising from commercial loans may be exempt from income tax, subject to compliance of the conditions provided in the treaty.

In 2005, RA 9337 or the R-VAT law was enacted. RA 9337 imposed 12% Value-added tax (VAT) on the sale of electricity, except for the sale of electricity sourced from renewable resources such as, but not limited to, biomass, solar, wind, hydropower, geothermal, ocean energy and other emerging energy resources, which is subject to zero 0% rate VAT. Thus, the sale by PSALM of generated power shall be subject to VAT at 12% or 0% rate as may be applicable.

Bonds Payable

Bonds payable are presented net of unamortized discount and are revalued at year-end to reflect Philippine peso exchange rate prevailing as of the balance sheet date.

Revenue Recognition

Revenue/gain from sale of the generation plants is recognized in full upon receipt of cash payment. The sale price is payable in cash or on installment. Normal terms for installment is 40% cash upfront and the 60% balance payable in 14 equal semi-annual payments at an agreed interest. The 60% deferred payment is recorded as Asset Sale Receivable.

The Concession Fee for the concession of the TransCo transmission assets to NGCP was recorded as Other Deferred Credits – Deferred Concession Income. The earned portion of the Deferred Concession Income is subsequently recorded as Concession Income over the life of the concession.

Gain from the privatization of IPPs is recorded as Other Deferred Credits – Unearned Finance Income. The earned portion will subsequently be recorded as Finance Income over the life of the Administration Agreement.

Other revenues are recognized when it is probable that future economic benefits will be received and such future benefits can be measured reliably.

Foreign Currency Transactions

The accounting records of the Corporation are maintained in Philippine pesos. Transactions denominated in foreign currencies are translated into Philippine pesos at exchange rates prevailing on the transaction dates in accordance with PAS 21, “The Effects of Changes in Foreign Exchange

Rates,” which requires that foreign currency transactions shall be recorded on initial recognition in the functional currency by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of transaction.

The Corporation translates its foreign currency-denominated deposits and loans at year-end rates in accordance with PAS 21, which requires foreign currency monetary items to be translated at balance sheet date using the closing rate. The resulting gains and losses from the exchange differences are recognized in the statement of income and expenses.

Year-end foreign currency exchange rates follow:

	<u>2009</u>	<u>2008</u>
Philippine Peso (₱) : US Dollar (\$)	46.3560	47.4850
Philippine Peso (₱) : Japanese Yen (¥)	0.5059	0.5221
Philippine Peso (₱) : Korean Won (KRW)	.0397	0.0357
Philippine Peso (₱) : Euro (EUR)	66.6646	66.2463

3. CASH AND CASH EQUIVALENTS

This account consists of the following:

	<u>2009</u>	<u>2008</u>
Cash on hand and in banks	24,907,074,181	8,517,775,380
Cash equivalents – Privatization proceeds	37,066,242,949	3,260,352,693
– Others	58,926,725	3,460,970,071
	<u>62,032,243,855</u>	<u>15,239,098,144</u>

Cash on hand and in banks increased due to the transfer of power bills collections to PSALM from NPC. The increase also pertains to the balance of the ₱46.67 billion proceeds from the issuance of US\$1.0 billion 10-year global bonds in May 2009 as well as the new cash component of the 2024 Bonds (part of the New Global Bonds exchanged for the Old Bonds) amounting to US\$600 million.

Cash equivalents includes the short-term placement with the Bangko Sentral ng Pilipinas (BSP), Land Bank of the Philippines (LBP) and Development Bank of the Philippines (DBP) of the balances of the proceeds from the sale of generation plants and the Commencement Fee of ₱46.28 billion and first deferred payment of ₱5.95 billion from the privatization of TransCo and short-term time deposits of regular funds.

4. POWER RECEIVABLES

This account is composed of receivables from the following entities:

	<u>2009</u>	<u>2008</u>
Utilities	63,682,955,199	55,201,243,406
Cooperatives	14,052,854,056	13,195,757,481
Industries	6,227,138,389	6,015,997,774
Government	8,959,187,282	13,789,471,290
Others	2,184,368,075	2,296,920,188
Total	95,106,503,001	90,499,390,139
Allowance for bad debts	(11,217,938,525)	(10,981,380,518)
	83,888,564,476	79,518,009,621
Refunds	(10,222,989,877)	(20,969,621,752)
	73,665,574,599	58,548,387,869
Current	71,177,621,036	58,023,697,436
Non-current	2,487,953,562	524,690,433

Power receivables consists of the trade collectibles for the power generation charges, including ancillary service charges, universal charges and restructured power receivables, net of refunds to power customers as a result of ERC decisions.

The basic power generation rate is based on a return-on-rate-base (“RORB”) method with time-of-use pricing. The RORB method takes a ratio (calculated as a percentage of investment in facilities and working capital necessary for day to day operations, or “rate base”) of rate base to determine the return on rate base that will be considered together with the operating costs in determining the generation charge.

PSALM and NPC jointly filed the Application for a revised basic generation charge in Luzon, Visayas and Mindanao grids with the ERC on 16 January 2009, docketed as ERC Case No. 2009-004RC. The revised basic generation charge application sought, among others, the issuance of a provisional authority and for an automatic adjustment in the succeeding quarters of the basic generation charges, to reflect the impact of the sale, transfer and disposal of NPC generation assets.

An Order dated 16 February 2009 was issued by the ERC, provisionally approving the implementation of the following new generation rate adjustments effective March 2009 billing period:

GRID	Provisionally Approved Generation Rate (PhP/kWh)	Provisionally Approved Rate Increase (PhP/kWh)
Luzon	4.3648	0.4682
Visayas	4.0339 *	1.1460 *
Mindanao	2.8177	0.7147

* On 23 March 2009, the ERC issued an Order modifying the 16 February 2009 Order and provisionally authorizing NPC and PSALM to implement, for the Visayas grid, a ₱0.8376 per kWh rate increase, instead of ₱1.1460 per kWh, effective 26 February to 25 March 2009 billing. Thus the new basic generation rate for Visayas, as provisionally approved by the ERC, is ₱3.7255/kWh.

The ERC provisional authority (PA) issued 16 February 2009 was implemented starting the March 2009 billing period. The provisional rates may still be revised depending on the outcome of hearings being conducted on the rate applications as well as additional evidence to be submitted by applicants and intervenors.

On 14 August 2008, PSALM submitted to the ERC its Proposed Rules for the Automatic Recovery of NPC/PSALM's Generation Assets' Monthly Fuel, Purchased Power and Foreign Exchange-Related Costs. After several consultative processes, the ERC passed Resolution No. 19 dated 3 August 2009 adopting the Rules for Automatic Recovery of Monthly Fuel and Purchased Power Costs and Foreign Exchange-Related Costs. This effectively replaced the existing GRAM and ICERA guidelines, thus eliminating the need for PSALM and NPC to file for cost recoveries every quarter and await a decision from the ERC before passing the costs to customers. However, on 12 November 2009, PSALM filed a Motion for Clarification of the Rules. Acting on the said Motion, the ERC issued an Order dated 14 December 2009 amending the Rules. The Rules shall take effect on 27 February 2010. The Automatic Cost Adjustment Mechanism (ACAM) based on these Rules shall be reflected as a separate item in the power bill starting 27 February – 25 March 2010 billing period.

Power receivables - utilities consists substantially of receivables from Meralco of ₱36.079 billion representing penalty on below contracted demand/energy for the period covering 2001 to 2004 which Meralco deducted from its power bill payments to NPC. This resulted in a dispute between the parties. In February 2002, the parties entered into negotiation to settle the dispute and on 15 July 2003, signed a Settlement Agreement.

Under the SA, Meralco shall pay NPC ₱27.5 billion representing the difference between the contracted energy for the years 2002 to 2004 and the total energy Meralco bought from January 2002 to April 2003, subject to adjustment from the date of signing of the SA and the energy that Meralco

will purchase from NPC for the rest of 2003 and 2004. On the other hand, NPC shall credit Meralco for transmission delays as well as for energy corresponding to NPC's sales to directly-connected customers located in Meralco's existing franchise areas, totaling ₱7.5 billion. The net payable of Meralco to NPC amounted to ₱20.05 billion.

In ERC Case No. 2004-109 dated 14 September 2009, the Joint Application for approval of the SA between Meralco and NPC is temporarily archived by the ERC until further notice. This was due to the challenge brought up on the validity of the SA by the Office of the Solicitor General (OSG) based on the following grounds:

- a. That the SA, being a compromise of reciprocal claims between NPC and Meralco, should have been submitted to the OSG for approval;
- b. That the NPC Board had no authority to compromise the NPC's claims mentioned in the SA, which only the COA had the power to compromise in behalf of the NPC; and
- c. That the SA is grossly disadvantageous and prejudicial to the government.

Meralco moved that the ERC issue an Order suspending its consideration of the application for pass-through until after it has commenced and completed proceedings in the regular courts for the adjudication of the issues the OSG has raised on the validity of the SA. This "Manifestation and Motion to Suspend Proceedings" filed by Meralco on 4 June 2008 was granted by ERC in the same ERC Case No. 2004-109.

Refunds represent billing adjustments (in the form of reductions in future power bills) arising from the ERC Orders.

The recognition of the refunds was based on Deferred Accounting Adjustments (DAAs), which were approved by the ERC in accordance with the existing Generation Rate Adjustment Mechanism (GRAM) and Incremental Currency Exchange Rate Adjustment (ICERA) Guidelines dated February 24, 2003.

For CY 2009, PSALM filed with the ERC the following GRAM and ICERA DAA applications for the recovery of incremental fuel and purchased power costs and fluctuation in currency exchange rates. The rate applications are still pending resolution before the ERC.

	Period Covered	Date Filed	TOTAL (₱)
I. GRAM			
13 th GRAM	October 2008 to December 2008	25 May 2009	7,665,888,400
14 th GRAM	January 2009 to March 2009	29 July 2009	9,489,887,680

Total			<u><u>17,155,776,080</u></u>
II. ICERA			
12 th ICERA	October 2008 to December 2008	25 May 2009	(11,764,716,034)
13 th ICERA	January 2009 to March 2009	29 July 2009	1,053,256,117
Total			<u><u>(10,711,459,917)</u></u>
TOTAL GRAM & ICERA			<u><u>6,444,316,163</u></u>

The approved amount (whether a refund or a recovery) is being monitored on a monthly basis by multiplying the approved rate per kWh by the sales volume for the month. The monthly resulting amounts are tracked until their total equals the approved amount.

5. PRIVATIZATION RECEIVABLES

	<u>2009</u>	2008
Asset sale receivable	12,298,689,887	2,910,259,468
Concession receivable	132,113,562,581	
IPPA receivable	241,002,108,951	
	<u>385,414,361,419</u>	<u>2,910,259,468</u>
Less non-current portion:		
Asset sale receivable	10,703,733,298	2,455,420,854
Concession receivable	124,240,584,375	
IPPA receivable	239,330,453,504	
	<u>374,274,771,177</u>	<u>2,455,420,854</u>
Current portion		
Asset sale receivable	1,594,956,589	454,838,614
Concession receivable	7,872,978,206	
IPPA receivable	1,671,655,447	
	<u>11,139,590,242</u>	<u>454,838,614</u>

Asset sale receivable includes the balance of the sales price of US\$129 million (P6.338 billion) on the sale of the 112 MW Pantabangan-Masiway Hydro-electric Power Plant complex to the First Generation Hydro Power Corporation (First Gen). The sales price is payable by First Gen as follows: 40% cash upfront and the 60% balance payable in 14 equal semi-annual payments with an interest of 12% per annum starting 17 May 2007. Amounts falling due in May and November of the succeeding year are presented separately as current assets. Also included under this account is the balance of the sales price of US\$361.71 million for the 600 MW Calaca Coal-Fired Thermal Power Plant, likewise, payable in 14 equal semi-annual payments with interest at 12% p.a. starting 02 June 2010.

Concession receivable refers to the 75% balance (amounting to US\$2.9625 billion or ₱126.647 billion) of the Concession Fee of US\$3.95 billion, payable with interest in semi-annual deferred payments falling on the 15th of January and July of each year for 20 years. Deferred payments falling due in the succeeding year are presented separately as current assets.

Initially, the interest rate applicable to the deferred payments shall be fixed until the last semi-annual payment date of the Second Regulatory Period to equal to the Philippine Dealing System (PDS) Treasury Fixing or “PDST-F” 10 year benchmark rate as published by the Philippine Dealing and Exchange Corporation on the Market page of the PDEX System (the “10 Year PDST-F Rate”) at approximately 11:16 am on a date one month before the Bid Date plus 230 basis points (2.3%). Thus, the interest rate for the Deferred Payments within the Second Regulatory Period is 9.3992% (7.0992% PDST-F plus 2.3%)

After the end of the Second Regulatory Period, the interest rate shall be adjusted for the next Regulatory Period and every Regulatory Period thereafter, and such adjusted interest rate shall be applicable for each Deferred Payment falling due during the relevant Regulatory Period. The adjusted interest rate shall be equal to the 10 year PDST-F Rate at approximately 11:16 am two (2) business days before the semi-annual payment date on which an adjustment is to take effect plus 230 basis points.

If the 10 year PDST-F Rate ceases to be published or is not available, PSALM may substitute such other benchmark rate as, in its opinion, reasonably reflects the yield on 10 year Philippine Government debt securities.

IPPA receivable represents the aggregate of the monthly payments by the appointed IPPAs for the contracted capacities of the Sual (₱168.36 billion) and Pagbilao (₱117.59 billion) IPPs. The monthly payments have both dollar and peso components.

6. DUE FROM GOVERNMENT AGENCIES

	2009	2008
Bureau of Internal Revenue	40,921,454,568	24,613,261,889
San Roque Multi-purpose Project	25,004,165,657	24,237,729,197
NPC – for reconciliation	10,635,799,802	9,624,513,512
National Government	4,157,749,422	4,077,091,491
Bureau of Customs	1,541,633,683	1,541,633,683
Advances to PGI	58,425,588	-

PHIVIDEC Industrial Authority	38,037,650	38,037,650
Department of National Defense	22,712,634	22,712,634
Others	19,324,545	10,783,084
	82,399,303,549	64,165,763,140

Due from government agencies includes claims from the following:

Bureau of Internal Revenue (BIR)

This account pertains mostly to taxes paid under protest in the amount of P10.867 billion and input taxes of P27.459 billion.

The P3.813 billion portion of the receivable from the BIR pertains to the payment by PSALM of VAT on the sale of Pantabangan-Masiway and Magat power plants. The payment was made pursuant to a Memorandum of Agreement (MOA) by and among BIR, NPC, and PSALM.

The MOA provides, among others, that;

- (i) the above amount representing the basic VAT shall be remitted to BIR by NPC/PSALM under protest;
- (ii) the parties will refer the resolution of the tax issue to the appropriate courts or body;
- (iii) any resolution in favor of NPC/PSALM shall be immediately executory, that a favorable ruling from the Department of Justice (DOJ) shall be tantamount to the filing of an application for refund (in cash)/ tax credit certificate (TCC) at the option of NPC/PSALM, and that BIR undertakes to release the tax refund/TCC within 15 working days from issuance of the ruling; and
- (iv) in the event of failure by BIR to fulfill the undertaking referred to in (iii) above, NPC/PSALM shall assign to DOF its right to the refund of the subject remittance, and the DOF shall offset such amount against any liability of NPC/PSALM to the National Government pursuant to the objectives of the EPIRA on the application of the privatization proceeds.

The DOJ, in its 13 March 2008 Decision, declared null and void the imposition of the VAT on the privatization sale of Pantabangan-Masiway and Magat power plants and directed the BIR to refund to NPC/PSALM the amount paid under protest. The BIR filed a Motion for Reconsideration, which motion was denied by DOJ in its Order dated 14 January 2009.

San Roque Multi-Purpose Project

The P25.004 billion advanced by NPC to the San Roque Multi-Purpose Project (SRMP) arose from a Memorandum of Agreement (MOA) in 1998 by and between the Department of Finance (DOF), Department of Budget and

Management (DBM), Department of Environment and Natural Resources (DENR), Department of Public Works and Highways (DPWH), National Irrigation Administration (NIA), and NPC.

San Roque is a power project of NPC approved by the National Economic Development Authority (NEDA) as one of the projects for development by the Government. San Roque is located in San Manuel, at the lower Agno River in Pangasinan. The project was bid out by NPC on a Build-Operate-Transfer (BOT) basis which gave rise to a Power Purchase Agreement (PPA) between NPC and the Consortium (Marubeni Corporation, Sithe Philippine Holdings, Ltd., and Italian Thai Development Public Company, Limited). As signatory to this PPA, NPC becomes responsible for the disbursement of the cost of the non-power component of the Project estimated at \$400 million.

SRMP is the non-power component of the project. It is a project serving several purposes: (i) annual generation of 1000 GWh energy; (ii) irrigation of about 87,000 hectares service areas in Pangasinan; (iii) flood forecasting and control; and (iv) water quality and environmental protection. As the Project encompasses several functional areas, its implementation was a multi-agency effort with NPC tasked to lead in the Project development. To ensure that the agencies meet their obligations in the implementation of the Project and the terms of the PPA, the agencies entered into the MOA.

The MOA provided, among others, that:

1. DOF shall (i) secure the financing of the \$400 million for disbursement to the Consortium through NPC, (ii) ensure the timely transfer of the \$400 million fund to NPC, and (iii) ensure that the advances to be made by NPC for SMRP non-power component shall not be offset against any receivables of the Government from NPC;
2. NIA, DENR, DPWH shall (i) include SRMP as a priority project in their programs, (ii) cause the inclusion in their annual budget, over and above its ceiling, their share in the \$400 million non-power cost, (iii) give authority to DBM and BTr to remit funds directly to NPC's account; (iv) coordinate with NPC and the Consortium in the implementation of Project matters under their jurisdiction;
3. DBM shall ensure the inclusion of each agency's contribution to SRMP, as defined in the MOA, in the agencies' respective annual budgets from 1999 to 2000;
4. NPC shall, among others, disburse to the Consortium the \$400 million non-power component funding in accordance with the schedule.

Certain amendments to the above MOA were made in September 1998, major of which follow:

1. NPC to borrow for the \$400 million non-power component of the Project, with repayments to NPC made over the same debt service period as the said loan;
2. DOF shall secure the full government guarantee for the NPC financing of the \$400 million non-power cost component of SRMP;
3. Longer spread of the agency's budget allocation for the contribution to the \$400 million non-power component (from years 1999 to 2000 to years 1999 to 2014)

National Government

The amount due from the National Government substantially pertains to NPC's advances for the preservation and maintenance of the mothballed Bataan Nuclear Power Plant.

7. OTHER RECEIVABLES

The following comprise this account:

	2009	2008
Interest receivable	6,855,385,705	6,136,906,306
Due from officers & employees	768,614	963,964
Other receivables, net	5,025,965,400	2,633,244,162
	11,882,119,719	8,771,114,432

Interest receivable represents interest income accruing on short-term placements/time deposits with authorized government depository banks.

Other receivables is a transferred account from NPC consisting of receivables from various private corporations, government agencies, suppliers and persons, the nature of which is subject to validation upon disclosure of further details by NPC.

8. ASSETS HELD FOR SALE

This account represents the generation plants with a total carrying amount of ₱6.237 billion scheduled for privatization in 2010. PSALM is set to dispose of the following generation plants, two of which represent packaged combinations – the Bacon-Manito Geothermal Power Plants (GPP) and the Navotas I & II Diesel Power Plants (DPP). With five of the six decommissioned plants already sold, the remaining Sucat Thermal Power Plant (TPP) and Land-Based Gas Turbine (LBGT) Power Plants are scheduled for privatization in 2010.

<u>Generating Plants</u>	<u>Bid Schedule</u>
Angat HEPP	April 2010
Bacon-Manito GPP	May 2010
Navotas 1 & 2 DPP	June 2010
Sucat LBGT & TPP 1, 2, 3, 4 (Decom)	Sept 2010

The 86.6% decrease in the 2009 balance (from ₱ 46.667 billion in 2008 to ₱ 6.237 billion in 2009) is attributable mainly to the sale of the assets. Also, the listing of the assets for sale varies as this is dependent on PSALM's privatization plan as approved by the Board.

9. OTHER CURRENT ASSETS

This account consists of the following:

	<u>2009</u>	<u>2008</u>
Assets in trust with NPC	12,392,156,293	22,717,203,947
Guaranty deposits	618,631,974	707,764,552
Inventory and prepaid expenses	5,678,668	5,718,658
	13,016,466,935	23,430,687,157

Assets in trust with NPC represents current assets held by NPC as part of its working capital as "Operator" under the Operations and Management Agreement with PSALM.

Guaranty deposits includes the marginal and guaranty deposits for Letters of Credit and for the Nomura bonds issuance.

10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of PSALM-acquired and NPC-transferred property, plant and equipment, as follows:

PSALM –acquired:

	Furniture, Fixtures/ Equipment	Transportation Equipment	Total
COST			
1 Jan 2009	143,426,944	13,154,968	156,581,912
Additions/Adjustments	12,138,144	2,668,750	14,806,894
31 Dec 2009	155,565,089	15,823,718	171,388,806
ACCUM DEPRECIATION			
1 Jan 2009	84,039,307	6,887,962	90,927,269
Provision/ Adjustment	11,036,891	1,810,127	12,847,018
31 Dec 2009	95,076,198	8,698,089	103,774,287
Carrying amount, 31 Dec 2009	60,488,890	7,125,629	67,614,519
Cost	143,426,944	13,154,968	156,581,911
Accum. Depreciation	84,039,307	6,887,962	90,927,269
Carrying amount, 31 Dec 2008	59,387,637	6,267,006	65,654,643

NPC—transferred assets:
(In million pesos)

	Electric Plants in Service	Electric Plants Leased to Others	Other Utility Plants	Non-Utility Properties	Total
COST					
1 Jan 2009	113,070	14,578	-	12,843	140,491
Additions/Adjustments	20,296	(286)	510	5,345	25,865
Balance, 31 Dec 2009	133,366	14,292	510	18,188	166,356
ACCUM DEPRECIATION					
1 Jan 2009	82,110	13,283	-	12,563	107,956
Provision/ Adjustment	17,008	(78)	426	4,644	22,000
31 Dec 2009	99,118	13,205	426	17,207	129,956
Carrying amount, 31 Dec 2009	34,248	1,087	84	981	36,400
Cost	113,070	14,578	-	12,843	140,491
Accum. Depreciation	82,110	13,283	-	12,563	107,956
Carrying amount, 31 Dec 2008	30,960	1,295	-	280	32,535

11. BOT ELECTRIC PLANTS UNDER CAPITAL LEASE

This account represents the total computed capacity fees of Build-Operate-Transfer (BOT) projects for the duration of the cooperation period, as follows:

Plant	Total Capacity fee	Accumulated Amortization	Net
Ilijan Nat Gas (1200 Mw)	107,387,216,363	32,452,878,665	74,934,337,698
CBK-Kalayaan 2 Unit 3 (177.5 Mw)	17,387,881,744	2,644,407,015	14,743,474,729
CBK-Kalayaan 2 Unit 4 (177.5 Mw)	17,387,881,744	2,644,407,015	14,743,474,729
Bauang (FFPC) (215 Mw)	16,811,841,026	12,345,141,369	4,466,699,657
San Roque Multi-Purpose Plant (345 Mw)	92,954,875,257	15,492,479,210	77,462,396,047
Bakun I (35 Mw)	24,500,769,930	10,719,086,844	13,781,683,086
Bakun II (35 Mw)	24,500,769,930	11,331,606,093	13,169,163,837
STEAG/Mindanao Coal Fired I (100 Mw)	13,738,656,531	1,798,629,830	11,940,026,701
STEAG/Mindanao Coal Fired 2 (100 Mw)	13,660,516,257	1,697,792,433	11,962,723,824
31 December 2009	328,330,408,782	91,126,428,474	237,203,980,308
31 December 2008	677,739,657,801	220,961,801,411	456,777,856,390

The 108 MW Enron Subic Diesel Power Plant was formally turned over by NPC/PSALM to the Subic Bay Metropolitan Authority (SBMA) effective 23 February 2009 upon the expiration of the BOT Agreement between Subic Power Corporation and NPC and the Ground Lease Agreement (GLA) between NPC and SBMA.

The turn-over was in conformity with Opinion No. 238 s. 2008 dated 16 October 2008 issued by the Office of the Government Corporate Counsel (OGCC) which provided, among others, that:

- Ownership of the Subic Power Station will be transferred from ENRON to NPC at the end of the cooperation period under the BOT Agreement, and from NPC to SBMA at the termination of the GLA.
- The Subic Power Station is not subject to privatization under the EPIRA since it is not “disposable” property of NPC within the ambit of the law.

12. INVESTMENT IN TRANSCO

This account represents the difference between the NPC assets and liabilities transferred to TransCo upon its separation from NPC and which represents PSALM's equity investment in TransCo. As provided for in the

EPIRA, TransCo is wholly-owned by PSALM, which assumed the foreign loan obligations related to the transmission assets. In 2009, this account increased by ₱69.8 billion due mainly to the recognition of TransCo's appraisal capital as part of PSALM's equity in TransCo. The balance is subject to reconciliation with TransCo's reciprocal account *Equity from PSALM* due to mainly to differences in booking the payments to Hyundai Corporation and the various adjustments made by Transco in its books. The payments to Hyundai Corporation are for the Maranag-Bunawan Transmission and Northern Panay Backbone Projects pending the effectivity of the Credit Agricole Corporate and Investment Bank Facility (Calyon Facility), which should have funded these projects.

13. ASSUMED RURAL ELECTRIFICATION PROGRAM (REP) LOANS

Section 60 of the EPIRA provides that all outstanding financial obligations of the electric cooperatives (ECs) to NEA and other government agencies incurred for the purpose of financing the REP shall be assumed by PSALM in accordance with the program approved by the President of the Philippines within one (1) year from the effectivity of the Act which shall be implemented and completed within three (3) years from the effectivity of the Act. Section 2, Rule 31 of the Implementing Rules and Regulations of EPIRA states that the assumption covers all outstanding REP-related financial obligations of the ECs as of 26 June 2001.

The Act also provides that ERC shall ensure a reduction in the rates of ECs commensurate with the resulting savings due to the removal of the amortization payments of their loans. However, any EC which shall transfer ownership or control of its assets, franchise or operations within five years shall repay PSALM the total debts including accrued interests thereon.

To carry out the aforementioned objective and that of Executive Order (EO) No. 119, Restructuring Program for Electric Cooperatives, PSALM and NEA entered into a Memorandum of Agreement (MOA) on 3 October 2003 to lay down the operational legal framework upon which the financial obligations of ECs to NEA shall be lawfully assumed by PSALM. Article IV of the MOA provides that repayment of the assumed loan shall be for the period of 10 years in accordance with the amortization schedule as may be mutually agreed by the parties.

The condonation was subject to compliance with certain conditions required under Executive Order (EO) No. 119. On 2 September 2006, EO 460 was issued amending EO 119 by giving retroactive effect to the effectivity of the assumption by PSALM of the rural electrification loan obligations of the ECs to NEA and other government agencies.

The total amount of ECs' obligations to NEA assumed by PSALM amounted to ₱17.978 billion. The obligations of ECs to local government units and other government agencies amounted to ₱0.096 billion, putting the total loans assumed to-date by PSALM at ₱18.074 billion. Of this amount, the following remain outstanding:

	2009	2008
Current portion	3,363,769,334	2,936,245,026
Non-current	4,557,916,830	6,355,711,966
Total	7,921,686,164	9,291,956,992

These assumed loans were previously recognized as asset and liability at the same time. The asset is amortized annually. However, with the recommendation by COA to close the recognized asset as a deduction from the Capital from Asset-Debt Transfer account, only the liability account remains in the books.

14. OTHER NON-CURRENT ASSETS

This account consists of the following:

	2009	2008
Stored energy- Leyte A & B	5,823,343,304	5,823,343,304
Other non-current receivables, net	4,523,050,806	3,060,575,843
Stored fuel – Ilijan natural gas	1,422,738,875	28,861,981,853
Universal charge (UC)	992,529,649	1,428,726,949
Various	2,446,499,991	223,934,720
	15,208,162,625	39,398,562,669

Stored energy refers to advance payments made to PNOC-EDC for the cost of contracted steam energy for Leyte A & B.

Other non-current receivables substantially consists of the receivable from Metropolitan Waterworks and Sewerage System (MWSS) which have accumulated since 1992. The amount represents energy and capacity losses incurred by the Angat Hydroelectric Power Plant (AHEPP) due to the implementation of MWSS' Angat Water Supply Optimization Project (AWSOP). The Memorandum of Understanding between NPC and MWSS on 9 February 1990 provides that MWSS shall compensate NPC the energy and capacity losses, if any, which the latter may incur as a result of the operation of the former's Auxiliary Unit No. 5.

Stored Fuel represents the difference between the actual gas lifted by NPC versus the contracted volume per the Gas Supply and Purchase Agreement with Shell Philippines Exploration B. V. (SPEX). The decrease of P27,439,242,978 in 2009 was due to the sale to PNOC of a portion of the banked gas funded by DOE/BTr.

Universal charge refers to the charge imposed on all electricity end-users for various purposes as enumerated in Note 1. In May 2003, ERC approved the P0.0025/kWh for UC-watershed management. The UC for missionary electrification was first approved at P0.0168 effective February 2003 and increased to P0.0373/kWh effective July 2003.

At year-end, the composition of UC fund is as follows:

	2009	2008
Special Trust Fund (STF)	590,531,270	889,125,235
Receivables	401,998,379	539,601,714
	992,529,649	1,428,726,949

Transactions affecting the UC are as follows (cumulative) since March 2003:

	2009	2008
Remittances by collecting entities (CEs):		
For missionary electrification	11,320,671,050	9,208,332,051
For watershed rehabilitation	743,396,074	620,453,600
Others (no identification of specific purpose)	226,081	226,080
	12,064,293,205	9,829,011,731
Interest earnings	135,422,136	122,156,626
	12,199,715,341	9,951,168,357
Disbursements to NPC	(11,609,184,071)	(9,062,043,122)
STF balance	590,531,270	889,125,235
Receivables from CEs	401,297,586	539,005,486
Interest receivable	700,793	596,228
	992,529,649	1,428,726,949

Disbursements to NPC represents disbursements for missionary electrification of P9.24 billion, watershed of P0.34 billion, and DAA for ICERA and GRAM of P2.03 billion. *Receivables from CEs* pertains to the difference between the reported collections of CEs versus their remittances to PSALM.

The same amount of UC is presented under Other Long-Term Liabilities in Note 18.

15. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Below is the breakdown of the account:

	<u>2009</u>	<u>2008</u>
Accounts payable		
Check vouchers payable	10,589,944,486	11,551,749,442
Accounts payable - others	10,545,959,840	35,233,150,627
Fuel payables	7,678,156,177	3,115,749,093
Materials, supplies, equipment payables	491,465,709	860,828,295
Interest payable	10,246,226,458	9,565,259,208
Current portion – fixed O&M payable	3,034,390,973	-
Performance/bidders bonds	837,034,558	231,248,716
Due to officers & employees	498,235,454	58,205,320
Guaranty deposits payable	388,235,053	508,695,660
Other payables		
Guaranty fees payable	2,841,431,506	4,183,994,724
Financial assistance/benefits payable		
	1,044,658,646	883,482,654
Suppliers and contractors	960,448,393	29,529,322
Various	3,437,652	3,443,822
	49,159,624,905	66,225,336,883

16. BOT LEASE OBLIGATION

This account pertains to the liability set up for capital cost recovery fees of the BOT power plants during the cooperation period indicated in the BOT contracts.

	<u>2009</u>	<u>2008</u>
Total lease obligation	441,541,885,613	487,876,887,631
Less current portion	34,044,161,197	36,182,630,879
Non-current	407,497,724,416	451,694,256,752

17. LONG-TERM LIABILITIES

This account consists of:

	2009	2008
Bonds payable	275,650,171,114	214,733,927,376
Loans payable	46,176,636,147	86,124,001,305
Other long-term liabilities	6,804,712,855	35,968,531,360
	328,631,520,116	336,826,460,041
Less bond discount	6,606,799,251	10,794,564,776
Net	322,024,720,865	326,031,895,265
Less current portion	43,019,049,633	50,252,876,459
Long-term	279,005,671,232	275,779,018,807

On a per bank/creditor basis, the amounts are summarized as follows:

	2009	2008
DBP/Morgan Stanley and UBS AG	55,627,200,000	-
Bank of New York/JP Morgan Chase Manhattan	52,563,085,000	54,082,775,000
Deutsche Bank	49,632,024,876	71,227,500,000
HSBC/Deutsche/Morgan	46,356,000,000	-
Bureau of Treasury	34,861,000,000	38,613,000,000
Citibank	26,677,432,680	39,504,700,000
Int'l Bank for Reconstruction and Dev't	11,258,699,020	14,089,134,555
Eximbank of Japan	10,224,544,604	12,896,683,445
US Bank	9,933,428,558	11,305,952,376
Asian Development Bank	8,819,821,690	10,499,244,261
Kreditanstalt fur Wiederaufbau	7,869,632,459	8,169,007,897
Overseas Economic Cooperation Fund	3,712,630,410	4,244,439,155
Japan Bank for International Cooperation	3,358,237,502	3,816,088,342
National Government	3,151,327,236	3,322,310,817
Instituto de Credito Oficial	1,073,838,634	1,244,024,282
Natixis/Credit National	1,024,683,186	1,144,865,889
Caliraya-Botocan-Kalayaan Power Corporation	886,441,683	1,210,707,950
Nordic Investment/Development Fund	465,775,305	625,780,896
Artigiancassa MCA	345,265,523	707,348,640
Eximbank of Korea	301,849,223	305,550,909
Banco de Oro/Development Bank of Phils.	250,000,000	350,000,000
Department of Energy	199,143,936	28,297,252,592
US Agency for International Development	39,458,591	48,088,129
Bank of Tokyo-Mitsubishi UFJ	-	10,859,680,000

Erste Bank Osterreichischen	-	262,324,906
Land Bank of the Phils./Development Bank of the Phils	-	20,000,000,000
	328,631,520,116	336,826,460,041
Less bond discount	6,606,799,251	10,794,564,776
Net	322,024,720,865	326,031,895,265

Further details of the account follow:

<u>CREDITOR / PROJECT</u>	<u>MATURITIES</u>	<u>INTEREST RATES</u>	<u>CURR</u>	<u>ORIGINAL CURRENCY</u>	<u>2009</u>	
Asian Development Bank						
1288- PHI	Power Transmission Project	1997 to 2013	Cost of Qualified Borrowings	USD	47,456,213.74	2,199,880,244
1474- PHI	Leyte-Mindanao Interconnection Project	2000 to 2011	Cost of Qualified Borrowings	USD	1,250,337.98	57,960,667
1590- PHI	Power Transmission Reinforcement Project	2002 to 2017	Cost of Qualified Borrowings	USD	28,416,954.80	1,317,296,357
1662- PHI	Power Sector Restructuring Program	2002 to 2013	Cost of Qualified Borrowings	USD	50,000,000.00	2,317,800,000
1984- PHI	Electricity Market & Transmission Development Proj.	2009 to 2022	LIBOR + 0.60%	USD	34,406,560.05	1,594,950,498
SPIA	Special Project Agreement	1991 to 2026	FIXED at 9.65%	USD	28,459,465.00	1,319,266,960
#624P	Mindanao Power Project	1999 to 2011	FIXED at 7%	USD	273,254.04	12,666,964
International Bank for Reconstruction and Development						
3163- 0-PH	Energy Sector Loan	1995 to 2010	Cost of Qualified Borrowings + 0.50%	USD	10,965,000.00	508,293,540
3626- PH	Power Transmission Project	1999 to 2013	Cost of Qualified Borrowings + 0.50%	USD	19,215,651.80	890,760,755
3700- 0-PH	Leyte-Cebu Geothermal	1999 to 2014	Cost of Qualified Borrowings + 0.50%	USD	53,269,195.65	2,469,346,834
3700- A-PH	Leyte-Cebu Geothermal	1999 to 2014	Cost of Qualified Borrowings + 0.50%	USD	5,239,946.57	242,902,798
3746- 0-PH	Leyte-Luzon Geothermal	1999 to 2014	Cost of Qualified Borrowings + 0.50%	USD	37,142,542.73	1,721,779,711
3746- A-PH	Leyte-Luzon Geothermal	1999 to 2014	Cost of Qualified Borrowings + .50%	USD	4,234,009.83	196,271,760
3996- 0 PH	Transmission Grid Reinforcement Project	2001 to 2016	Cost of Qualified Borrowings + 0.50%	USD	18,978,577.72	879,770,948
3997- 0 PH	Transmission Grid Reinforcement Project	2001 to 2016	LIBOR + 0.50%	USD	60,548,606.15	2,806,791,187
296- PHI	Bataan Thermal 2	1982 to 2022	Service Charge at 0.75%	USD	3,755,973.41	174,111,903
3996- A-PH	Transmission Grid Reinforcement Project	2001 to 2016	Cost of Qualified Borrowings + 0.50%	JPY	1,632,706,356.00	825,986,145
4887- PH	Bicol Power Restoration Project	2008 to 2025		USD	11,706,865.11	542,683,439
Overseas Economic Cooperation Fund (OECF)						
PH-C8	Extra High Voltage Transmission Line Project 1&2	1989 to 2004	FIXED at 3.50%	JPY	5,361,445,783.13	2,712,355,422
PH-	Cagayan Electrification	2002 to 2012	FIXED at 3.20%	JPY	237,700,534.00	120,252,700

009						
PH-013	Abulog River Hydro Electric Power	2002 to 2012	FIXED at 3.20%	JPY	28,705,022.00	14,521,871
PH-029	Power Plant Barge Project 1	2002 to 2012	FIXED at 3.20%	JPY	303,676,924.00	153,630,156
PH-031	Tongonan Geothermal Mindanao	2002 to 2012	FIXED at 3.20%	JPY	276,987,019.00	140,127,733
PH-043	Transmission Line Project	2002 to 2012	FIXED at 3.20%	JPY	143,647,036.00	72,671,035
PH-048	Extra High Voltage Transmission Line Project 1	2002 to 2012	FIXED at 3.20%	JPY	667,165,642.00	337,519,098
PH-057	Extra High Voltage Transmission Line Project 2	2002 to 2012	FIXED at 3.20%	JPY	92,949,287.00	47,023,044
PH-065	Power Plant Barge Project 2	2002 to 2012	FIXED at 3.20%	JPY	226,387,332.00	114,529,351
Japan Bank for International Cooperation						
	Electricity Market & Transmission Dev't Project	2009 to 2022	Tokyo Swap Reference Rate + 1.25%	JPY	2,994,735,034.00	1,515,036,454
	Leyte-Cebu Interconnection Upgrading Project	2006 to 2015	FIXED at 3.69%	JPY	3,643,409,860.00	1,843,201,048
Eximbank of Japan						
ESPL	Energy Sector Loan	1995 to 2010	Long-Term Prime Rate	JPY	269,635,473.00	136,408,586
	Leyte-Luzon Interconnection Project	1999 to 2014	Long-Term Prime Rate + 0.20%	JPY	1,716,994,130.00	868,627,330
Series A	San Roque Multi-Purpose Project	2004 to 2014	Long-Term Prime Rate + 0.20%	JPY	9,762,882,000.00	4,939,042,004
Series B	San Roque Multi-Purpose Project	2004 to 2014	LIBOR + 0.90%	USD	92,339,000.00	4,280,466,684
Kreditanstalt fur Wiederaufbau						
87652	Sucacat 1&4					
24	Rehabilitation Project	1998 to 2018	FIXED at 6.50%	EUR	9,995,756.32	666,363,096
88651						
64	Various Spare Parts	1999 to 2019	FIXED at 3.50%	EUR	5,590,594.90	372,694,773
91654	Sucacat 2&3					
32	Rehabilitation Sucacat 2&3	2002 to 2032	FIXED at 9.0%	EUR	22,635,914.15	1,509,014,162
	Rehabilitation (Additional)					
	Sucacat/Sta.Mesa/Balint	2006 to 2036	FIXED at 7.0%	EUR	5,689,656.08	379,298,646
91658	awak Transmission Project					
61	Sucacat/Sta.Mesa/Balint	2006 to 2023	FIXED at 9.0%	EUR	12,343,608.61	822,881,731
91658	awak Transmission Project					
61	Northern Luzon Generation & Transmission Proj.	2006 to 2033	FIXED at 9.0%	EUR	26,701,195.91	1,780,024,545
	Northern Luzon Generation & Transmission Proj.	2010 to 2035	FIXED at 7.50%	EUR	22,804,494.32	1,520,252,492
	Northern Luzon Generation & Transmission Proj.	2006 to 2025	FIXED at 7.50%	EUR	42,072.13	2,804,721
	Energy Sector Loan	2008 to 2035	FIXED at 7.0%	EUR	12,244,853.99	816,298,293
Natixis/Credit National						
1528	Navotas Gas Turbine	1997 to 2016	FIXED at 5.45%	EUR	6,402,858.70	426,844,014
1543	Sucacat Gas Turbine	1999 to 2019	FIXED at 5.45%	EUR	2,080,929.03	138,724,302

467-OA1	Pielstick for Diesel Power Plant	2000 to 2022	FIXED at 3.0%	EUR	1,950,029.50	129,997,937
467-OB1	Bataan Gas Turbine	1999 to 2020	FIXED at 3.0%	EUR	3,652,047.76	243,462,303
747-OD1	Northern Luzon 230KV Transmission Line	2001 to 2016	FIXED at 3.10%	EUR	1,284,859.28	85,654,630
Instituto de Credito Oficial						
	Palawan Backbone Transmission Line	2003 to 2013	FIXED at 2.0%	USD	6,433,333.46	298,223,606
	200MW Mindanao Barge	2003 to 2023	FIXED at 1.25%	USD	16,731,707.39	775,615,028
Nordic Investment/ Development Fund						
	Leyte-Cebu HV Interconnection Project	2005 to 2034	Service Charge at 0.75%	EUR	3,767,616.87	251,166,672
PIL95/1	Leyte-Cebu HV Interconnection Project	2000 to 2014	LIBOR + 0.85%	USD	3,379,576.18	156,663,633
	Leyte-Cebu HV Interconnection Project	2000 to 2010	LIBOR + 0.65%	USD	1,250,000.00	57,945,000
Eximbank of Korea						
94-2063	Transmission & Substation Project in Luzon	2004 to 2018	FIXED at 3.50%	KRW	3,708,550,000.00	147,229,435
	Mindanao Power Transmission	2002 to 2017	FIXED at 3.50%	KRW	3,894,705,000.00	154,619,788
National Government						
	New Money Bond (B)	1997 to 2009	LIBOR + 0.8125%	USD	67,981,000.00	3,151,327,236
Deutsche Bank						
	Leyte Interconnection Project	2009	FIXED at 9.75%	USD		
	General Funding Requirements	2011	LIBOR + 4.25%	USD	292,533,000.00	13,560,659,748
	General Funding Requirements	2011	LIBOR + 4.25%	USD	100,000,000.00	4,635,600,000
	General Funding Requirements	2016	FIXED at 6.875%	USD	500,000,000.00	23,178,000,000
	General Funding Requirements	2010	FIXED at 9.875%	USD	178,138,000.00	8,257,765,128
Citibank						
	General Funding Requirements	2010	FIXED at 9.467%	USD	44,530,000.00	2,064,232,680
	General Funding Requirements	2010	FIXED at 10.09%	USD	400,000,000.00	18,542,400,000
	General Funding Requirements	2015	FIXED at 4.65%	JPY	12,000,000,000.00	6,070,800,000
Bank of New York/JP Morgan Chase Manhattan						
	General Funding Requirements	2016	FIXED at 8.40%	USD	160,000,000.00	7,416,960,000
	General Funding Requirements	2028	FIXED at 9.625%	USD	300,000,000.00	13,906,800,000
	General Funding Requirements	2020	FIXED at 3.22%	JPY	24,750,000,000.00	12,521,025,000
	General Funding Requirements	2022	FIXED at 3.55%	JPY	37,000,000,000.00	18,718,300,000

US Bank

General Funding Requirements	2008 to 2018	FIXED at 5.40%	USD	214,285,714.00	9,933,428,558
Bureau of Treasury					
General Funding Requirements	2009	MART + 0.50%	PhP	3,752,000,000.00	-
General Funding Requirements	2011	MART + 0.625%	PhP	8,800,000,000.00	8,800,000,000
General Funding Requirements	2012	FIXED at 9.875%	PhP	11,000,000,000.00	11,000,000,000
General Funding Requirements	2010	FIXED at 9.125%	PhP	2,061,000,000.00	2,061,000,000
General Funding Requirements	2012	FIXED at 10.375%	PhP	3,000,000,000.00	3,000,000,000
General Funding Requirements	2011	FIXED at 5.25%	PhP	3,680,000,000.00	3,680,000,000
General Funding Requirements	2016	FIXED at 5.875%	PhP	6,320,000,000.00	6,320,000,000
Caliraya-Botocan-Kalayaan Power Corporation					
General Funding Requirements	2006 to 2016		USD	19,122,480.00	886,441,683
Artigiancassa MCA					
Bacon-Manito Geothermal	2001 to 2010	FIXED at 1.50%	USD	7,448,129.99	345,265,523
US Agency for International Development					
492-H-032 Tiwi Geothermal 1&2	1985 to 2015	FIXED at 3.0%	USD	761,233.93	35,287,760
492-H-032 Tiwi Geothermal 1&2	2002 to 2012	FIXED at 3.0%	USD	89,973.92	4,170,831
Banco de Oro/Development Bank of Phils.					
Leyte-Cebu Interconnection Uprating Project.	2006 to 2012	FIXED at 11.32%	PhP	250,000,000.00	250,000,000
Department of Energy					
Gas Sale and Purchase Agreement			PhP	199,143,935.86	199,143,935.86
HSBC/Deutsche/Morgan					
HSBC/Deutsche/Morgan \$1B	2019	FIXED AT 7.25%	USD	1,000,000,000.00	46,356,000,000
DBP/Morgan Stanley and UBS AG					
DBP/MS/UBS NEW CASH OFFER	2024	FIXED at 7.39%	USD	600,000,000.00	27,813,600,000
DBP/MS/UBS BOND EXCHANGE-2019	2019	FIXED AT 7.25%	USD	20,986,000.00	972,827,016
DBP/MS/UBS BOND EXCHANGE-2024	2024	FIXED at 7.39%	USD	579,014,000.00	26,840,772,984
Total long-term liabilities					328,631,520,116

18. OTHER LONG-TERM LIABILITIES

This account consists of the following:

	<u>2009</u>	<u>2008</u>
Liability for the fixed O&M	43,991,986,052	-
Deferred credits	1,223,259,999	604,850,732
Universal charge	992,529,649	1,428,726,949
Various	-	1,412,194
	<u>46,207,775,700</u>	<u>2,034,989,875</u>

Liability for the Fixed O&M pertains to the obligation of PSALM to the IPP for the fixed operating and maintenance expenses of the plants put under the IPP Administration Agreement. *Deferred credits* refers mostly to the unearned portion of (P1.08 billion) of the rent income from lease of land pertaining to sold plants. The details of the Universal Charge are in Note 14.

19. DUE TO GOCCs AND NATIONAL GOVERNMENT AGENCIES

This account consists of the following:

	<u>2009</u>	<u>2008</u>
Due to national government agencies	19,436,765,774	11,825,290,944
Due to GOCCs	6,094,264,493	11,590,084,446
	<u>25,531,030,267</u>	<u>23,415,375,390</u>

The amount due to National Government Agencies (NGAs) consists mostly of the liabilities to the BIR (P10.29 billion) and the National Treasury (P 9.11 billion).

The decrease of P5.5 billion in the amount due to GOCCs is due to the decrease of P2.6 billion in the liabilities of NPC to other agencies and the decrease of P2.9 billion in the reciprocal accounts with NPC brought about by the ongoing reconciliation of the accounts.

20. CAPITAL FROM ASSET-DEBT TRANSFER

This account pertains to the difference in the carrying amount of assets transferred from NPC to PSALM and TransCo and the amount of liabilities assumed by PSALM and TransCo. This includes the balances initially transferred in September 2008, the additional accounts transferred reflecting the October to December 2008 transactions, and the subsequent

adjustments related to the asset-debt accounts transfer. Since the fair value or the reserve price, in this case, of any of the assets held for sale is set only on bidding date, the assets held for sale are carried at cost on initial recognition in the books of PSALM. These costs which are lower than the assumed liabilities created the negative balance in the account. An asset appraisal is dispensed with for the assets for privatization since appraised values are not crucial consideration in establishing minimum acceptable sale prices (reserve price). PSALM has chosen the Discounted Cash Flow Analysis valuation method, which best optimized the value of these assets.

The decrease of ₱51.36 billion in the negative balance of the *Capital from Asset-Debt Transfer* was due mainly to the adjustment to the account pertaining to the TransCo's appraisal capital of ₱69.58 billion and the Assumed Rural Electrification Program Loans (Note 13) pursuant to the recommendation of COA.

21. RETAINED EARNINGS

Movement in this account is brought about by the ₱15.419 billion net income for CY 2009, the adjustment of the ₱10.834 billion amortization of the deferred asset account established upon the assumption of rural electrification loans of electric cooperatives from NEA and other government agencies, and ₱16.145 billion net credit adjustments relating to asset-debt accounts transfer balances and OMA transactions.

22. INCOME

PSALM's income for 2009 is still derived mostly from its privatization-related activities as power generation activities transferred from NPC resulted in losses, partly offsetting gains from privatization, resulting in the gross income of ₱21.57 billion, as shown below:

	2009	2008
Gain on sale/disposal of assets	16,254,531,911	33,598,174,884
Concession fee	18,056,954,781	
Power generation	(12,738,836,707)	(2,868,816,205)
	21,572,649,985	30,729,358,679

23. MAINTENANCE AND OTHER OPERATING EXPENSES (MOOE)

In 2009, major expense items that constituted MOOE were professional services (₱1.16 billion) and taxes, insurance premiums and other fees

(₱0.56 billion), which made up 54% and 26% of MOOE, respectively. Other maintenance and operating expenses of ₱0.32 billion made up 15% of MOOE.

Professional Services increased by ₱1,042.7 million largely due to the payment of fees to NM Rothschild & Sons (₱527.9 million) and Credit Suisse (₱387.6 million) in relation to the privatization of TransCo.

Taxes jumped by ₱531.3 million mainly due to the payment of ₱400.2 million documentary stamp taxes, ₱91.1 million transfer taxes and ₱48.7 million taxes and duties related to Operation and Maintenance Service Contracts (OMSC).

Other Maintenance and Operating Expenses went up by ₱239.9 million due mainly to the recognition of bad debts amounting to ₱236.7 million.

24. FINANCIAL EXPENSES

Interest expense leaped from ₱4,968.0 million to ₱20,412.2 million, or an increase of ₱15,444.2 million; Financial Charges rose from ₱877.4 million to ₱2,137.9 million, or an addition of ₱1,260.5 million. These increases arose from the full year effect of PSALM's assumption of the liabilities of NPC.

25. OTHER INCOME (EXPENSES)

Gain (Loss) on Foreign Exchange

As the Corporation translates its foreign currency transactions/monetary items in accordance with PAS 21, the resulting gains and losses from the exchange differences are recognized in the statement of income and expenses, as follows:

	<u>2009</u>	<u>2008</u>
Realized forex gain (loss) on foreign currency-related transactions	615,489,966	6,408,988,353
Unrealized forex gain (loss) on translation	16,626,700,608	(13,102,401,778)
	<u>17,242,190,574</u>	<u>(6,693,413,425)</u>

The appreciation of peso (₱46.356/US\$ in 2009 versus ₱47.485/US\$ in 2008; ₱0.5059/Y in 2009 versus ₱0.5221/Y in 2008) reversed last year's forex loss to this year's forex gain.

Miscellaneous Income

The increase of ₱706.7 million came primarily from the recognition of interest income from NPC advances to San Roque Multi-Purpose Project.

26. ORGANIZATIONAL DEVELOPMENT AND EFFICIENCY

A highly significant corporate milestone is the initiation by PSALM of an ISO certification program to enhance investor confidence on PSALM and, at the same time, effect a culture change in the organization and improve management systems. The program was started in March 2008.

Teams such as the Documentation and IQA Teams were created to ensure implementation of the program. An external auditor, the Certification International Philippines, Inc. (CIPI), was awarded the contract to determine the readiness of PSALM's Quality Management System (QMS) for certification. The external audit began in January 2009. On 01 June 2009, PSALM obtained ISO 9001:2000 Standard QMS Certification from CIPI for its business processes that now conform to internationally-recognized management standards. On 10 December 2009, PSALM received a Certificate of Recognition from President Gloria M. Arroyo in ceremonies held at Malacanang Palace for this corporate achievement.

Towards the achievement of enhanced organizational efficiency, the internal audit of various risk management, governance and control processes were undertaken in 2009 and recommendations provided to the different functional groups based on the results of these audit engagements. Specifically, the internal audit focused on the following;

1. Pre-turnover inventory taking and sweep inventory processes;
2. Vehicle utilization and administration process;
3. Electricity trading process;
4. Information technology governance and management process, which was given high priority, given the magnitude of the financial accounts and transactions of PSALM;
5. Adequacy and compliance audit on the implementation of the OMA with NPC;
6. Property management system, particularly the adequacy of controls installed for the protection of OMA assets;
7. Financial accounts, systems and processes;
8. Compliance with the TransCo Concession Agreement ;
9. Compliance of the NPC asset-debt transfer with COA rules and regulations and underlying accounting standards; and
10. Bidding processes.

The focus on personnel development was evident with the substantial number and variety of training and development programs held in 2008. Seven (7) in-house training and development programs were conducted/facilitated while selected personnel were sent to forty-five (45) local external training programs and professional conventions/ conferences held within the country.

Gender and Development (GAD) was given more emphasis with the activities and programs undertaken to direct attention to the subject and institutionalize the creation of the PSALM GAD Focal point system.

Employee wellness continues to be given attention. An annual physical and medical examination for all PSALM officers and employees totaling one hundred sixty-seven (167) personnel, including contractual personnel, was held on 21 December 2009 (1st stage) and completed on 18-21 January 2010 (2nd stage). Vaccination activities and fitness program were undertaken and various fora on health concerns were conducted.

Strong logistic support was provided to the different departments within PSALM through the development and/or implementation of various Information and communications technology programs, systems and capability building activities. Key activities and programs relate to the modernization/upgrade of individual workstations and enterprise communication system; acquisition of off-site data back-up system; establishment of virtualization program for a more cost-effective management of server, application and storage; development of the CY 2010-2012 Information Systems Strategic Plan; initiation of the digitization program that will commence the paperless document management; reengineering of corporate website (portal) and intranet; and the creation of a web-based Universal Levy Administration System (ULAS) to facilitate UC remittances by distribution utilities and other collecting entities.

27. CONTINGENCIES

A total of ₱1.519 billion of account balances with Land Bank of the Philippines and Philippine National Bank have been garnished representing claims against PSALM/NPC resulting from various civil cases.

Legal Proceedings Involving PSALM

PSALM is involved in various legal and administrative proceedings, including litigation and proceedings related to electricity charges and challenges to certain provisions of the EPIRA. Because of the nature of these proceedings, PSALM cannot predict the ultimate outcomes of these proceedings, some of which may be unfavorable. However, PSALM does

not expect the outcomes of these proceedings, either individually or in the aggregate, to have a material adverse effect on its financial position.

On 23 April 2009 and 7 May 2009, respectively, PSALM was impleaded in two separate actions by NPC's employees to enjoin implementation of the Operations and Maintenance Agreement (OMA). The first case, **G.R. 187359 (NECU and NEW vs. NPC and PSALM)**, seeks to enjoin implementation of the OMA in an effort to collect on a judgment rendered in the employees' favor against NPC for unpaid employment compensation-related claims. The second case, **G.R. No. 187420 (PGEA-NPC vs. NPC, NP Board, PSALM and PSALM Board)**, seeks to enjoin the OMA's implementation based on a claim that it violates the EPIRA. PSALM does not expect these cases to have a material adverse effect on its results of operations or financial condition. The two cases were consolidated in the First Division of the Supreme Court in the Resolution dated 9 September 2009 of the Third Division of the Supreme Court and are now pending action on the consolidation of the cases. PSALM is reviewing these cases independently, and is also coordinating with the Office of the Government Corporate Counsel.

Petition for Basic Rate Adjustment Mechanisms

The ERC has promulgated two price adjustment mechanisms to the basic rates of electricity under the EPIRA. These adjustment mechanisms are (i) the GRAM and (ii) the ICERA.

The GRAM was approved by the ERC in 2003 to allow for recovery of incremental fuel and purchased power costs resulting from changes in either fuel prices or the cost of power purchased from IPPs.

The ICERA allows for the recovery of incremental costs that are incurred as a result of foreign currency exchange fluctuations. Under current ERC rules, PSALM is required to file applications quarterly for GRAM and ICERA adjustments. These adjustments can cause the basic rate to be increased or decreased depending on developments in fuel prices, IPP costs and foreign exchange rate fluctuations.

The ERC approval of the Automatic Cost Adjustment Mechanism (ACAM) eliminated the need for PSALM and NPC to file for cost recoveries every quarter and await a decision from the ERC before passing the costs to customers.

Petition for Recovery of Universal Charge

The Universal Charge is imposed on every end-user of electricity for specific uses that are enumerated under Section 34 of the EPIRA. The

amount for each component of the Universal Charge is determined by the ERC as mandated by Section 32 of the EPIRA. It is also collected from end-users on a monthly basis and remitted to PSALM.

PSALM is mandated under Section 51(d) of the EPIRA to calculate the amount of stranded debts and stranded contract costs of NPC which shall form the basis for ERC in the determination of the Universal Charge.

On 30 June 2009, PSALM filed before the ERC two separate petitions for the recovery of the Universal Charge for Stranded Contract Cost and Stranded Debt.

The first petition seeks to recover NPC's stranded costs portion of the Universal Charge for the Luzon Grid, docketed as **ERC Case No. 2009-046RC**. Stranded Contract Cost refers to the excess of the contracted cost of electricity under eligible IPP contracts of NPC over the actual selling price of the contracted energy output of such contracts in the market. To be eligible for recovery under the UC, such contracts must have been approved by the then Energy Regulatory Board (ERB) as of 31 December 2000. Based on a 5-year recovery period, PSALM proposed to ERC a UC for stranded cost amounting to ₱0.0920 per kWh. The petition is currently under evidentiary hearing before the ERC.

The second petition seeks to recover NPC's stranded debt portion of the Universal Charge for the Luzon, Visayas and Mindanao Grids, docketed as **ERC Case No. 2009-047RC**. Stranded Debt refers to any unpaid financial obligations of NPC which have not been liquidated by the proceeds from the sales and privatization of NPC assets. Financial obligations pertain to net obligations of NPC after deducting the ₱200 billion debt assumed by the National Government (Section 32 of the EPIRA). Based on a 17-year recovery period, PSALM proposed to ERC a ₱0.3049 per kWh UC for Stranded Debt of NPC. The petition is now under evidentiary hearing before the ERC.

On 22 April 2009, the Senate approved Senate Bill No. 2121, which proposed, among other amendments, the deletion of the EPIRA provision providing for the collection of Universal Charge for stranded debt and stranded contract costs. However, this bill still has to be deliberated upon by a bicameral conference committee composed of members from both houses of Congress before its submission to the President of the Philippines for enactment into law. If the Universal Charge is significantly lower than the amount necessary to cover the stranded debt and stranded contract cost of NPC, or worst, if it is removed entirely, the financial condition of the corporation will be adversely affected and the corporation will need to obtain funding from other sources.

28. OTHER SUBSEQUENT EVENTS

The following are the other events subsequent to balance sheet date:

The Peso Retail Bonds' Final Terms and Conditions was presented to the Board for approval and confirmation. Said transaction, which was part of the approved structures under LMP-II, was successfully launched on 06 April 2010 via the Bureau of the Treasury's ("BTr") release of the Notice of Offering to Government Securities Eligible Dealers ("GSEDs"). The auction was held on 12 April 2010, wherein the coupon on both bond series was set via a Dutch auction. The deal was priced at 36 bps and 43 bps over the 5-year and 7-year PDST-F benchmark rates, respectively. This is significantly below the Board-approved spread of 100 bps. The public offer period is scheduled from 12-19 April 2010 and settlement is set on 22 April 2010. Furthermore, PSALM intends to list the bonds in the Philippine Dealing and Exchange System ("PDEX") for secondary market trading.

Two other financing structures under LMP-II have been submitted to the approving authorities and remain to be implemented: the TransCo Concession Fee Securitization, and the Short-term FX Forwards. On the TransCo Concession Fee Securitization, certain commercial and legal issues have negatively affected investors' interest. Under such circumstances, PSALM has decided to defer the Securitization Program until these issues are resolved.

While the short-term FX forwards remain pending, the BSP allowed PSALM to advance the purchase of FX covering PSALM's obligations from January to July 2010 amounting to US\$916.54 million. PSALM intends to enter into short-term FX for its remaining FX obligations for August to December 2010. Pending receipt of DOF concurrence on the short-term FX forwards, the execution of vanilla FX hedges is also delayed.

To address the issue of the guarantee ceiling, PSALM has initiated talks with various banks on the viability of a non-guaranteed transaction. PSALM has forwarded to the DOF for a DOJ opinion various proposed structures for this transaction.

29. AUTHORITY FOR ISSUANCE

These financial statements have been approved for issue by the PSALM Board of Directors on 5 May 2010.