

CORPORATE GOVERNANCE REPORT

The company philosophy Service Excellence with Integrity speaks much about our company's intrinsic commitment to corporate governance principles and best practices. The adoption of a Manual on Corporate Governance approved by the Board of Directors in August 2002 gave vitality to the company philosophy. Since then the Manual has gone through regular reviews and updates such that it was able to reflect newly embraced leading standards.

The succeeding sections briefly describe the key components in Meralco's infrastructure towards the attainment of good corporate governance.

BOARD OF DIRECTORS

Key Responsibilities

The Board is charged with the primary responsibility on governance matters. It directs and supervises the affairs of the company in a responsible and effective manner for long-term success and sustained value enhancements for stakeholders.

The Board oversees the adequacy of internal control mechanisms in the company to ensure the reliability of financial reporting, efficiency and effectiveness in operations, safeguarding of assets and compliance with applicable laws and regulations.

There are certain types of decisions which are reserved for approval at the Board level: those relating to strategic directions, monitoring of Management's performance, operating and capital budgets, major acquisitions and disposal of assets, major investments, contracts and financing transactions.

Board Composition

In 2007, the Board has 11 directors: five executive directors, five independent directors and one non-executive director.

The Board represents a mix of expertise, professional competencies and experience necessary to thoroughly examine and deliberate on various issues and matters affecting the company. All the directors, except for Mr. Jose Manuel Prieto, a Spanish national and Union Fenosa representative who was unable to serve his term, have attended seminars on Corporate Governance. This is prescribed by the SEC and the ERC under Resolution No. 1, Series 2004 entitled "Program to Promote Good Corporate Governance in Distribution Utility."

Election of Directors

Nominees for director undergo a nomination and screening process through the Nomination and Governance Committee of the Board. This is in accordance with the provisions of the Company's By-Laws and of the Manual of Corporate Governance, and in consideration of the guidelines prescribed in the Securities Regulation Code Rule 38. The company considers the requirements of the Securities Regulation Code Rule 38 in the nomination and election of independent directors.





Board Remuneration

Board directors do not receive any stated salary for their services. They receive remuneration in the form of a specific sum for attendance at each regular or special meeting of the Board, and per Board or committee meeting attended. The remuneration is intended to provide reasonable compensation to the directors in recognition of their responsibilities and the potential liability they assume. The existing compensation package for the directors is the result of a benchmark study made by the company for purposes of evaluating its level of reasonability. Board directors are covered by a Directors Liability Insurance to fend for any liabilities, damages or civil suits arising from the discharge of their functions as directors of the company.

Board Performance

The Board holds regular monthly meetings and special board meetings to discuss and decide on major critical issues affecting the company.

In normal circumstances, the Board adopts a formal and sequential agenda for each regular meeting. The agenda includes a brief report or update of the Chairman and the Board committees, the President's report on operational and financial performance, reports and updates of senior executives on regulatory, networks and retail matters; and deliberation and approval of items that require formal board resolutions.

Details of directors' attendance at the Board and Board Committee meetings held in 2007 is shown in the table (Figure 1). The overall attendance rate of directors at Board meetings was 85%.

BOARD COMMITTEES

The Meralco Board has seven standing committees. All committees have approved Charters which were revised within the year for further enhancements or improvements.

The responsibilities of each Board committee and activities in 2007 are as follow.

Executive Committee

M. M. Lopez (Chairman), F. B. Alfonso, J. P. Francisco, W. Z. Sycip, C. E.A. Virata

The Executive Committee is composed of five Board directors, one of whom is an independent director. In between sessions of the Board, the Executive Committee assumes all its powers in the oversight of the business and the affairs of the company. It acts based on the rule of the majority of its members. All actions of this Committee are reported to the Board and are subject to revision or modification by the Board. The Board may prescribe rules and regulations for the calling and conduct of the Executive Committee and other matters relating to its procedures and the exercise of its powers.

The Executive Committee was not convened in 2007 since there were no urgent matters that necessitated a call for action.

Nomination & Governance Committee

F. B. Alfonso (Chairman), A. R. Defensor, G. L. Domingo, C. S. Monsod

This committee is responsible for providing recommendations to the Board on: qualified nominees for appointment as directors; assessing the independence of directors; improvements on board organization and procedures; mechanisms for evaluating performance of the Board and Management; and the continuing education of the Board, including specific training for individual directors.

Its accomplishments were:

- Screened nominees for directors and finalized the list of candidates.
- Recommended the proposed chairmanship and membership of Board committees.
- Recommended modifications in Board committee structure that include the dissolution of an ad hoc committee and creation of a new committee.
- Recommended a review of Board committee charters and endorsed to the Board for approval the revised or new charters of some Board committees.
- Reviewed and approved enhancements to the Meralco's Manual of Corporate Governance.
- Reviewed the annual Corporate Governance Report of the Compliance Officer; the Corporate Governance Scorecard self-assessment submitted to SEC.
- Provided directions on the Company's corporate governance improvement program.

Audit & Compliance Committee

W. Z. Sycip (Chairman), F. B. Alfonso, A. R. Defensor, M. M. Lopez

This committee provides oversight functions on the Company's internal and external auditors, evaluates the integrity and accuracy of the financial reports, elevates to international standards the accounting and auditing processes, practices and methodologies in the Company; and monitors compliance to laws and regulations.

It completed the following activities:

- Reviewed the external auditor's key financial audit and Management Letter issues; the Internal Audit's annual report and status reports that include existing and significant audit issues and monitoring of outstanding audit issues of prior years and the Internal Audit's high-level review of quarterly financial statements.
- Reviewed and endorsed the external auditor's new engagement and signing partner; the audited financial statements; and the enhancements to the Audit & Compliance Committee's charter.
- Reviewed and acknowledged the external auditor's 2007 Audit Plan.
- Reviewed and approved the 2007 Internal Audit Plan and the external auditor's fees and scope of services.

Figure 1

	Regular Board	Execom	Nomination & Governance	Audit & Compliance	Compensation & Retirement	Finance	Risk Mgt	Retirement Fund
No. of Meetings Directors	12	0	4	5	5	9	1	4
M. M. Lopez	12/12	0		5/5				
F. B. Alfonso	12/12	0	4/4	5/5	5/5			1/1
J. P. Francisco	11/12	0				7/9	1/1	1/1
B. R. Abes*	6/7						0	3/3
A. R. Defensor, Jr.*	9/12		2/4	5/5				
G. L. Domingo*	11/12		4/4		5/5		1/1	
O. V. R. Espiritu*	4/5		2/2		2/3	0/3		
C. S. Monsod	11/12		4/4			8/9	1	3/3
F. E. Puno*	11/12		2/3		2/2	7/9	1	
J. M. Prieto	0/7			0/2		0/6	0	
W. Z. Sycip*	11/12			5/5	3/5			
E. A. Vicens	4/5	0		0/3				
C. E. A. Virata	11/12	0			4/5	9/9		4/4

* Independent Director

The following changes in the Board's composition took effect within the year:

- Mr. Bernardino R. Abes was elected on May 29, 2007 replacing Mr. Octavio Victor R. Espiritu.
- Mr. Jose Manuel Prieto, the Union Fenosa representative was elected on June 25, 2007 replacing Mr. Emilio A. Vicens who resigned on June 1, 2007.

Compensation & Retirement Committee

F. E. Puno (Chairman) F. B. Alfonso, G. L. Domingo, W. Z. Sycip, C.E.A. Virata

This committee is responsible for formulating and developing the overall corporate philosophy and policy on the total compensation package of the Board of Directors and officers of the Company. When used in reference to the functions of this committee, "compensation package" shall mean to cover all types of remuneration including retirement and benefits.

The committee's accomplishments were:

- Deliberated and recommended adjustments to the Meralco Board fees;
- Reviewed and endorsed the Company's Retirement Benefits Plan for 2007; the Performance Based-Recognition in view of the restated 2004 and 2005 Meralco financial statements; and the changes and enhancements to the Compensation & Retirement Committee's charter;
- Reviewed the Meralco's Compensation Philosophy and Profile and the overall results of Meralco's 2006 Performance Appraisal;
- Reviewed and approved Meralco's 2007 and 2008 Performance Management System; the 2006 Meralco Overall Employee Incentive Plan payout; the 2007 Meralco Incentive Plan goals;
- Reviewed the results and impact of the Comparative Compensation Study for those in the Superintendents and up rank.
- Developed and approved the Compensation & Retirement Committee's 2007 work plan.

Finance Committee

C.E.A. Virata (Chairman), J. P. Francisco, C.S. Monsod, J.M. Prieto, F.E. Puno

The primary responsibility of this committee is to review the financial operations of the Company and matters pertaining to the acquisition/ divestiture of or investments in companies, businesses or projects. It also advises and recommends approval or action on financial matters like establishment or changes in major

financial and treasury policies, financing transactions, corporate plans and budgets; major contracts, acquisitions and divestitures, financing guarantees and indemnities and mortgaging of company assets.

Among the many important issues that this committee acted upon within its delegated authority were:

- Reviewed, evaluated and endorsed proposed acquisition of and investments in new businesses; the acquisition of Transco's sub-transmission assets; the 2007 Corporate Budget; the declassification of Meralco shares of stock; the 2007 Retirement Benefits Conversion Plan including the funding requirements; the amendments to the Trust Agreement; and the proposed revisions in the Finance Committee charter;
- Reviewed strategies and measures on Meralco Pension Fund contributions, asset composition and build-up as well as investment policies and funding for pension conversion programs;
- Reviewed and recommended the awarding of service contract for a Surety Bond for WESM Prudential requirements; the settlement agreement with Quezon Power on transmission line charges; the Management proposal to secure various Loan Facilities; and the settlement of advances to subsidiaries;
- Reviewed Meralco's Cash Flow status: updates on deferral of payments to power suppliers and status of settlement; and reports on short-term investments; and
- Reviewed contracts with amounts exceeding P50 million.

Risk Management Committee

G.L. Domingo (Chairman), B.R. Abes, J.P. Francisco, C.S. Monsod, J.M. Prieto, F.E. Puno

This committee's primary function is to ensure that the Company has an effective risk management system. It provides an oversight over Management's activities in managing the most significant risks of the Company. The task includes receiving periodic information on risk

exposures and risk management activities.

This committee reviewed the prior years' significant risks and the Company Management's risk scan and rating results for 2007.

Retirement Fund Committee

C.S. Monsod (Chairman), B. R. Abes, C.E.A. Virata

This newly created committee reviews and oversees matters pertaining to the investments and management of the Meralco Pension Fund.

The accomplishments of this committee were:

- Reviewed and endorsed changes or revisions in the organizational chart of the Meralco Pension Fund and amendments in the Trust Agreement; the Pension Fund Policy; the 2007 Retirement Benefits Conversion Plan and the related cost-benefit study; and the charter for the Retirement Fund Committee
- Endorsed the appointment of the Meralco Pension Fund Trustees.
- Reviewed the fund status and the proposed strategies to re-institutionalize the fund.

MANAGEMENT

Management's primary accountability is to the Board. It is in charge of the company's successful implementation of the strategy and direction as approved by the Board.

In Meralco, Management is represented by a Management Committee (ManCom) composed of corporate officers and executives formed and headed by the Chief Executive Officer, and in his absence, the President. ManCom meets regularly, at least once a week, to ensure the formulation and implementation of major policies and directions governing the company and its subsidiaries. It reports to the Board during regular Board meetings or during special meetings through the Chief Executive Officer and/or the President. Management also formed various committees to provide special attention to critical functions or processes such as power supply management, procurement and human resources.

Management's performance is annually assessed through the achievement of the company's established Balanced Scorecard indicators.

In order to ensure continued success in managing the company's operations, structured executive training and development; compensation and benefit plans and succession planning, programs for senior management and the executive levels were put in place.

Management, all employees, and the Board of Directors as well, are subject to the Code of Ethics. This Code of Ethics contains 12 rules and norms manifesting the company's full commitment and dedication to uphold the fundamental principles of fairness, honesty and integrity. Ethical practices and prudent management of the company's affairs by Management and the Board is further being reinforced through the adoption of a Code on Employee Discipline, Conflict of Interest Policy, Full Business Interest Disclosure, Policy on Subsidiary Management and Strategic Guidelines for Major Capital Investments.

ACCOUNTABILITY AND AUDIT

The Audit Committee provides oversight functions over external and internal auditors. The current Chairman of this committee is an independent director who is a distinguished business professional and a luminary in the field of accountancy and auditing.

Independent Public Accountants

Sycip, Gorres & Velayo (SGV & Co.) was reappointed as the external auditors of the company during the year. Its new Engagement Partner assigned to the company is Mr. Jose Joel Sebastian who has extensive experience as auditor in other public utility companies. He replaces a predecessor who handled the company for the last five years, in compliance with the SEC rotation requirement of the external auditor.

SGV&Co. has not been engaged by the company to perform non-audit services except for specific tax compliance/assessment reviews during 2007. The nature of these services and the corresponding fees are not significant to impair the independence of the auditors.

There have been no instances of disagreement with the independent auditors on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Internal Auditor

The company has an independent internal audit function which provides independent advisory and consulting services to help improve effectiveness and efficiency, and to evaluate whether the company's organizational and procedural controls are effective, appropriate and complied with.

Internal Audit conducts its activities guided by the International Standards for the Professional Practice of Internal Auditing (ISPPA).

The Head of Corporate Audits, as Chief Audit Executive (CAE), reports functionally to the Audit Committee and administratively to the Chairman & Chief Executive Officer. As a matter of practice, the CAE presents its audit reports to Management and secures its response and commitment before presenting the same report to the Audit Committee on a regular basis.

Internal Control

The primary responsibility on the design, implementation and maintenance of internal controls rests on Management while the Board and its Audit Committee oversee the actions of Management and monitor the effectiveness of the controls that have been put in place.

FINANCIAL REPORTING

The parent company's and the consolidated financial statements of Meralco were prepared in accordance with Philippine Financial Reporting Standards which are aligned with International Financial Reporting Standards. The year-end audited financial statements are reviewed by the Audit Committee to ensure that they fairly present, in all material respects, the financial position of the company.

In 2007, the Internal Audit conducted high-level review of the company's quarterly financial statements and reported its findings to the Audit Committee. Also during the year, the company was always on time in the submission of required financial reports and statements to SEC.

DEALINGS IN SECURITIES

Meralco has established an internal reporting system intended to guide the directors and principal officers when they trade the company's securities. This is a means to control the handling and dissemination of price sensitive information and to comply with the disclosure requirements on direct and indirect ownership of company securities. The concerned directors and principal officers are required to report their trading transactions to the designated Assistant Corporate Secretary not later than the following day after the required event or transaction.

DISCLOSURES ON OWNERSHIP STRUCTURE

Meralco ensures that it consistently complies with the required disclosure on shareholdings of the company's securities. It annually discloses the top 20 shareholders of its common shares and the shareholdings and percentage ownership of the directors and key officers. It also provides an annual disclosure of security ownership of certain record and beneficial owners who hold more than 5% of the company's equity shares. In compliance to the SEC requirements, the company submits a quarterly report of the top 100 stockholders and discloses this in the company website.

SHAREHOLDER RELATIONS

The company recognizes the rights of its shareholders, as well as the general investing public, to obtain relevant information about the company in a timely and regular basis.

The company's financial performance and prospects are contained in the regular or mandatory reports submitted to the SEC and PSE. These reports were immediately made available to the public upon confirmation by the SEC of the disclosure receipt, through public release and/or posting in the company's website.

The company conducts regular quarterly Investors' Briefings. Representatives of the local and foreign institutional investors, securities brokerage firms and investment bankers are invited in these briefings. Through conference call, analysts of foreign-based institutional investors and investment banks are afforded the opportunity to participate in such sessions.

Shareholders and investors are provided with adequate means and facility to communicate and inquire with the company. The Investor Relations Office supervises the investors' briefings and attends to institutional investors needs while the Stock and Dividends Administration attends to the other concerns of the shareholders. Inquiries are entertained by telephone, mail or electronic mail. The Meralco website also serves as a communication tool and a reference for pertinent information about the company.

The Annual Stockholders Meeting likewise provides

an opportunity for shareholders to raise questions and clarify issues relevant to the company. The Board, the Chairman & CEO, Management and the external auditors are present. They accommodate questions brought up in these meetings.

COMPLIANCE AND MONITORING

The Board has appointed a Compliance Officer for corporate governance. On a periodic basis, the Compliance Officer discusses with the Nomination and Governance Committee and the Chairman of the Board the status of the company's compliance with the Manual of Corporate Governance and identifies areas for improvement. The Compliance Officer also seeks direction and guidance from the Nomination and Governance Committee to further bring the company's corporate governance practices to higher standards.

The company considers regulatory compliance as one of its high-priority areas. A Regulatory Management organizational unit was created to further strengthen and drive more focus to the overall orchestration and management of regulatory management initiatives. Specifically, this unit is responsible for the outcome of major regulatory management processes on regulatory agenda development, policy research, policy advocacy management, rate case management and compliance management.

OBLIGATIONS TO OTHER STAKEHOLDERS

The company gives due regard to the impact of business decisions both on the shareholders of the company and other key stakeholders. An explicit statement of such regard is contained in the Declaration of Corporate Principles, Part 1 of the Company's Manual of Corporate Governance. An example is, "The Company's objective is to protect and enhance the interest of its stakeholders through adherence to specific principles for customers, employees, investors, suppliers and competitors, community, and the government." The company also respects and maintains a cooperative relationship with its creditors who grant unwavering trust and confidence in the provision of financial facility, thus intensifying the company's leverage.

CORPORATE GOVERNANCE APPLICABILITY TO SUBSIDIARIES

The company recognizes the equally important contribution of its subsidiary companies in boosting its shareholders value and pecuniary yield. To serve as a buttress of corporate governance application in Meralco subsidiaries, a Subsidiary Management Policy has been developed and implemented. This policy institutionalizes a standard set of rules for creating and managing subsidiaries based on the criteria and principles embodied in the parent company's Manual of Corporate Governance, Code of Ethics and existing laws, rules and regulations. Two of the many provisions in this policy pertain to the limit on the number of directorship in Meralco subsidiaries and affiliated companies by the parent company's officers. This is to ensure that the capacity of directors to serve with diligence is not compromised, and the rationalization of directorship appointments to avoid potential conflict of interest.