

Corporate Governance Report

The largest electric distribution company in the Philippines with 106 years of experience, Meralco, continues to create business value enhancements for its stakeholders.

Our philosophy of “Service Excellence with Integrity” conveys the unwavering commitment to high standards of corporate governance principles and practices. Accountability, transparency and integrity are paramount considerations in the development and realization of the company’s strategies, plans and objectives. These, too, are in our evolving culture and tradition creating a mindset that cultivates esteemed values of integrity, *malasakit*, customer focus, community service, teamwork and employee development.

On top of Meralco’s mechanism for corporate governance are the pertinent provisions in its Articles of Incorporation and By-Laws, embodying the fundamental structure of the company, as well as the composition, qualifications, duties and responsibilities of its directors and officers. The adoption of a Manual of Corporate Governance approved by the Board of Directors (“the Board”) in August 2002 reinforces Meralco’s vision towards long-term business opulence and ever-growing shareholder value.

The succeeding sections briefly describe the key components in the company’s good corporate governance infrastructure.

BOARD OF DIRECTORS

Key Responsibilities

The primary responsibility of compliance with corporate governance principles is lodged with the Board. The Board controls the affairs of the company with utmost responsibility and effectiveness, to ensure long-term success and sustained value enhancements for the company’s stakeholders. The directors are cognizant of their collective and individual responsibilities. Each director acts in good faith, with

due diligence and care, and in the best interest of the company and shareholders.

The Board also oversees the adequacy of internal control mechanisms in the company to ensure the reliability of financial reporting, efficiency and effectiveness in operations, protection of assets, and compliance with applicable laws and regulations. There are certain types of decisions which are reserved for approval at the Board level, including 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

The Board is composed of eleven (11) directors. As of the end of December 2008, three (3) are executive directors, two (2) are independent directors, and six (6) are non-executive directors.

The Chairman of the Board and Chief Executive Officer is Manuel M. Lopez; while the President and Chief Operating Officer is Jose P. De Jesus. The existing Board structure and practices provide a clear division of responsibilities at the top of the corporation—between the Board exercising oversight function and the Management discharging its executive responsibilities for the business.

The Board represents a mix of expertise, professional competencies and experience necessary to thoroughly examine and deliberate on the various issues and matters affecting the company. Each director is capable of adding value and contributing his own independent judgment to the formulation of sound corporate strategies and policies. All the directors have attended seminars on Corporate Governance, as prescribed under ERC Resolution No. 1, Series 2004 entitled “Program to Promote Good Corporate Governance in Distribution Utility.”

The names and profiles of each director are found in

the Board of Directors section of this Annual Report and in the Definitive Information Statement.

Election of Directors

In accordance with the provisions of the Company's By-Laws and Manual of Corporate Governance, the Corporation Code and the Securities Regulation Code, the nominees to the Board undergo a nomination and screening process through the Board's Nomination and Governance Committee. The directors are elected by stockholders entitled to vote during the Annual Stockholders Meeting. They hold office for one year and until their successors are elected and qualified.

Throughout the year 2008, the company has complied with the requirement of SEC Memorandum Circular No.2 Series of 2002 on the number of independent directors- which is at least two (2) directors, or at least twenty percent (20%) of the members of the Board, whichever is the lesser. The independent directors in the company's Board provide the necessary balance and ensure the demarcation of responsibilities to prevent any individual or group from dominating in the Board's decision-making. The company defines an independent director to be independent of management; neither providing any other services, nor receiving compensation, income or privileges and benefits other than pertaining to a director; and can provide independent judgment and outside experience and objectivity, not subordinated to operational considerations, on all issues which come before the Board. The company also considers the requirements of the Securities Regulation Code Rule 38 in the nomination and election of independent directors.

Board Remuneration

The company's directors do not receive any compensation other than reasonable per diems for each regular or special Board or committee meeting attended. The remuneration is intended to provide the directors reasonable allowance in recognition of their responsibilities and the potential liability they assume. The existing rate of allowance for directors is the result of a benchmark study made by the company for purposes of evaluating its reasonableness.

Board Performance

The Board holds regular monthly meetings and special

board meetings to deliberate on major issues affecting the company.

In normal circumstances, the Board adopts a formal and sequential agenda for each regular meeting. The agenda include brief reports or updates by the Chairman and the Board Committees, reports on operational and financial performance by the President and Chief Operating Officer, and reports on regulatory, networks and retail matters by the senior executives. The agenda also include items for the Board's deliberation and approval.

In 2008, the Board held twelve (12) regular meetings and three (3) special meetings. The details of attendance in these meetings are shown in the table (Figure 1). The average attendance rate in 2008 was 90%.

The Corporate Secretary, or in his absence, the Assistant Corporate Secretary provides assistance and advisory services to the directors on their responsibilities and obligations. The Corporate Secretary supplies the directors with detailed reports and materials pertinent to the agenda in Board and Committee meetings, at least a day prior to the scheduled meeting. He also assists any director who may need to communicate with the Management to clarify certain matters submitted for the Board's consideration.

BOARD COMMITTEES

The Company's Board has six (6) standing committees. All committees have approved Charters which define and specify the scope of their responsibilities. The members of each Board committee and their record of attendance in 2008 meetings are shown in the table (Figure 2).

The functions, authority, and responsibilities of each Board committee are as follows.

Executive Committee

The Executive Committee is composed of five (5) Board members, one of whom is an independent director. In between sessions of the Board, the Executive Committee assumes all the powers of the Board in the oversight of the business and the affairs of the company. The Executive Committee is guided by the rule of the majority of its members.

FIGURE 1
Board of Directors
Attendance in
Meetings
(2008)

	REGULAR MEETINGS											
	01-29	02-26	03-17	04-28	05-26	06-23	07-28	08-26	09-22	10-27	11-24	12-15
Manuel M. Lopez	P	P	P	P	P	P	P	P	P	P	P	P
Felipe B. Alfonso	P	P	P	P	P	P	P	P	P	P	P	P
Jesus P. Francisco	P	P	P	P	P	P	P	P	P	P	P	P
Bernardino R. Abes	P	P	P	P	P	A	P	P	P	P	P	P
Daisy P. Arce						P	P	P	P	P	P	P
Arthur R. Defensor, Jr. *												
Gregory L. Domingo *	A											
Winston F. Garcia		A	P	P	P	P	P	P	P	P	A	A
Peter D. Garrucho, Jr.		P	P	P	P							
Christian S. Monsod	P	P	P	P	P	P	P	P	P	P	P	P
Artemio V. Panganiban *						P	P	P	P	P	P	P
Vicente L. Panlilio *						P	P	P	P	P	P	P
Jeremy Z. Parulan						P	P	P	P	P	P	P
Jose Manuel Prieto												
Federico E. Puno *	P	P	A	P	P							
Washington Z. Sycip *	A	P	P	P	P							
Generoso D.C. Tulagan *	P	P	P	P	P							
Cesar E.A. Virata	P	P	A	P	P	P	P	P	A	P	P	P
P - Present A - Absent * Independent Director												

	SPECIAL			ASM			ORGANIZATIONAL		
	01-07	05-15	07-17		05-27			05-27	
Manuel M. Lopez	P	P	P		P			P	
Felipe B. Alfonso	P	P	P		P			P	
Jesus P. Francisco	P	P	P		P			P	
Bernardino R. Abes	A	P	P		P			A	
Daisy P. Arce			P					A	
Arthur R. Defensor, Jr. *	P								
Gregory L. Domingo *	P								
Winston F. Garcia		P	P		P			A	
Peter D. Garrucho, Jr.		P			P				
Christian S. Monsod	P	P	P		P			P	
Artemio V. Panganiban *			P					P	
Vicente L. Panlilio *			P					A	
Jeremy Z. Parulan			P					A	
Jose Manuel Prieto	A								
Federico E. Puno *	P	A			A				
Washington Z. Sycip *	P	A			A				
Generoso D.C. Tulagan *		P			P				
Cesar E.A. Virata	P	P	P		P			P	
P - Present A - Absent * Independent Director									

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

- Mr. Arthur Defensor, Jr. resigned effective January 8, 2008. He was replaced by Mr. Generoso D.C. Tulagan
- Mr. Jose Manuel Prieto resigned effective January 24, 2008. He was replaced by Mr. Peter D. Garrucho, Jr.
- Mr. Gregory L. Domingo resigned on January 31, 2008. He was replaced by Mr. Winston F. Garcia.
- The new directors like Ms. Daisy P. Arce, Chief Justice Artemio V. Panganiban, Mr. Vicente L. Panlilio, Mr. Jeremy Z. Parulan were elected during the Annual Stockholders' Meeting on May 27, 2008.

FIGURE 2
Board Committees' Meeting Attendance (2008)

	Executive	Nomination & Governance	Audit & Compliance	Compensation & Retirement	Finance Committee	Risk Management
Manuel M. Lopez	C (4/4)		M (5/5)			
Felipe B. Alfonso	M (4/4)	C (9/9)	M (14/14)	C (2/2)		M (2/2)
Jesus P. Francisco	M (1/1)		M (9/9)		M (4/4)	C (2/2)
Bernardino R. Abes	M (0/1)					
Daisy P. Arce					M (7/8)	
Arthur R. Defensor, Jr. *						
Gregory L. Domingo *		M (1/1)				
Winston F. Garcia						M (0/2)
Peter D. Garrucho, Jr.						
Christian S. Monsod		C (9/9)			M (11/12)	M (2/2)
Artemio V. Panganiban *	M (3/3)		C (9/9)	M (1/1)		
Vicente L. Panlilio *	M (2/2)	M (2/2)	M (9/9)			M (2/2)
Jeremy Z. Parulan			M (8/9)			
Jose Manuel Prieto						
Federico E. Puno *		M (5/5)		C (1/1)	M (3/4)	
Washington Z. Sycip *	M (0/1)		C (5/5)	M (0/1)		
Generoso D.C. Tulagan *						
Cesar E.A. Virata	M (4/4)			M (2/2)	C (12/12)	
C - Chairman M - Member * Independent Director						

In 2008, the Executive Committee met four (4) times. It approved some significant business matters which were subsequently deliberated by the Board in its regular meetings.

Nomination & Governance Committee

The Nomination and Governance Committee is responsible for screening qualified nominees for election as directors; assessing the independence of directors; introducing improvements on board organization and procedures; setting-up of mechanisms for performance evaluation of the Board and Management; and, providing programs for continuing education of the Board, including training for individual directors.

In 2008, the Nomination and Governance Committee held nine (9) meetings. Among the activities undertaken by the committee are the following: review and selection of the nominees for election as members of the Board; adoption of rules on proxy, validation and ballot appreciation and canvassing in preparation for the company's Annual Stockholders' Meeting in May 2008; recommendation of persons to occupy the positions of Compliance Officer and Corporate Secretary; the review of indicators used in Board performance evaluation; endorsement of proposed changes in the Board Committees' composition; discussion of the 2007 Corporate Governance Compliance Report; and, review of the Nomination

and Governance Committee's charter.

Audit & Compliance Committee

The Audit and Compliance Committee assists the Board in fulfilling its oversight responsibilities over the company's internal and independent auditors, their financial statements and financial reporting process, as well as their compliance with legal and regulatory matters.

The committee held fourteen (14) meetings in 2008. Among the matters taken-up by the committee are the following: review of the company's 2007 audited financial statements; deliberation of issues relating to the review of the company's quarterly financial statements, function of independent auditors; performance evaluation of independent auditor; approval of the fees of independent auditor; review of the company's response to SEC's comments on the company's 2006 audited financial statements; review of the Internal Audit's 2007 report and approval of 2008 Internal Audit Plan and Budget; and, the confirmation of the appointment of new Engagement Partners by the independent auditor and the company's new Head of Corporate Audits.

Compensation & Retirement Committee

The Compensation and Retirement Committee is responsible for formulating and developing the overall corporate philosophy and policy on 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" covers all types of remuneration including retirement benefits.

It held two (2) meetings in 2008. Discussions and deliberations pertained to the company's performance management and rewards practices; performance management system implementation and evaluation results; company incentive plan, targets and results; Board remuneration survey; and, review of the Compensation and Retirement Committee's charter.

Finance Committee

The Finance Committee's primary responsibility is to review the financial operations of the company and other matters pertaining to the acquisition, investments in companies, businesses or projects. It also advises and recommends approval or action on financial matters like establishment of changes in major financial and treasury policies, financing transactions, corporate plans and budgets; major contracts, acquisitions and divestitures, financing guarantees and indemnities, and mortgage of company assets.

This committee held twelve (12) meetings. Among the matters acted upon by the committee were: the approval of corporate budget; review of significant contracts; and, deliberations on financing facilities, declaration of dividends, cash flow and long-term indebtedness.

Risk Management Committee

The Risk Management 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.

It conducted two meetings in 2008. It covered the following matters: the company's Enterprise-wide Risk Management process; review of the listing/matrix of company's risks; the appointment of the Chief Risk Officer; and, business continuity management initiatives.

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.

Management is represented by a Management Committee (ManCom) composed of the corporate officers and executives formed and headed by the Chief Executive Officer, or 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 focus on critical functions or processes, like 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 are all subject to the Code of Ethics. This Code of Ethics embodies twelve (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 are further reinforced through the adoption of a Code on Employee Discipline, Conflict of Interest Policy, Full Business Interest Disclosure, Strategic Guidelines for Major Capital Investment, and Subsidiary Management Policy.

ENTERPRISE WIDE RISK MANAGEMENT

The company recognizes the importance of institutionalizing a focused and disciplined approach to managing its business risks. An Enterprise-wide Risk Management Office was created to coordinate the development of an enterprise risk management framework and to re-tool the infrastructure to effectively operationalize risk management at all levels of the organization. All the progressive initiatives of the company towards reaching the maturity level on risk management have executive guidance and review by the Chief Risk Officer and an oversight approval by the

Risk Management Committee of the Board.

Since 2005, this Enterprise-wide Risk Management Office has embarked on an awareness and education program, starting with the identification of risks at the strategic level and evaluating the existing strategies and processes to further improve mitigation of such risks. In 2008, three (3) offices were piloted for the implementation of risk and control self-assessment project.

ACCOUNTABILITY AND AUDIT

The Audit Committee performs an oversight role to evaluate the performance of the independent and internal auditors. The Chairman of this committee is an independent director, in compliance with the pertinent provisions of the SEC Code of Corporate Governance and the Company's Manual of Corporate Governance.

Independent Public Accountants

Sycip, Gorres & Velayo (SGV&Co.) was reappointed as the principal accountant and independent auditor of the company. The new engagement partner assigned to the company is Mr. Gemilio J. San Pedro who has extensive accounting and auditing experience. SGV&Co. has not been engaged by the company to perform non-audit services.

The following fees (in Php million; exclusive of VAT) were incurred by the company for SGV&Co.'s services.

Audit Fees	13.35
Audit-related Fees	8.30
Total	21.65

There has been no instance 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 the Chief Audit Executive (CAE) reports functionally to the Audit Committee and administratively to the Chairman and Chief Executive Officer.

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 put in place.

FINANCIAL REPORTING

The company's consolidated financial statements were prepared in accordance with the Philippine Financial Reporting Standards, which are aligned with the 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 2008, the review of the company's financial statements was conducted by the independent auditor. The results of the review were discussed by the Audit Committee and presented to the Board; after which, the financial statements were filed with the SEC and released to the public. The company has always been prompt in the submission of required financial statements to the SEC.

DEALINGS IN SECURITIES

The company has established an internal reporting system intended to guide the directors and principal officers when they trade the company's securities. This is 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 Compliance Officer not later than the following day after the required event or transaction.

DISCLOSURES ON OWNERSHIP STRUCTURE

The company ensures that it consistently complies with the required disclosure on shareholdings of its securities. It annually discloses the top 20 shareholders of its common shares. It also provides an annual disclosure of security ownership of certain record and beneficial owners who hold more than 5% of its equity shares. In compliance with the SEC requirements, a quarterly report of the company's top 100 stockholders is disclosed 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 are 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 to 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 with and inquire from 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 company 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 and CEO, Management and the external auditors are present to 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 from the Nomination and Governance Committee direction and guidance to further elevate the company's corporate governance practices to higher standards.

The company considers regulatory compliance as one of the high-priority areas. A Regulatory Management organizational unit has been created to further strengthen and drive more focus in 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. A Regulatory Compliance Officer is also appointed to execute plans and programs related to such regulatory matters.

OBLIGATIONS TO OTHER STAKEHOLDERS

The company gives due regard on the impact of business decision both on the company's shareholders 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.

COPORATE 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 its 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 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 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.