HAWAIIAN ELECTRIC CO INC
Form 10-K
February 28, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number	Registrant; State of Incorporation; Address; and Telephone Number	I.R.S. Employer Identification No.
1-8503	HAWAIIAN ELECTRIC INDUSTRIES, INC., a Hawaii corporation 900 Richards Street, Honolulu, Hawaii 96813 Telephone (808) 543-5662	99-0208097
1-4955	HAWAIIAN ELECTRIC COMPANY, INC., a Hawaii corporation 900 Richards Street, Honolulu, Hawaii 96813 Telephone (808) 543-7771	99-0040500

Securities registered pursuant to Section 12(b) of the Act:

Registrant	Title of each class	Name of each exchange

		on which registered
Hawaiian Electric Industries, Inc.	**Common Stock, Without Par Value**	**New York Stock Exchange**
Hawaiian Electric Industries, Inc.	**Preferred Stock Purchase Rights**	**New York Stock Exchange**
Hawaiian Electric Company, Inc.	**Guarantee with respect to 6.50% Cumulative Quarterly Income Preferred Securities Series 2004 (QUIPS[SM])**	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

Registrant	Title of each class
Hawaiian Electric Industries, Inc.	**None**
Hawaiian Electric Company, Inc.	**Cumulative Preferred Stock**

Indicate by check mark if Registrant Hawaiian Electric Industries, Inc. is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if Registrant Hawaiian Electric Company, Inc. is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if Registrant Hawaiian Electric Industries, Inc. is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark if Registrant Hawaiian Electric Company, Inc. is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether Registrant Hawaiian Electric Industries, Inc. (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether Registrant Hawaiian Electric Company, Inc. (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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Indicate by check mark whether Registrant Hawaiian Electric Industries, Inc. is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether Registrant Hawaiian Electric Company, Inc. is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether Registrant Hawaiian Electric Industries, Inc. is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate by check mark whether Registrant Hawaiian Electric Company, Inc. is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

	Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrants as of	**Number of shares of common stock outstanding of the registrants as of**	
	June 30, 2006	**June 30, 2006**	**February 21, 2007**
Hawaiian Electric Industries, Inc. (HEI)	$2,268,395,604.61	81,275,371 (Without par value)	81,471,220 (Without par value)
Hawaiian Electric Company, Inc. (HECO)	None	12,805,843 ($6 2/3 par value)	12,805,843 ($6 2/3 par value)

DOCUMENTS INCORPORATED BY REFERENCE

HECO Consolidated 2006 Financial Statements Parts I, II, III and IV

HECO Consolidated Selected Financial Data Part II

Portions of Proxy Statement of Hawaiian Electric Industries, Inc. for the 2007 Annual Meeting of Shareholders to be filed Part III

This combined Form 10-K represents separate filings by Hawaiian Electric Industries, Inc. and Hawaiian Electric Company, Inc. Information contained herein relating to any individual registrant is filed by each registrant on its own behalf. Neither registrant makes any representations as to the information relating to the other registrant.

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GLOSSARY OF TERMS

Defined below are certain terms used in this report:

Terms	Definitions
1935 Act	Public Utility Holding Company Act of 1935
2005 Act	Public Utility Holding Company Act of 2005
AES Hawaii	AES Hawaii, Inc., formerly known as AES Barbers Point, Inc.
ASB	American Savings Bank, F.S.B., a wholly-owned subsidiary of HEI Diversified, Inc. and parent company of American Savings Investment Services Corp. (and its subsidiary since March 15, 2001, Bishop Insurance Agency of Hawaii, Inc.) and AdCommunications, Inc. Former subsidiaries include American Savings Mortgage Co., Inc. (dissolved in July 2003), ASB Service Corporation (dissolved in January 2004) and ASB Realty Corporation (dissolved in May 2005).
BIF	Bank Insurance Fund
BLNR	Board of Land and Natural Resources of the State of Hawaii
Btu	British thermal unit
CERCLA	Comprehensive Environmental Response, Compensation and Liability Act
Chevron	Chevron Products Company, a fuel oil supplier
Company	When used in Hawaiian Electric Industries, Inc. sections, the Company refers to Hawaiian Electric Industries, Inc. and its direct and indirect subsidiaries, including, without limitation, Hawaiian Electric Company, Inc. and its subsidiaries, Hawaii Electric Light Company, Inc., Maui Electric Company, Limited, Renewable Hawaii, Inc. and HECO Capital Trust III; HEI Diversified, Inc. and its subsidiary, American Savings Bank, F.S.B. and its subsidiaries (listed under ASB); Pacific Energy Conservation Services, Inc.; HEI Properties, Inc.; HEI Investments, Inc.; Hycap Management, Inc. (in dissolution); Hawaiian Electric Industries Capital Trust II and Hawaiian Electric Industries Capital Trust III (inactive financing entities); and The Old Oahu Tug Service, Inc. (formerly Hawaiian Tug & Barge Corp.). Former subsidiaries include HECO Capital Trust I (dissolved and terminated in 2004)*, HECO Capital Trust II (dissolved and terminated in 2004)*, HEI District Cooling, Inc. (dissolved in October 2003), ProVision Technologies, Inc. (sold in July 2003), HEI Leasing, Inc. (dissolved in October 2003), Hawaiian Electric Industries Capital Trust I (dissolved and terminated in 2004)*, HEI Preferred Funding, LP (dissolved and terminated in 2004)*, Malama Pacific Corp. (discontinued operations, dissolved in June 2004), ASB Service Corporation (dissolved in January 2004) and HEIPC (discontinued operations, dissolved in 2006) and its dissolved subsidiaries. (*unconsolidated subsidiaries as of January 1, 2004)
	When used in Hawaiian Electric Company, Inc. sections, the Company refers to Hawaiian Electric Company, Inc. and its direct subsidiaries, including, without limitation, Hawaii Electric Light Company, Inc., Maui Electric Company, Limited, Renewable Hawaii, Inc. and HECO Capital Trust III. Former subsidiaries include HECO Capital Trust I (dissolved and terminated in 2004)* and HECO Capital Trust II (dissolved and terminated in 2004)*. (*unconsolidated subsidiaries as of January 1, 2004)
Consumer Advocate	Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii
CT	Combustion turbine
D&O	Decision and order
DG	Distributed generation
DOD	Department of Defense federal
DOH	Department of Health of the State of Hawaii
DRIP	HEI Dividend Reinvestment and Stock Purchase Plan
DSM	Demand-side management
ECAC	Energy cost adjustment clause
EITF	Emerging Issues Task Force
EOTP	East Oahu Transmission Project
EPA	U.S. Environmental Protection Agency
ERL	Environmental Response Law of the State of Hawaii
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act of 1991

federal	U.S. Government
FERC	Federal Energy Regulatory Commission
FHLB	Federal Home Loan Bank
FICO	Financing Corporation

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GLOSSARY OF TERMS *(continued)*

Terms	Definitions
GAAP	U. S. generally accepted accounting principles
HCPC	Hilo Coast Power Company, formerly Hilo Coast Processing Company
HC&S	Hawaiian Commercial & Sugar Company, a division of A&B-Hawaii, Inc.
HECO	Hawaiian Electric Company, Inc., an electric utility subsidiary of Hawaiian Electric Industries, Inc. and parent company of Hawaii Electric Light Company, Inc., Maui Electric Company, Limited, Renewable Hawaii, Inc. and HECO Capital Trust III. Former subsidiaries include HECO Capital Trust I (dissolved and terminated in 2004)* and HECO Capital Trust II (dissolved and terminated in 2004)*. (*unconsolidated subsidiaries as of January 1, 2004)
HECO s Consolidated Financial Statements	Hawaiian Electric Company, Inc. s Consolidated Financial Statements, incorporated by reference into Parts I, II, III and IV of this Form 10-K, which is filed as HECO Exhibit 99.4
HECO s MD&A	Hawaiian Electric Company, Inc. s Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 herein
HEI	Hawaiian Electric Industries, Inc., direct parent company of Hawaiian Electric Company, Inc., HEI Diversified, Inc., Pacific Energy Conservation Services, Inc., HEI Properties, Inc., HEI Investments, Inc., Hycap Management, Inc., Hawaiian Electric Industries Capital Trust II, Hawaiian Electric Industries Capital Trust III and The Old Oahu Tug Service, Inc. (formerly Hawaiian Tug & Barge Corp.). Former subsidiaries include HEI District Cooling, Inc. (dissolved in October 2003), ProVision Technologies, Inc. (sold in July 2003), HEI Leasing, Inc. (dissolved in October 2003), Hawaiian Electric Industries Capital Trust I (dissolved and terminated in 2004)* and Malama Pacific Corp. (discontinued operations, dissolved in June 2004) and HEI Power Corp. (discontinued operations, dissolved in 2006). (*unconsolidated subsidiaries as of January 1, 2004)
HEI s Consolidated Financial Statements	Hawaiian Electric Industries, Inc. s Consolidated Financial Statements in Item 8 herein
HEI s MD&A	Hawaiian Electric Industries, Inc. s Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 herein
HEI s 2007 Proxy Statement	Portions of Hawaiian Electric Industries, Inc. s 2007 Proxy Statement to be filed, which portions are incorporated into this Form 10-K by reference
HEIDI	HEI Diversified, Inc., a wholly-owned subsidiary of Hawaiian Electric Industries, Inc. and the parent company of American Savings Bank, F.S.B.
HEIII	HEI Investments, Inc. (formerly HEI Investment Corp.), a direct subsidiary of Hawaiian Electric Industries, Inc. since January 2007 and formerly a wholly-owned subsidiary of HEI Power Corp.
HEIPC	HEI Power Corp., formerly a wholly owned subsidiary of Hawaiian Electric Industries, Inc., and the parent company of numerous subsidiaries, several of which were dissolved or otherwise wound up since 2002, pursuant to a formal plan to exit the international power business (formerly engaged in by HEIPC and its subsidiaries) adopted by the HEI Board of Directors in October 2001. HEIPC was dissolved in December 2006.
HEIPC Group	HEI Power Corp. and its subsidiaries
HEIPI	HEI Properties, Inc., a wholly-owned subsidiary of Hawaiian Electric Industries, Inc.
HEIRSP	Hawaiian Electric Industries Retirement Savings Plan
HELCO	Hawaii Electric Light Company, Inc., an electric utility subsidiary of Hawaiian Electric Company, Inc.
HEP	Hamakua Energy Partners, L.P., formerly known as Encogen Hawaii, L.P.
HITI	Hawaiian Interisland Towing, Inc.
HRD	Hawi Renewable Development, LLC
HTB	Hawaiian Tug & Barge Corp. On November 10, 1999, HTB sold substantially all of its operating assets and the stock of Young Brothers, Limited, and changed its name to The Old Oahu Tug Services, Inc.
IPP	Independent power producer
IRP	Integrated resource plan
Kalaeloa	Kalaeloa Partners, L.P.

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GLOSSARY OF TERMS *(continued)*

Terms	Definitions
kV	kilovolt
KWH	Kilowatthour
KWP	Kaheawa Wind Power, LLC
LSFO	Low sulfur fuel oil
MBtu	Million British thermal unit
MECO	Maui Electric Company, Limited, an electric utility subsidiary of Hawaiian Electric Company, Inc.
MSFO	Medium sulfur fuel oil
MW	Megawatt/s (as applicable)
NA	Not applicable
NM	Not meaningful
O&M	operation and maintenance
OPA	Federal Oil Pollution Act of 1990
OTS	Office of Thrift Supervision, Department of Treasury
PCB	Polychlorinated biphenyls
PECS	Pacific Energy Conservation Services, Inc., a wholly-owned subsidiary of Hawaiian Electric Industries, Inc.
PGV	Puna Geothermal Venture
PPA	Power purchase agreement
PUC	Public Utilities Commission of the State of Hawaii
PURPA	Public Utility Regulatory Policies Act of 1978
QF	Qualifying Facility under the Public Utility Regulatory Policies Act of 1978
QTL	Qualified Thrift Lender
RCRA	Resource Conservation and Recovery Act of 1976
Registrant	Each of Hawaiian Electric Industries, Inc. and Hawaiian Electric Company, Inc.
ROACE	Return on average common equity
ROR	Return on rate base
SAIF	Savings Association Insurance Fund
SARs	Stock appreciation rights
SEC	Securities and Exchange Commission
See	Means the referenced material is incorporated by reference
ST	Steam turbine
state	State of Hawaii
Tesoro	Tesoro Hawaii Corporation dba BHP Petroleum Americas Refining Inc., a fuel oil supplier
TOOTS	The Old Oahu Tug Service, Inc. (formerly Hawaiian Tug & Barge Corp.), a wholly-owned subsidiary of Hawaiian Electric Industries, Inc. On November 10, 1999, HTB sold the stock of YB and substantially all of HTB s operating assets and changed its name.
UST	Underground storage tank
VIE	Variable interest entity
YB	Young Brothers, Limited, which was sold on November 10, 1999, was formerly a wholly-owned subsidiary of Hawaiian Tug & Barge Corp.

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Forward-Looking Statements

This report and other presentations made by Hawaiian Electric Industries, Inc. (HEI) and Hawaiian Electric Company, Inc. (HECO) and their subsidiaries contain forward-looking statements, which include statements that are predictive in nature, depend upon or refer to future events or conditions, and usually include words such as expects, anticipates, intends, plans, believes, predicts, estimates or similar expressions. I addition, any statements concerning future financial performance, ongoing business strategies or prospects and possible future actions are also forward-looking statements. Forward-looking statements are based on current expectations and projections about future events and are subject to risks, uncertainties and the accuracy of assumptions concerning HEI and its subsidiaries (collectively, the Company), the performance of the industries in which they do business and economic and market factors, among other things. **These forward-looking statements are not guarantees of future performance.**

Risks, uncertainties and other important factors that could cause actual results to differ materially from those in forward-looking statements and from historical results include, but are not limited to, the following:

- the effects of international, national and local economic conditions, including the state of the Hawaii tourist and construction industries, the strength or weakness of the Hawaii and continental U.S. real estate markets (including the fair value of collateral underlying loans and mortgage-related securities) and decisions concerning the extent of the presence of the federal government and military in Hawaii;

- the effects of weather and natural disasters, such as hurricanes, earthquakes, tsunamis and the potential effects of global warming;

- global developments, including the effects of terrorist acts, the war on terrorism, continuing U.S. presence in Iraq and Afghanistan, potential conflict or crisis with North Korea and in the Middle East, North Korea s and Iran s nuclear activities and potential avian flu pandemic;

- the timing and extent of changes in interest rates and the shape of the yield curve;

- the risks inherent in changes in the value of and market for securities available for sale and pension and other retirement plan assets;

- changes in assumptions used to calculate retirement benefits costs and changes in funding requirements;

- increasing competition in the electric utility and banking industries (e.g., increased self-generation of electricity may have an adverse impact on HECO s revenues and increased price competition for deposits, or an outflow of deposits to alternative investments, may have an adverse impact on American Savings Bank, F.S.B. s (ASB s) cost of funds);

- capacity and supply constraints or difficulties, especially if generating units (utility-owned or independent power producer (IPP)-owned) fail or measures such as demand-side management (DSM), distributed generation (DG), combined heat and power (CHP) or other firm capacity supply-side resources fall short of achieving their forecasted benefits or are otherwise insufficient to reduce or meet peak demand;

- increased risk to generation reliability as generation peak reserve margins on Oahu continue to be strained;

fuel oil price changes, performance by suppliers of their fuel oil delivery obligations and the continued availability to the electric utilities of their energy cost adjustment clauses (ECACs);

the ability of IPPs to deliver the firm capacity anticipated in their power purchase agreements (PPAs);

the ability of the electric utilities to negotiate, periodically, favorable fuel supply and collective bargaining agreements;

new technological developments that could affect the operations and prospects of HEI and its subsidiaries (including HECO and its subsidiaries and ASB and its subsidiaries) or their competitors;

federal, state and international governmental and regulatory actions, such as changes in laws, rules and regulations applicable to HEI, HECO and their subsidiaries (including changes in taxation, environmental laws and regulations, the potential regulation of greenhouse gas emissions and governmental fees and assessments); decisions by the Public Utilities Commission of the State of Hawaii (PUC) in rate cases (including decisions on ECACs) and other proceedings and by other agencies and courts on land use, environmental and other permitting issues; required corrective actions, restrictions and penalties (that may arise, for example, with respect to environmental conditions, renewable portfolio standards (RPS), capital adequacy and business practices);

increasing operations and maintenance expenses for the electric utilities and the possibility of more frequent rate cases;

the risks associated with the geographic concentration of HEI s businesses;

the effects of changes in accounting principles applicable to HEI, HECO and their subsidiaries, including the adoption of new accounting principles (such as the effects of Statement of Financial Accounting Standards (SFAS) No. 158 regarding employers accounting for defined benefit pension and other postretirement plans and Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48 regarding uncertainty in income taxes), continued regulatory accounting under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, and the possible effects of applying FIN 46R, Consolidation of Variable Interest Entities, and Emerging Issues Task Force Issue No. 01-8, Determining Whether an Arrangement Contains a Lease, to PPAs with independent power producers;

the effects of changes by securities rating agencies in their ratings of the securities of HEI and HECO and the results of financing efforts;

faster than expected loan prepayments that can cause an acceleration of the amortization of premiums on loans and investments and the impairment of mortgage servicing rights of ASB;

changes in ASB s loan portfolio credit profile and asset quality which may increase or decrease the required level of allowance for loan losses;

changes in ASB s deposit cost or mix which may have an adverse impact on ASB s cost of funds;

the final outcome of tax positions taken by HEI, HECO and their subsidiaries;

the ability of consolidated HEI to generate capital gains and utilize capital loss carryforwards on future tax returns;

- the risks of suffering losses and incurring liabilities that are uninsured; and

- other risks or uncertainties described elsewhere in this report (e.g., Item 1A. Risk Factors) and in other periodic reports previously and subsequently filed by HEI and/or HECO with the Securities and Exchange Commission (SEC).

Forward-looking statements speak only as of the date of the report, presentation or filing in which they are made. Except to the extent required by the federal securities laws, HEI and its subsidiaries undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

ITEM 1. BUSINESS

HEI

HEI was incorporated in 1981 under the laws of the State of Hawaii and is a holding company with its principal subsidiaries engaged in electric utility, banking and other businesses operating primarily in the State of Hawaii. HEI s predecessor, HECO, was incorporated under the laws of the Kingdom of Hawaii (now the State of Hawaii) on October 13, 1891. As a result of a 1983 corporate reorganization, HECO became an HEI subsidiary and common shareholders of HECO became common shareholders of HEI.

HECO and its operating subsidiaries, Maui Electric Company, Limited (MECO) and Hawaii Electric Light Company, Inc. (HELCO), are regulated electric public utilities providing the only electric public utility service on the islands of Oahu, Maui, Lanai, Molokai and Hawaii, which islands collectively include approximately 95% of Hawaii s population. HECO also owns all the common securities of HECO Capital Trust III (Delaware statutory trust), which was formed to effect the issuance of $50 million of cumulative quarterly income preferred securities in 2004, for the benefit of HECO, HELCO and MECO. In December 2002, HECO formed a subsidiary, Renewable Hawaii, Inc., to invest in renewable energy projects.

Besides HECO and its subsidiaries, HEI also owns directly or indirectly the following subsidiaries: HEI Diversified, Inc. (HEIDI) (a holding company) and its subsidiary, ASB, and the subsidiaries of ASB; Pacific Energy Conservation Services, Inc. (PECS); HEI Properties, Inc. (HEIPI); HEI Investments, Inc.; Hycap Management, Inc. (in dissolution); Hawaiian Electric Industries Capital Trusts II and III (formed in 1997 to be available for trust securities financings); The Old Oahu Tug Service, Inc. (TOOTS); and HEI Power Corp. (HEIPC) (discontinued operations, dissolved in December 2006).

ASB, acquired in 1988, is the third largest financial institution in the State of Hawaii based on total assets as of December 31, 2006. ASB has subsidiaries involved in the sale and distribution of insurance products and an inactive advertising agency for ASB and its subsidiaries. Former ASB subsidiary, ASB Realty Corporation, which had elected to be taxed as a real estate investment trust, was dissolved in May 2005 (see Note 10 to HEI s Consolidated Financial Statements under ASB state franchise tax dispute and settlement).

HEIPI, whose predecessor company was formed in February 1998, holds venture capital investments (in companies based in Hawaii and the U.S. mainland) with a carrying value of $2.8 million as of December 31, 2006.

HEI Investment Corp. (HEIIC), incorporated in May 1984 primarily to make passive investments in corporate securities and other long-term investments, changed its name to HEI Investments, Inc. (HEIII) in January 2000. HEIII is not an investment company regulated under the Investment Company Act of 1940. In February 2000, HEIII became a subsidiary of HEIPC, but, in connection with the dissolution of HEIPC and related transactions, it again is a direct subsidiary of HEI. HEIII s long-term investments currently consist primarily of investments in leveraged leases accounted for in the Company s continuing operations. In 2005, HEIII sold its approximate 25% interest in a trust that is the owner/lessor of a 60% undivided interest in a coal-fired electric generating plant in Georgia for a pretax gain of $14 million.

PECS was formed in 1994 and currently is a contract services company providing limited support services in Hawaii.

Hycap Management, Inc., HEI Preferred Funding, LP (a limited partnership in which Hycap Management, Inc. was the sole general partner) and Hawaiian Electric Industries Capital Trust I (a Delaware statutory trust in which HEI owned all the common securities) were formed to effect the issuance of $100 million of 8.36% HEI-obligated trust preferred securities in 1997, which securities were redeemed in April 2004. Hawaiian Electric Industries Capital Trust I and HEI Preferred Funding, LP were dissolved and terminated in 2004, and Hycap Management, Inc. began dissolution in 2004 and will terminate in 2007.

In November 1999, Hawaiian Tug & Barge Corp. (HTB) sold substantially all of its operating assets and the stock of YB for a nominal gain, changed its name to TOOTS and ceased maritime freight transportation operations. TOOTS currently administers certain employee and retiree-related benefits programs and monitors matters related to its former operations and the operations of its former subsidiary.

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For information about the Company s discontinued international power operations formerly conducted by HEIPC and its subsidiaries, see Note 14 to HEI s Consolidated Financial Statements.

For additional information about the Company, see HEI s MD&A, HEI s Quantitative and Qualitative Disclosures about Market Risk and HEI s Consolidated Financial Statements.

The Company s website address is www.hei.com. The information on the Company s website is not incorporated by reference in this annual report on Form 10-K unless specifically incorporated herein by reference. HEI and HECO currently make available free of charge through this website their annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports (since 1994) as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC.

Electric utility

HECO and subsidiaries and service areas

HECO, HELCO and MECO are regulated operating electric public utilities engaged in the production, purchase, transmission, distribution and sale of electricity on the islands of Oahu; Hawaii; and Maui, Lanai and Molokai, respectively. HECO was incorporated under the laws of the Kingdom of Hawaii (now State of Hawaii) in 1891. HECO acquired MECO in 1968 and HELCO in 1970. MECO acquired the Lanai City power plant on the island of Lanai in 1988 and all the outstanding common stock of Molokai Electric Company, Limited (currently a division of MECO) in 1989. In 2006, the electric utilities revenues and net income amounted to approximately 84% and 69%, respectively, of HEI s consolidated revenues and income from continuing operations, compared to approximately 82% and 57% in 2005 and approximately 81% and 75% in 2004, respectively.

The islands of Oahu, Maui, Lanai, Molokai and Hawaii have a combined population estimated at 1.2 million, or approximately 95% of the Hawaii population, and comprise a service area of 5,766 square miles. The principal communities served include Honolulu (on Oahu), Wailuku and Kahului (on Maui) and Hilo and Kona (on Hawaii). The service areas also include numerous suburban communities, resorts, U.S. Armed Forces installations and agricultural operations. The state has granted HECO, MECO and HELCO nonexclusive franchises, which authorize the utilities to construct, operate and maintain facilities over and under public streets and sidewalks. HECO s franchise covers the City & County of Honolulu, MECO s franchises cover the County of Maui and the County of Kalawao, and HELCO s franchise covers the County of Hawaii. Each of these franchises will continue in effect for an indefinite period of time until forfeited, altered, amended or repealed.

For additional information about HECO, see HECO s MD&A, HECO s Quantitative and Qualitative Disclosures about Market Risk and HECO s Consolidated Financial Statements.

Sales of electricity

The following table sets forth the number of electric customer accounts as of December 31, 2006, 2005 and 2004 and electric sales revenues by company for each of the years then ended:

Years ended December 31	**2006**		**2005**		**2004**	
(dollars in thousands)	**Customer accounts***	**Electric sales revenues**	**Customer accounts***	**Electric sales revenues**	**Customer accounts***	**Electric sales revenues**
HECO	292,988	$ 1,361,566	291,580	$ 1,201,156	288,456	$ 1,050,388
HELCO	76,417	338,786	73,835	293,739	71,594	240,947
MECO	64,937	343,916	63,901	301,755	61,996	250,750
	434,342	$ 2,044,268	429,316	$ 1,796,650	422,046	$ 1,542,085

* As of December 31.

Revenues from the sale of electricity in 2006 were from the following types of customers in the proportions shown:

	HECO	HELCO	MECO	Total
Residential	31%	41%	36%	34%
Commercial	32	40	34	34
Large light and power	36	19	29	32
Other	1		1	
	100%	100%	100%	100%

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Seasonality. Kilowatthour (KWH) sales of HECO and its subsidiaries follow a seasonal pattern, but they do not experience the extreme seasonal variation due to extreme weather variations like some electric utilities on the U.S. mainland. KWH sales in Hawaii tend to increase in the warmer summer months, probably as a result of increased demand for air conditioning.

Significant customers. HECO and its subsidiaries derived approximately 10% of their operating revenues from the sale of electricity to various federal government agencies in each of 2006, 2005 and 2004.

In 1995, HECO and the U.S. General Services Administration entered into a Basic Ordering Agreement under which HECO would arrange for the financing and installation of energy conservation projects at federal facilities in Hawaii. In 1996, HECO signed an umbrella Basic Ordering Agreement with the Department of Defense (DOD-BOA). In 2001, HECO signed a new DOD-BOA, which expired in 2006. In January 2007, HECO signed another new DOD-BOA, which expires in 2012. Under these and other agreements, HECO has completed energy conservation and other projects for federal agencies over the years, although the number of projects completed has decreased through the years.

Executive Order 13123, adopted in 1994, mandated that each federal agency develop and implement a program to reduce energy consumption by 35% by the year 2010 to the extent that these measures are cost effective. The 35% reduction was measured relative to the agency s 1985 energy use. The Energy Policy Act of 2005 further mandated that federal buildings reduce energy consumption by up to 20% in fiscal year 2015 relative to base fiscal year 2003 consumption to the extent that these measures are cost effective. The Act also establishes energy conservation goals at the state level for federally funded programs; stricter conservation measures for a variety of large energy consuming products; tax credits for energy efficient homes, solar energy, fuel cells and microturbine power plants; and includes other energy-related provisions. HECO continues to work with various federal agencies to implement DSM programs that will help them achieve their energy reduction objectives. Neither HEI nor HECO management can predict with certainty the impact of federal mandates on HEI s or HECO s future financial condition, results of operations or liquidity.

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Selected consolidated electric utility operating statistics

Years ended December 31,	**2006**	**2005**	**2004**	**2003**	**2002**
KWH sales (millions)					
Residential	3,022.2	3,008.0	3,000.6	2,875.9	2,778.5
Commercial	3,313.3	3,288.5	3,247.3	3,168.3	3,073.6
Large light and power	3,728.8	3,742.0	3,762.6	3,676.5	3,639.2
Other	51.5	51.4	52.8	54.4	53.0
	10,115.8	10,089.9	10,063.3	9,775.1	9,544.3
KWH net generated and purchased (millions)					
Net generated	6,610.8	6,485.3	6,572.5	6,280.2	6,249.7
Purchased	4,094.4	4,167.5	4,066.5	4,054.3	3,829.6
	10,705.2	10,652.8	10,639.0	10,334.5	10,079.3
Losses and system uses (%)	5.3	5.1	5.2	5.2	5.1
Energy supply (December 31)					
Net generating capability MW	1,669	1,644	1,642	1,606	1,606
Firm purchased capability MW	535	540	529	531	510
	2,204	2,184	2,171	2,137	2,116
Net peak demand MW[1]	1,685	1,641	1,694	1,638	1,583
Btu per net KWH generated	10,848	10,873	10,767	10,663	10,673
Average fuel oil cost per Mbtu (cents)	1,094.1	908.6	684.3	580.5	466.4
Customer accounts (December 31)					
Residential	376,783	372,638	366,217	362,400	356,244
Commercial	55,493	54,647	53,854	52,659	51,386
Large light and power	567	559	555	549	551
Other	1,499	1,472	1,420	1,385	1,374
	434,342	429,316	422,046	416,993	409,555
Electric revenues (thousands)					
Residential	$ 690,425	$ 607,031	$ 527,970	$ 471,697	$ 426,291
Commercial	695,247	611,403	522,230	474,017	425,595
Large light and power	648,066	569,016	483,737	434,319	389,312
Other	10,530	9,200	8,148	7,758	7,028
	$ 2,044,268	$ 1,796,650	$ 1,542,085	$ 1,387,791	$ 1,248,226
Average revenue per KWH sold (cents)	20.21	17.81	15.32	14.20	13.08
Residential	22.85	20.18	17.60	16.40	15.34
Commercial	20.98	18.59	16.08	14.96	13.85
Large light and power	17.38	15.21	12.86	11.81	10.70
Other	20.44	17.92	15.44	14.26	13.26
Residential statistics					
Average annual use per customer account (KWH)	8,056	8,141	8,239	8,004	7,840
Average annual revenue per customer account	$ 1,840	$ 1,643	$ 1,450	$ 1,313	$ 1,203
Average number of customer accounts	375,143	369,495	364,225	359,288	354,419

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[1] Sum of the net peak demands on all islands served, noncoincident and nonintegrated.

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Generation statistics

The following table contains certain generation statistics as of, and for the year ended, December 31, 2006. The net generating and firm purchased capability available for operation at any given time may be more or less than shown because of capability restrictions or temporary outages for inspection, maintenance, repairs or unforeseen circumstances.

	Island of Oahu- HECO	Island of Hawaii- HELCO	Island of Maui- MECO	Island of Lanai- MECO	Island of Molokai- MECO	Total
Net generating and firm purchased capability (MW) as of December 31, 2006[1]						
Conventional oil-fired steam units	1,106.8	62.2	35.9			1,204.9
Diesel	24.6	30.8	82.5	10.3	9.6	157.8
Combustion turbines (peaking units)	101.8					101.8
Combustion turbines		88.9			2.2	91.1
Combined-cycle unit			113.6			113.6
Firm contract power[2]	434.0	84.7	16.0			534.7
	1,667.2	266.6	248.0	10.3	11.8	2,203.9
Net peak demand (MW)	1,266.0	201.3	206.4	5.5	6.2	1,685.4[3]
Reserve margin	33.8%	32.4%	20.2%	87.1%	91.0%	32.3%
Annual load factor	73.1%	71.1%	70.6%	62.6%	71.2%	72.5%[3]
KWH net generated and purchased (millions)	8,104.9	1,254.5	1,276.9	30.2	38.7	10,705.2

1 HECO units at normal ratings; MECO and HELCO units at reserve ratings.

2 Nonutility generators HECO: 208 MW (Kalaeloa Partners, L.P., oil-fired), 180 MW (AES Hawaii, Inc., coal-fired) and 46 MW (HPower, refuse-fired); HELCO: 25 MW (Puna Geothermal Venture, geothermal) and 60 MW (Hamakua Energy Partners, L.P., oil-fired); MECO: 16 MW (Hawaiian Commercial & Sugar Company, primarily bagasse-fired).

3 Noncoincident and nonintegrated.

Generating reliability and reserve margin

HECO serves the island of Oahu and HELCO serves the island of Hawaii. MECO has three separate electrical systems one each on the islands of Maui, Molokai and Lanai. HECO, HELCO and MECO have isolated electrical systems that are not interconnected to each other or to any other electrical grid and thus, each maintain a higher level of reserve generation than is typically carried by interconnected mainland U.S. utilities, which are able to share reserve capacity. These higher levels of reserve margins are required to meet peak electric demands, to provide for scheduled maintenance of generating units (including the units operated by IPPs relied upon for firm capacity) and to allow for the forced outage of the largest generating unit in the system. Although the planning for, and installation of, adequate levels of reserve generation have contributed to the achievement of generally high levels of system reliability, HECO is below preferred levels of reserve margin and has made several public calls for energy conservation when reserves were especially narrow. See Integrated resource planning, requirements for additional generating capacity and adequacy of supply in HEI s MD&A under Electric utility.

Integrated resource planning and requirements for additional generating capacity

The PUC issued an order in 1992 requiring the energy utilities in Hawaii to develop integrated resource plans (IRPs), which may be approved, rejected or modified by the PUC. The goal of integrated resource planning is the identification of demand- and supply-side resources and the integration of these resources for meeting near- and long-term consumer energy needs in an efficient and reliable manner at the lowest reasonable cost. See Integrated resource planning, requirements for additional generating capacity and adequacy of supply in HEI s MD&A.

New capital projects

The capital projects of the electric utilities may be subject to various approval and permitting processes, including obtaining PUC approval of the project, air permits from the Department of Health of the State of Hawaii (DOH) and/or the U.S. Environmental Protection Agency (EPA), land use permits from the Hawaii Board of Land and Natural Resources (BLNR) and land use entitlements from the applicable county. Difficulties in obtaining, or the inability to obtain, the necessary approvals or permits could result in project delays, increased project costs and/or project abandonment. Extensive project delays and significantly increased project costs could result in a portion of

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the project costs being excluded from rates. If a project is abandoned, the project costs are generally written-off to expense, unless the PUC determines that all or part of the costs may be deferred for later recovery in rates.

Significant capital projects include HECO s East Oahu Transmission Project (see discussion in Note 11 to HECO s Consolidated Financial Statements) and HELCO s ST-7, currently under construction, HELCO s West Hawaii Transmission projects and MECO s Waena power plant expansion. HECO s New Dispatch Center project houses a modernized Energy Management System and will be integrated with new Outage Management and Customer Information systems. The New Dispatch Center building and associated equipment and the Energy Management System became operational in 2006, with the remainder of the project expected to be completed in 2007. HECO has also requested approval from the PUC to install a new generating unit in Campbell Industrial Park (an approximately 110 MW combustion turbine scheduled for commercial operation in 2009) and a two-mile-long 138 kilovolt (kV) overhead transmission line to provide additional transmission capacity for the new generating unit as well as for existing units at Campbell Industrial Park. See discussion in Integrated resource planning and requirements for additional generating capacity in HEI s MD&A under Electric utility.

Nonutility generation

The Company has supported state and federal energy policies which encourage the development of renewable energy sources that reduce the use of fuel oil. The Company s renewable energy sources range from wind, geothermal and hydroelectric power, to energy produced by the burning of bagasse (sugarcane waste) and municipal waste.

HECO PPAs. HECO currently has three major PPAs. In March 1988, HECO entered into a PPA with AES Barbers Point, Inc. (now known as AES Hawaii, Inc. (AES Hawaii)), a Hawaii-based, indirect subsidiary of The AES Corporation. The agreement with AES Hawaii, as amended, provides that, for a period of 30 years beginning September 1992, HECO will purchase 180 MW of firm capacity. The AES Hawaii 180 MW coal-fired cogeneration plant utilizes a clean coal technology and is designed to sell sufficient steam to be a Qualifying Facility (QF) under the Public Utility Regulatory Policies Act of 1978 (PURPA). In 2003, HECO consented to AES Hawaii s proposed refinancing and received consideration for its consent, primarily in the form of a PPA amendment that reduced the cost of firm capacity retroactive to June 1, 2003, which benefit is being passed on to ratepayers through a reduction in rates. AES Hawaii also granted HECO an option, subject to certain conditions, to acquire an interest in portions of the AES Hawaii facility site that are not needed for the existing plant operations, and which potentially could be used for the development of another coal-fired facility.

In October 1988, HECO entered into an agreement with Kalaeloa Partners, L.P. (Kalaeloa), a limited partnership whose sole general partner was an indirect, wholly-owned subsidiary of ASEA Brown Boveri, Inc. (ABB), which, through affiliates, contracted to design, build, operate and maintain the facility. The ownership of Kalaeloa was subsequently restructured and its current owners are PSEG Kalaeloa Inc., a Delaware corporation and 1% general partner, and Kalaeloa Investment Partners, L.P., a Delaware limited partnership and 99% limited partner. The agreement with Kalaeloa, as amended, provides that HECO will purchase 180 MW of firm capacity for a period of 25 years beginning in May 1991. The Kalaeloa facility is a combined-cycle operation, consisting of two oil-fired combustion turbines burning low sulfur fuel oil (LSFO) and a steam turbine that utilizes waste heat from the combustion turbines, and is designed to sell sufficient steam to be a QF. On October 12, 2004, HECO and Kalaeloa executed two amendments to the PPA: 1) Confirmation Agreement Concerning Section 5.2B(2) Of PPA and Amendment No. 5 To PPA (Amendment No. 5) and 2) Agreement For Increment Two Capacity and Amendment No. 6 To PPA (Amendment No. 6). Amendment No. 5 confirms that Kalaeloa s facility is able to deliver 189 MW of capacity and sets the capacity payment rate for capacity above 180 MW at $112 per kilowatt per year. Amendment No. 6 provides for the purchase of up to 20 MW of additional capacity, beyond the 189 MW capacity confirmed in Amendment No. 5, at $112 per kilowatt per year. Amendment Nos. 5 and 6 became effective on September 28, 2005, when HECO received an interim decision and order (D&O) allowing the recovery of the costs of the additional 29 MW (subsequently revised to 28 MW) of additional capacity (see FIN 46R discussion in Note 3 to HECO s Consolidated Financial Statements). Kalaeloa currently supplies HECO with 208 MW of firm capacity.

HECO also entered into a PPA in March 1986 and a firm capacity amendment in April 1991 with the City and County of Honolulu with respect to a refuse-fired plant (HPower). The HPower facility currently supplies HECO with 46 MW of firm capacity. Under the amendment, HECO will purchase firm capacity until mid-2015.

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HECO purchases energy on an as-available basis from two nonutility generators, which are qualifying cogeneration facilities at two oil refineries, Chevron USA, Inc. (10 MW) and Tesoro Hawaii Corporation (19 MW). These generators burn a variety of fuels available from within their refinery. HECO s contract with Chevron USA, Inc. began in 1990 and the contract with Tesoro Hawaii Corporation began in 1984. Both contracts continue unless either party wants to terminate with 90 days notice.

The PUC has allowed rate recovery for the firm capacity and purchased energy costs related to HECO s three major PPAs that provide a total of 434 MW of firm capacity, representing 26% of HECO s total net generating and firm purchased capacity on Oahu as of December 31, 2006. The PUC also has allowed rate recovery for the purchased energy costs related to HECO s as-available energy PPAs.

HELCO and MECO PPAs. As of December 31, 2006, HELCO has PPAs for 90 MW and MECO has 16 MW (includes 4 MW of system protection) of firm capacity, which PPAs have been approved by the PUC.

HELCO has a 35-year PPA with Puna Geothermal Venture (PGV) for 30 MW of firm capacity from its geothermal steam facility expiring on December 31, 2027. Since April 2002, PGV s output has been reduced. If PGV does not provide the contracted 30 MW of capacity, the PPA provides for annual availability sanctions, which amounted to $0.7 million, $0.2 million, $0.1 million, $0.1 million and $0.1 million for 2002, 2003, 2004, 2005 and 2006, respectively. In 2005, PGV re-drilled an existing well, and drilled for a new production and a new injection well. As a result, from July 2005 through June 2006, PGV exported 30 MW to HELCO with all of its wells and converters in service. In July 2006, PGV experienced well problems, which required it to be derated to approximately 20 MW. PGV cleaned out two production wells, converted an injection well to a production well, and worked on sealing an existing injection well. As a result, PGV output steadily increased to an average 25 MW by December 2006. With the completion of the injection well repairs and permanent piping for the converted well, PGV estimates that it will restore to its full 30 MW capacity level by April 2007. PGV has indicated its intent to pursue improvements to the plant to increase its capacity by 8 MW, and to pursue negotiations with HELCO for a new or amended PPA. In November 2006, HELCO delineated to PGV the desired ancillary characteristics of an expanded PGV facility.

On October 4, 1999, HELCO entered into a PPA with Hilo Coast Power Company (HCPC) effective January 1, 2000 through December 31, 2004, whereby HELCO purchased 22 MW of firm capacity from HCPC s coal-fired facility. HELCO terminated the PPA as of January 1, 2005.

In October 1997, HELCO entered into an agreement with Encogen, which has been succeeded by Hamakua Energy Partners, L. P. (HEP). The agreement provides that HELCO will purchase up to 60 MW (net) of firm capacity for a period of 30 years. The dual-train combined-cycle DTCC facility, which primarily burns naphtha, consists of two oil-fired combustion turbines and a steam turbine that utilizes waste heat from the combustion turbines. In December 2000, HEP began providing HELCO with firm capacity. In June 2001, HEP demonstrated 60 MW of output from the facility. Subsequently, the output deteriorated due to technical problems, but HEP returned to providing 60 MW in 2003 and has been consistently maintained since that time.

HELCO purchases energy on an as-available basis from a number of nonutility generators. Wailuku River Hydroelectric L.P., the owner of a 12.1 MW run-of-the-river hydroelectric facility, has an existing contract to provide HELCO with as-available power through May 2023.

Apollo Energy Corporation (Apollo), the owner of a 7 MW wind facility, had a contract to provide HELCO with as-available windpower through June 29, 2002 (and extending thereafter until terminated by HELCO or Apollo). HELCO and Apollo reached agreement on a PPA on October 13, 2004. The PPA enables Apollo to repower its existing facility, and install an additional 13.5 MW of capacity, for a total windfarm capacity of 20.5 MW. The PUC approved the PPA on March 10, 2005 and it became effective in April 2005. The existing 7 MW wind facility was shut down in August 2006, prior to construction of the new 20.5 MW windfarm, which will be operated by Tawhiri Power LLC, a subsidiary of Apollo. Apollo has informed HELCO that it can meet the April 2007 target for commercial operation.

On December 30, 2003, HELCO and Hawi Renewable Development, LLC (HRD) entered into a PPA under which HRD would sell energy from an expanded wind farm (approximately 10.6 MW) at HRD s 5 MW wind farm site. It is anticipated that the output of the 10.6 MW wind farm may be limited on occasion. The PUC approved the PPA on May 14, 2004. HELCO began purchasing as-available energy from the HRD wind farm during its test period, which began in February 2006, and the 15-year contract term started in May 2006 after HRD completed its control system acceptance test.

MECO has a PPA with Hawaiian Commercial & Sugar Company (HC&S) for 16 MW of firm capacity. The HC&S generating units primarily burn bagasse (sugar cane waste) along with secondary fuels of oil or coal. HC&S has had some difficulties in meeting its contractual obligations to MECO over the years through 2003 due to operational constraints. On June 28, 2005, MECO and HC&S agreed to extend the PPA through December 31, 2011, and from year to year thereafter, subject to termination on or after December 31, 2011 on not less than two years prior written notice by either party. MECO informed the PUC of the PPA extension by letter dated July 27, 2005.

Beginning in June 2006, MECO began purchasing as-available energy from a 30 MW windfarm at Ukumehame, Maui owned by Kaheawa Wind Power, LLC (KWP) under a PPA between MECO and KWP dated December 3, 2004. The PUC had approved the PPA on March 18, 2005.

On May 10, 2005, MECO entered into a PPA with Makila Hydro, LLC (Makila) for the purchase of as-available energy from an existing 0.5 MW hydro electric plant, which Makila has refurbished. The PPA was approved by the PUC on May 10, 2006.

The PUC has allowed rate recovery for the firm capacity and purchased energy costs for HELCO s and MECO s approved firm capacity and as-available energy PPAs.

Fuel oil usage and supply

The rate schedules of the Company s electric utility subsidiaries include energy cost adjustment clauses (ECACs) under which electric rates (and consequently the revenues of the electric utility subsidiaries generally) are adjusted for changes in the weighted-average price paid for fuel oil and certain components of purchased power, and the relative amounts of company-generated power and purchased power. See discussion of rates and issues relating to the ECAC below under Rates, and Certain factors that may affect future results and financial condition Electric utility Regulation of electric utility rates and Material estimates and critical accounting policies Electric utility Electric utility revenues in HEI s MD&A.

HECO s steam power plants burn LSFO. HECO s combustion turbine peaking units burn No. 2 diesel fuel (diesel). MECO s and HELCO s steam power plants burn medium sulfur fuel oil (MSFO) and their combustion turbine and diesel engine generating units burn diesel. The LSFO supplied to HECO is primarily derived from Chinese, Vietnamese and other Far East crude oils processed in Hawaii refineries. The MSFO supplied to MECO and HELCO is derived from U.S. domestic crude oil and various foreign crude oil grades processed in Hawaii refineries. Diesel supplies to HECO, HELCO and MECO are derived from all of the various grades of crude oil processed at the Hawaii refineries.

In March and April of 2004, HECO executed 10-year extensions of the existing contracts, commencing January 1, 2005, for the purchase of LSFO with Chevron Products Company (Chevron) and Tesoro Hawaii Corporation (Tesoro) with no material changes in the primary commercial arrangements including volumes and pricing formulas. The PUC approved these contract extensions in December 2004. The PUC currently permits the inclusion of costs incurred under these contracts in HECO s ECAC. HECO pays market-related prices for fuel supplies purchased under these agreements. In December 2004, HECO executed long-term contracts with Chevron for the continued use of certain Chevron fuel distribution facilities and for the operation and maintenance of certain HECO fuel distribution facilities.

In March and April of 2004, HECO, HELCO and MECO executed 10-year extensions of existing contracts with Chevron and Tesoro, commencing January 1, 2005, for the purchase of diesel and MSFO, including the use of certain petroleum storage and distribution facilities, with no material changes in the primary commercial arrangements including volumes and pricing formulas. The PUC approved these contract extensions in December 2004. The electric utilities pay market-related prices for diesel and MSFO supplied under these agreements.

The diesel supplies acquired by the Lanai Division of MECO are purchased under a contract with a local petroleum wholesaler, Lanai Oil Co., Inc. An amendment extending the current supply arrangement was executed December 1, 2006 and will become effective upon the approval of the PUC for the recovery of costs incurred under the contract. Under the amendment, the term of the contract would continue through December 31, 2008.

See the fuel oil commitments information set forth in the Fuel contracts section in Note 11 to HECO s Consolidated Financial Statements.

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The following table sets forth the average cost of fuel oil used by HECO, HELCO and MECO to generate electricity in the years 2006, 2005 and 2004:

	HECO		HELCO		MECO		Consolidated	
	$/Barrel	¢/MBtu	$/Barrel	¢/MBtu	$/Barrel	¢/MBtu	$/Barrel	¢/MBtu
2006	63.33	1,004.9	70.21	1,138.7	85.46	1,431.9	68.13	1,094.1
2005	52.61	833.1	57.44	935.4	70.88	1,188.3	56.61	908.6
2004	40.53	641.8	42.32	688.3	51.02	855.1	42.67	684.3

The average per-unit cost of fuel oil consumed to generate electricity for HECO, HELCO and MECO reflects a different volume mix of fuel types and grades. In 2006, over 99% of HECO s generation fuel consumption consisted of LSFO. The balance of HECO s fuel consumption was diesel. Diesel made up approximately 30% of HELCO s and 75% of MECO s fuel consumption. MSFO made up the remainder of the fuel consumption of HELCO and MECO. In general, MSFO is the least costly fuel, diesel is the most expensive fuel and the price of LSFO falls between the two on a per-barrel basis. During 2006, the prices of LSFO, MSFO and diesel rose with crude oil prices during the first half of the year, peaked in the May-June period and gradually fell in the year s second half to end relatively close to the January 2006 level. The average prices paid by the utilities in 2006 for LSFO, MSFO and diesel averaged approximately 18%, 25% and 18%, respectively, above the average price paid for that grade of fuel in 2005. During 2006, the prices of LSFO, MSFO and diesel rose slightly above the levels reached in the fall of 2005 when hurricanes Katrina and Rita seriously damaged U.S. Gulf crude oil and natural gas production facilities, but declined during the late summer and fall of 2006 reflecting moderate weather and stagnating end-user demand, rising U.S. crude oil inventory levels and weakened natural gas prices, among other factors. During 2005, the prices of LSFO, MSFO and diesel rose above the levels reached at the end of 2004, reflecting demand supported by continued strong economic growth in the U.S. and China, and continued geopolitical uncertainty. Elevated price levels continued into the later part after hurricanes Katrina and Rita caused a significant, if temporary, loss in regional refinery processing capability. Thus, the average prices paid by the utilities in 2005 for LSFO, MSFO and diesel averaged approximately 30%, 33% and 37%, respectively, above the average price paid for that grade of fuel in 2004.

In December 2000, HELCO and MECO executed contracts of private carriage with Hawaiian Interisland Towing, Inc. (HITI) for the shipment of MSFO and diesel supplies from their fuel suppliers facilities on Oahu to storage locations on the islands of Hawaii and Maui, respectively, commencing January 1, 2002. On December 10, 2001, the PUC approved these contracts and issued a final order that permits HELCO and MECO to include the fuel transportation and related costs incurred under the provisions of these agreements in their respective ECACs. The contracts provided for the employment of a new-building double-hull bulk petroleum barge (which has been in service since March 2002). The contracts were extended for a second 5-year term commencing January 1, 2007 and contain options for two additional 5-year extensions.

HITI never takes title to the fuel oil or diesel fuel, but does have custody and control while the fuel is in transit from Oahu. If there were an oil spill in transit, HITI is generally contractually obligated to indemnify HELCO and/or MECO for resulting clean-up costs, fines and damages. HITI has liability insurance coverage for oil spill related damage of $1 billion. State law provides a cap of $700 million on liability for releases of heavy fuel oil transported interisland by tank barge. In the event of a release, HELCO and/or MECO may be responsible for any clean-up, damages, and/or fines that HITI or its insurance carrier does not cover.

The prices that HECO, HELCO and MECO pay for purchased energy from nonutility generators are generally linked to the price of oil. The AES Hawaii energy prices vary primarily with an inflation indicator. The energy prices for Kalaeloa, which purchases LSFO from Tesoro, vary primarily with world LSFO prices. The HPower, HC&S and PGV energy prices are based on the electric utilities respective PUC-filed short-run avoided energy cost rates (which vary with their respective composite fuel costs), subject to minimum floor rates specified in their approved PPAs. HEP energy prices vary primarily with HELCO s diesel costs.

The Company estimates that 77.2% of the net energy generated and purchased by HECO and its subsidiaries in 2007 will be generated from the burning of oil. Increases in fuel oil prices are passed on to customers through the electric utility subsidiaries ECACs. Any changes in the ECACs by the PUC, and/or the failure by the Company s oil suppliers to provide fuel pursuant to the supply contracts, and/or substantial increases in fuel prices, could adversely affect consolidated HECO s and the Company s financial condition, results of operations and/or liquidity. HECO generally maintains an average system fuel inventory level equivalent to 35 days of forward consumption. HELCO and MECO generally maintain an average system fuel inventory level equivalent to approximately one month s supply of both MSFO and diesel. The PPAs with AES Hawaii and HEP require that they maintain certain minimum fuel inventory levels.

Transmission systems

HECO has 138 kV transmission and 46 kV sub-transmission lines. HELCO has 69 kV transmission and 34.5 kV transmission and sub-transmission lines. MECO has 69 kV transmission and 23 kV sub-transmission lines on Maui and 34.5 kV transmission lines on Molokai. Lanai has no transmission lines and uses 12 kV lines to distribute electricity. The electric utilities overhead and underground transmission and sub-transmission lines, as well as their distribution lines, are uninsured because the amount of insurance available is limited and the premiums are extremely high.

Lines are added when needed to serve increased loads and/or for reliability reasons. In some design districts on Oahu, lines must be placed underground. Under Hawaii law, the PUC generally must determine whether new 46 kV, 69 kV or 138 kV lines can be constructed overhead or must be placed underground. The process of acquiring permits and regulatory approvals for new lines can be contentious, time consuming (leading to project delays) and costly.

HECO system. HECO serves Oahu s electricity requirements with firm capacity (net) generating units (as of December 31, 2006) located in West Oahu (1,055 MW); Waiau, adjacent to Pearl Harbor (481 MW); and Honolulu (107 MW). HECO also leases fifteen 1.64 MW generating units that provide a total of 24.6 MW (net) of firm power and are located at three substation sites, at HECO s Kalaeloa pole yard and at HECO s Iwilei tank farm. HECO transmits power to its service areas on Oahu through approximately 220 miles of overhead and underground 138 kV transmission lines (of which approximately 8 miles are underground) and approximately 521 miles of overhead and underground 46 kV sub-transmission lines (of which approximately 41 miles are underground). See East Oahu Transmission Project (EOTP) in Note 11 to HECO s Consolidated Financial Statements for a further discussion of the transmission system and the EOTP.

HELCO system. HELCO serves the island of Hawaii s electricity requirements with firm capacity (net) generating units (as of December 31, 2006) located in West Hawaii (78 MW) and East Hawaii (189 MW). HELCO transmits power to its service area on the island of Hawaii through approximately 468 miles of 69 kV overhead lines and approximately 173 miles of 34.5 kV overhead lines.

MECO system. MECO serves its electricity requirements with firm capacity (net) generating units (as of December 31, 2006) located on the island of Maui (232 MW), Molokai (12 MW) and Lanai (10 MW). MECO transmits power to its service area through approximately 143 miles of 69 kV overhead lines, approximately 15 miles of 34.5 kV overhead lines, and approximately 90 miles of 23 kV overhead lines.

Rates

HECO, HELCO and MECO are subject to the regulatory jurisdiction of the PUC with respect to rates, issuance of securities, accounting and certain other matters. See Regulation and other matters Electric utility regulation.

All rate schedules of HECO and its subsidiaries contain ECACs as described previously. Under current law and practices, specific and separate PUC approval is not required for each rate change pursuant to automatic rate adjustment clauses previously approved by the PUC. Rate increases, other than pursuant to such automatic adjustment clauses, require the prior approval of the PUC after public and contested case hearings. PURPA requires the PUC to periodically review the ECACs of electric and gas utilities in the state, and such clauses, as well as the rates charged by the utilities generally, are subject to change. Further, Act 162 may impact the ECACs. See Act 162 discussion in Energy cost adjustment clauses in Note 3 of HEI s Notes to Consolidated Financial Statements.

See Electric utility Results of operations Most recent rate requests, Certain factors that may affect future results and financial condition Electric utility Regulation of electric utility rates and Material estimates and critical accounting policies Electric utility Electric utility revenues in HEI s MD&A and Energy cost adjustment clauses in Note 11 of HECO s Notes to Consolidated Financial Statements.

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Public Utilities Commission and Division of Consumer Advocacy of the State of Hawaii

Carlito P. Caliboso (an attorney previously in private practice) continues to serve as Chairman of the PUC (term expiring June 30, 2010). Also serving as commissioner is John E. Cole (whose term expires June 30, 2012), who previously served as the Executive Director of the Division of Consumer Advocacy and, prior to holding that position, served as a member of the Governor of the State of Hawaii s Policy Team, which served as advisor to the Governor on state-wide policy matters.

Commissioner Wayne H. Kimura resigned effective August 1, 2006. A replacement has not yet been announced.

Catherine P. Awakuni, an attorney formerly with the PUC staff, was named Executive Director of the Division of Consumer Advocacy effective September 18, 2006.

Competition

See Certain factors that may affect future results and financial condition Consolidated Competition Electric utility in HEI s MD&A.

Electric and magnetic fields

Research on potential adverse health effects from exposure to electric and magnetic fields (EMF) continues. To date, no definite relationship between EMF and health risks has been clearly demonstrated. In 1996, the National Academy of Sciences examined more than 500 studies and stated that the current body of evidence does not show that exposure to EMFs presents a human-health hazard. An extensive study released in 1997 by the National Cancer Institute and the Children s Cancer Group found no evidence of increased risk for childhood leukemia from EMF. In 1999, the National Institute of Environmental Health Sciences (NIEHS) Director s Report concluded that while EMF could not be found to be entirely safe, the evidence of a health risk was weak and did not warrant aggressive regulatory actions. In 2002, the NIEHS further stated that for most health outcomes, there is no evidence that EMF exposures have adverse effects, and also that there is some evidence from epidemiology studies that exposure to power-frequency EMF is associated with an increased risk for childhood leukemia. In the same brochure, the NIEHS further concluded that this association is difficult to interpret in the absence of reproducible laboratory evidence or a scientific explanation that links magnetic fields with childhood leukemia.

While EMF has not been established as a cause of any health condition by any national or international agency, EMF remains the subject of ongoing studies and evaluations. EMF has been classified as a possible human carcinogen by more than one public health organization. In 2004, the U.K. National Radiological Protection Board (NRPB) published a report that supported a precautionary approach and recommended adoption of guidelines for limiting exposure to EMF. In the U.S., there are no federal standards limiting occupational or residential exposure to 60-Hz EMF.

The implications of the foregoing reports have not yet been determined. However, these reports may raise the profile of the EMF issue for electric utilities.

HECO and its subsidiaries are monitoring the research and continue to participate in utility industry-funded studies on EMF and, where technically feasible and economically reasonable, continue to pursue a policy of prudent avoidance in the design and installation of new transmission and distribution facilities. Management cannot predict the impact, if any, the EMF issue may have on HECO, HELCO and MECO in the future.

Global warming

The Company shares the concerns of many regarding the potential effects of global warming and the human contributions to the phenomenon, including burning of fossil fuels for electricity production, transportation, manufacturing, agricultural activities and deforestation. Recognizing that effectively addressing global warming requires commitment by the private sector, all levels of government, and the public, the Company is committed to taking direct action to mitigate greenhouse gas emissions from its operations.

Currently, there are no regulatory requirements for HECO and its subsidiaries to track or reduce greenhouse gas emissions. Nonetheless, consistent with the Company s position on global warming, HECO and its subsidiaries have been tracking carbon dioxide emissions, the primary greenhouse gas emitted by fossil fuel combustion for electricity production, since 1996 and reporting them to the federal Department of Energy. Consistent with their commitment to reduce greenhouse gas emissions, HECO and its subsidiaries have taken and continue to identify

opportunities to take direct action to reduce such emissions from their operations, including, but not limited to, creating a DSM program that fosters energy efficiency, using renewable resources for energy production and purchasing power from IPPs generated by renewable resources, committing to burn biofuels in HECO s next unit, and using biodiesel for startup and shutdown of selected MECO generation units. Through its subsidiary, RHI, HECO seeks to identify and support viable technology for electricity production that will increase energy efficiency and reduce or eliminate greenhouse gas emissions.

Legislation

See Electric utility Results of operations Legislation and regulation in HEI s MD&A.

Commitments and contingencies

See Certain factors that may affect future results and financial condition Other regulatory and permitting contingencies in HEI s MD&A, Item 1A. Risk Factors, and Note 11 to HECO s Consolidated Financial Statements for a discussion of important commitments and contingencies, including (but not limited to) HELCO s Keahole power plant units; HECO s East Oahu Transmission Project; and the Honolulu Harbor environmental investigation.

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Bank American Savings Bank, F.S.B.

General

ASB was granted a federal savings bank charter in January 1987. Prior to that time, ASB had operated since 1925 as the Hawaii division of American Savings & Loan Association of Salt Lake City, Utah. As of December 31, 2006, ASB was the third largest financial institution in the State of Hawaii based on total assets of $6.8 billion and deposits of $4.6 billion. In 2006, ASB s revenues and net income amounted to approximately 17% and 52%, respectively, of HEI s consolidated revenues and income from continuing operations, compared to approximately 18% and 51% in 2005 and approximately 19% and 38% in 2004, respectively.

At the time of HEI s acquisition of ASB in 1988, HEI agreed with the Office of Thrift Supervision s (OTS) predecessor regulatory agency that ASB s regulatory capital would be maintained at a level of at least 6% of ASB s total liabilities, or at such greater amount as may be required from time to time by regulation. Under the agreement, HEI s obligation to contribute additional capital to insure that ASB would have a capital level required by the OTS was limited to a maximum aggregate amount of approximately $65.1 million. As of December 31, 2006, as a result of certain HEI contributions to ASB, HEI s maximum obligation to contribute additional capital has been reduced to approximately $28.3 million. ASB is subject to OTS regulations on dividends and other distributions applicable to financial institutions and ASB must receive a letter of non-objection from the OTS before it can declare and pay a dividend to HEI.

ASB s earnings depend primarily on its net interest income the difference between the interest income earned on earning assets (loans receivable and investment and mortgage-related securities) and the interest expense incurred on costing liabilities (deposit liabilities and other borrowings, including advances from the Federal Home Loan Bank (FHLB) of Seattle and securities sold under agreements to repurchase). Other factors affecting ASB s operating results include fee income, provision for (or reversal of) allowance for loan losses, gains or losses on sales of securities available-for-sale, and noninterest expense.

For additional information about ASB, see the sections under Bank in HEI s MD&A, HEI s Quantitative and Qualitative Disclosures about Market Risk and Note 4 to HEI s Consolidated Financial Statements.

The following table sets forth selected data for ASB for the years indicated (average balances calculated using the average daily balances, except for common equity, which is calculated using the average month-end balances):

Years ended December 31	**2006**	**2005**	**2004**
Common equity to assets ratio			
Average common equity divided by average total assets	8.25%	8.15%	7.10%
Return on assets			
Net income for common stock divided by average total assets	0.82	0.95	0.62
Return on common equity			
Net income for common stock divided by average common equity	9.9	11.7	8.7
Tangible efficiency ratio			
Total noninterest expense divided by net interest income and noninterest income	64	61	61

ASB s tangible efficiency ratio the cost of earning $1 of revenue increased from 61% in 2004 to 64% in 2006 due to higher noninterest expense as a result of continued investment in employees and technology necessary to adapt and remain competitive in the banking industry and higher legal and litigation-related expenses. ASB s ongoing challenge is to increase revenues faster than expenses.

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Consolidated average balance sheet

The following table sets forth average balances of ASB s major balance sheet categories for the years indicated (average balances have been calculated using the daily average balances, except for common equity, which is calculated using the average month-end balances):

Years ended December 31 (in thousands)	2006	2005	2004
Assets			
Investment and mortgage-related securities	$ 2,679,754	$ 2,962,994	$ 3,039,769
Loans receivable, net	3,687,673	3,411,389	3,121,878
Other	433,421	442,368	424,464
	$ 6,800,848	$ 6,816,751	$ 6,586,111
Liabilities and stockholder s equity			
Deposit liabilities	$ 4,540,292	$ 4,453,762	$ 4,114,070
Other borrowings	1,613,667	1,703,353	1,819,598
Other	85,920	104,009	109,544
Stockholder s equity	560,969	555,627	542,899
	$ 6,800,848	$ 6,816,751	$ 6,586,111

In 2006, average loans receivable increased by $276.3 million, or 8.1% over 2005 average loans receivable. Continued strength in the Hawaii economy and real estate market enabled the average residential mortgage portfolio balance to grow by $113.8 million, or 4.3% over the 2005 average residential mortgage portfolio. The average commercial loan portfolio balance increased by $95.0 million, or 27.2% due to higher commercial loan originations. The average commercial real estate loan portfolio balance was $48.1 million, or 18.4% higher than the 2005 average commercial real estate loan portfolio balance primarily due to higher construction fundings. Average consumer loan balances also grew by $21.5 million, or 8.9% over 2005 average consumer loan portfolio balances. Average deposit balances increased by $86.5 million, enabling ASB to replace other, more costly borrowings.

In 2005, the average loans receivable increased by $289.5 million, or 9.3%, over 2004 average loans receivable due to the continued strength in the Hawaii economy and real estate market. The average residential mortgage portfolio for 2005 grew by $139.8 million, or 5.6%, over the 2004 average residential mortgage portfolio. Average commercial real estate loans, net of undisbursed loan funds, increased $51.1 million, or 24.2%, over 2004 primarily due to commercial construction real estate loans originated in 2005 of $39.8 million. ASB s average commercial portfolio increased by $65.6 million, or 23.1%, during 2005 primarily due to higher commercial loan originations. The average consumer loan portfolio increased $22.5 million, or 10.3%, from 2004. ASB s average deposit balances increased by $339.7 million, or 8.3%, during 2005, enabling ASB to replace other borrowings and to help fund loan growth.

Asset/liability management

See HEI s Quantitative and Qualitative Disclosures about Market Risk.

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Interest income and interest expense

See Results of operations Bank in HEI s MD&A for a table of average balances, interest and dividend income, interest expense and weighted-average yields earned and rates paid for certain categories of earning assets and costing liabilities for the years ended December 31, 2006, 2005 and 2004.

The following table shows the effect on net interest income of (1) changes in interest rates (change in weighted-average interest rate multiplied by prior year average balance) and (2) changes in volume (change in average balance multiplied by prior period weighted-average interest rate). Any remaining change is allocated to the above two categories on a *pro rata* basis.

(in thousands)		2006 vs. 2005			2005 vs. 2004	
Increase (decrease) due to	Rate	Volume	Total	Rate	Volume	Total
Income from earning assets						
Loans receivable, net	$ 9,464	$ 17,062	$ 26,526	$ 2,861	$ 17,450	$ 20,311
Investment and mortgage-related securities	3,781	(12,545)	(8,764)	6,158	(2,581)	3,577
	13,245	4,517	17,762	9,019	14,869	23,888
Expense from costing liabilities						
Deposit liabilities	13,576	7,974	21,550	(15)	4,895	4,880
Other borrowings	6,900	(3,780)	3,120	8,091	(4,332)	3,759
	20,476	4,194	24,670	8,076	563	8,639
Net interest income	$ (7,231)	$ 323	$ (6,908)	$ 943	$ 14,306	$ 15,249

Noninterest income

In addition to net interest income, ASB has various sources of noninterest income, including fee income from credit and debit cards and fee income from deposit liabilities and other financial products and services. Noninterest income totaled approximately $59.6 million in 2006, $56.9 million in 2005 and $57.2 million in 2004. The increase in noninterest income for 2006 was due to higher fee income on deposit liabilities and gain on sale of securities, partially offset by lower income from the sale of investment and insurance products.

Lending activities

General. Loans and mortgage-related securities of $6.0 billion represented 88.1% of total assets as of December 31, 2006, compared to $6.2 billion, or 90.3%, and $6.2 billion, or 91.3%, as of December 31, 2005 and 2004, respectively. ASB s loan portfolio consists primarily of conventional residential mortgage loans.

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The following table sets forth the composition of ASB s loan and mortgage-related securities portfolio as of the dates indicated:

December 31	**2006**		**2005**		**2004**		**2003**		**2002**	
(dollars in thousands)	**Balance**	**% of total**	**Balance**	**% of total**	**Balance**	**% of total**	**Balance**	**% of total**	**Balance**	**% of total**
Real estate loans [1]										
Conventional (1-4 unit residential)	$ 2,697,422	45.0	$ 2,617,194	42.4	$ 2,464,133	39.9	$ 2,438,573	42.1	$ 2,347,446	40.9
Commercial	264,458	4.4	229,430	3.7	226,699	3.6	208,683	3.6	193,627	3.4
Construction and development	268,672	4.5	241,311	3.9	202,466	3.3	100,986	1.8	46,150	0.8
	3,230,552	53.9	3,087,935	50.0	2,893,298	46.8	2,748,242	47.5	2,587,223	45.1
Less: Deferred fees and discounts	(21,153)	(0.4)	(21,484)	(0.3)	(20,701)	(0.3)	(20,268)	(0.4)	(18,937)	(0.3)
Undisbursed loan funds	(124,895)	(2.1)	(140,271)	(2.3)	(132,208)	(2.1)	(69,884)	(1.2)	(21,412)	(0.4)
Allowance for loan losses	(13,693)	(0.2)	(16,212)	(0.3)	(15,663)	(0.3)	(14,734)	(0.3)	(23,708)	(0.4)
Total real estate loans, net	3,070,811	51.2	2,909,968	47.1	2,724,726	44.1	2,643,356	45.6	2,523,166	44.0
Other loans										
Consumer and other	275,046	4.5	259,048	4.2	232,189	3.8	222,743	3.9	245,853	4.3
Commercial	453,151	7.6	412,816	6.7	310,999	5.0	286,068	4.9	247,114	4.3
	728,197	12.1	671,864	10.9	543,188	8.8	508,811	8.8	492,967	8.6
Less: Deferred fees and discounts	(880)		(613)		(526)		(606)		(416)	
Undisbursed loan funds	(132)		(2)		(3)		(31)		(1)	
Allowance for loan losses	(17,535)	(0.3)	(14,383)	(0.2)	(18,194)	(0.3)	(29,551)	(0.5)	(21,727)	(0.4)
Total other loans, net	709,650	11.8	656,866	10.7	524,465	8.5	478,623	8.3	470,823	8.2
Mortgage-related securities, net	2,218,103	37.0	2,604,920	42.2	2,928,507	47.4	2,666,619	46.1	2,736,679	47.8
Total loans and mortgage-related securities, net	$ 5,998,564	100.0	$ 6,171,754	100.0	$ 6,177,698	100.0	$ 5,788,598	100.0	$ 5,730,668	100.0

[1] Includes renegotiated loans.

The Compensation Committee shall have authority to exercise discretion in determining the amount of the Incentive Pool and the amount of the targeted award granted to each Participant at the beginning of a performance period, provided that the Incentive Pool and each targeted award shall not exceed the foregoing maximum limits. The Compensation Committee shall determine the amount of the Incentive Pool and the targeted awards for any performance period no later than the latest time permitted by Section 162(m) of the Code (generally, for performance periods of one year or more, no later than 90 days after the commencement of the performance period) and while the performance relating to the performance goal remains substantially uncertain within the meaning of Section 162(m) of the Code.

The Compensation Committee shall have authority to exercise discretion to reduce the amount of the Incentive Pool and of any targeted award which shall be payable to any Participant at the end of each performance period, subject to the terms, conditions and limits of the Plan and of any other written commitment authorized by the Compensation Committee. The Compensation Committee may at any time establish (and once established, rescind, waive or amend) additional conditions and terms of payment of awards (including but not limited to the achievement of other financial, strategic or individual goals, which may be objective or subjective) as it deems desirable in carrying out the purposes of the Plan and may take into account such other factors as it deems appropriate in administering any aspect of the Plan. In determining the amount of any award to be granted or to be paid to any Participant, the Compensation Committee shall give consideration to the contribution which may be or has been made by the Participant to achievement of the Company s established objectives and such other matters as it shall deem relevant. However, the Compensation Committee shall have no

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authority to increase the amount of the Incentive Pool or the targeted award granted to any Participant after the latest date permitted by Section 162(m) of the Code or to pay an award under the Plan if the performance goal has not been satisfied.

The payment of an award to a Participant with respect to a performance period shall be conditioned upon the Participant s employment by the Company on the last day of the performance period; provided, however, that in the discretion of the Compensation Committee, awards may be paid to Participants who have died or have become disabled or whose employment with the Company has been terminated without cause prior to the last day of the performance period, subject to all other terms and conditions of the Plan.

VII. FORM OF AWARDS

All awards shall be determined by the Compensation Committee and shall be paid in cash or in Common Stock of the Company or in a combination of cash and Common Stock, as determined by the Committee in its discretion. Before the beginning of each performance period, each Participant may elect that all or part of the Participant s award for that period will be deferred and distributed at a later date under The Sempra Energy Deferred Compensation and Excess Savings Plan subject to the terms of the such plan or under any other plan designated by the Committee that provides for the deferral of compensation by Participants. Any shares of Common Stock paid to Participants under the Plan shall be paid pursuant to the Company s 1998 Long Term Incentive Plan or any other plan designated by the Compensation Committee that provides for the award of Common Stock to Participants.

VIII. PAYMENT OF AWARDS

Awards may be paid at any time following the end of the performance period; provided, however, that no awards shall be paid unless and until the Compensation Committee certifies, in writing, that the amounts payable with respect to each award, and all awards in the aggregate, does not exceed the amount of the Incentive Pool and that the amount payable to each Participant does not exceed the amount of the maximum targeted award permitted by the Plan or the amount of targeted award granted to the Participant at the beginning of the performance period.

IX. SPECIAL AWARDS AND OTHER PLANS

Nothing contained in the Plan shall prohibit the Company from granting awards or authorizing other compensation to any person under any other plan or authority or limit the authority of the Company to establish other special awards or incentive compensation plans providing for the payment of incentive compensation to employees (including those employees who are eligible to participate in the Plan).

X. STOCKHOLDER APPROVAL

No awards shall be paid under the Plan unless and until Sempra Energy s stockholders shall have approved the Plan and the performance goal as required by Section 162(m) of the Code.

XI. ADMINISTRATION, AMENDMENT AND INTERPRETATION OF THE PLAN

The Compensation Committee shall administer the Plan. The Compensation Committee shall consist solely of two or more members of the board of directors who shall qualify as outside directors under Section 162(m) of the Code. The Compensation Committee shall have full power to construe and interpret the Plan, establish and amend rules and regulations for its administration, and perform all other acts relating to the Plan, including the delegation of administrative responsibilities, that it believes reasonable and proper and in conformity with the purposes of the Plan.

The Board of Directors shall have the right to amend the Plan from time to time or to repeal it entirely or to direct the discontinuance of awards either temporarily or permanently; provided, however, that no amendment of the Plan that changes the maximum amount of the Incentive Pool or the maximum percentage of the Incentive Pool that may be payable to any Participant, as set forth in Section VI, or materially amends the definition of Operating Income as used in Section VI, shall be effective before approval by the affirmative vote of a majority of shares voting at a meeting of the Company s stockholders.

Any decision made, or action taken, by the Compensation Committee arising out of or in connection with the interpretation and/or administration of the Plan shall be final, conclusive and binding on all persons affected thereby.

XII. RIGHTS OF PLAN PARTICIPANTS

Neither the Plan, nor the adoption or operation of the Plan, nor any documents describing or referring to the Plan (or any part hereof) shall confer upon any Participant any right to continue in the employ of the Company or shall interfere with or restrict in any way the rights of the Company, which are hereby expressly reserved, to discharge any Participant at any time for any reason whatsoever, with or without cause.

No individual to whom an award has been made or any other party shall have any interest in the cash or any other asset of the Company prior to such amount being paid.

No right or interest of any Participant shall be assignable or transferable, or subject to any claims of any creditor or subject to any lien.

XIII. MISCELLANEOUS

The Company shall deduct all federal, state and local taxes required by law or Company policy from any award paid hereunder.

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In no event shall the Company be obligated to pay to any Participant an award for any period by reason of the Company s payment of an award to such Participant in any other period, or by reason of the Company s payment of an award to any other Participant or Participants in such period or in any other period. Nothing contained in this Plan shall confer upon any person any claim or right to any payments hereunder. Such payments shall be made at the sole discretion of the Compensation Committee.

The Plan shall be unfunded. Amounts payable under the Plan are not and will not be transferred into a trust or otherwise set aside. The Company shall not be required to establish any special or separate fund or to make any other segregation of assets to assure the payment of any award under the Plan. Any accounts under the Plan are for bookkeeping purposes only and do not represent a claim against the specific assets of the Company.

It is the intent of the Company that the Plan and awards made hereunder shall satisfy and shall be interpreted in a manner that satisfies any applicable requirements as performance-based compensation within the meaning of Section 162(m) of the Code. Any provision, application or interpretation of the Plan that is inconsistent with this intent to satisfy the standards in Section 162(m) of the Code shall be disregarded.

Any provision of the Plan that is prohibited or unenforceable shall be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions of the Plan.

The Plan and the rights and obligations of the parties to the Plan shall be governed by, and construed and interpreted in accordance with, the law of the State of California (without regard to principles of conflicts of law).

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