

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

Telephone (808) 543-7771
Securities registered pursuant to Section 12(b) of the Act:

Registrant	Title of each class	Name of each exchange
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Hawaiian Electric Industries, Inc.	Common Stock, Without Par Value	on which registered
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 (QUIPSSM)	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 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

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

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

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 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 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.

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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 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

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

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

	Aggregate market value of the voting and non-	Number of shares of common stock	
	voting common equity held by non-affiliates of the registrants as of June 30, 2006	outstanding of the registrants as of 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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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

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federal
FERC
FHLB
FICO

U.S. Government
Federal Energy Regulatory Commission
Federal Home Loan Bank
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. In 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;

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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	
	Customer accounts*	Electric sales revenues	Customer accounts*	Electric sales revenues	Customer accounts*	Electric sales revenues
(dollars in thousands)						
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:

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	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.

Table of Contents**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	1,685	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

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

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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-	Island of Hawaii-	Island of Maui-	Island of Lanai-	Island of Molokai-	Total
	HECO	HELCO	MECO	MECO	MECO	
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

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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,

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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

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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); Waiiau, 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

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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.

Table of Contents**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.

Table of Contents**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.

Table of Contents**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) Increase (decrease) due to	2006 vs. 2005			2005 vs. 2004		
	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	
	Balance	% of total	Balance	% of total	Balance	% of total	Balance	% of total	Balance	% of total
(dollars in thousands)										
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 following table summarizes ASB's loan portfolio as of December 31, 2006 and 2005, excluding loans held for sale and undisbursed commercial real estate construction and development loan funds, based upon contractually scheduled principal payments and expected prepayments allocated to the indicated maturity categories:

December 31	2006				2005			
	In	After 1 year	After 1 year	After 5 years	In	After 1 year	After 1 year	After 5 years
Due (in millions)	or less	5 years	5 years	Total	or less	5 years	5 years	Total
Residential loans - Fixed	\$ 456	\$ 1,002	\$ 1,129	\$ 2,587	\$ 361	\$ 920	\$ 1,120	\$ 2,401
Residential loans - Adjustable	110	86	6	202	82	142	82	306
	566	1,088	1,135	2,789	443	1,062	1,202	2,707

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Commercial real estate loans - Fixed	27	36	73	136	4	19	42	65
Commercial real estate loans - Adjustable	127	31	56	214	107	38	65	210
	154	67	129	350	111	57	107	275
Consumer loans - Fixed	11	18	5	34	11	19	14	44
Consumer loans - Adjustable	51	117	63	231	52	106	47	205
	62	135	68	265	63	125	61	249
Commercial loans - Fixed	69	122	54	245	109	104	51	264
Commercial loans - Adjustable	154	54		208	107	38	4	149
	223	176	54	453	216	142	55	413
Total loans - Fixed	563	1,178	1,261	3,002	485	1,062	1,227	2,774
Total loans - Adjustable	442	288	125	855	348	324	198	870
	\$ 1,005	\$ 1,466	\$ 1,386	\$ 3,857	\$ 833	\$ 1,386	\$ 1,425	\$ 3,644

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Origination, purchase and sale of loans. Generally, residential and commercial real estate loans originated by ASB are secured by real estate located in Hawaii. As of December 31, 2006, approximately \$6.2 million of loans purchased from other lenders were secured by properties located in the continental United States. For additional information, including information concerning the geographic distribution of ASB's mortgage-related securities portfolio and the geographic concentration of credit risk, see Note 13 to HEI's Consolidated Financial Statements.

The amount of loans originated during 2006, 2005, 2004, 2003 and 2002 were \$1.3 billion, \$1.4 billion, \$1.4 billion, \$1.6 billion and \$1.2 billion, respectively. The demand for loans is primarily dependent on the Hawaii real estate market, business conditions, interest rates and loan refinancing activity. The decrease in loan originations in 2006 compared to 2005 was due to lower residential loan originations as a result of a slowdown in real estate transaction volumes and lower refinancing activity. Loan originations in 2005 approximated 2004 as higher commercial loan originations were offset by lower commercial real estate originations. The decrease in loan originations in 2004 compared to 2003 was due to a slowdown in residential refinancing activity. The increase in loan originations in 2003 was due to the strength in the Hawaii real estate market and low interest rates which had resulted in increased affordability of housing for consumers and higher loan refinancings.

Residential mortgage lending. ASB's general policy is to require private mortgage insurance when the loan-to-value ratio of the property exceeds 80% of the lower of the appraised value or purchase price at origination. For nonowner-occupied residential properties, the loan-to-value ratio may not exceed 90% of the lower of the appraised value or purchase price at origination.

Construction and development lending. ASB provides both fixed- and adjustable-rate loans for the construction of one-to-four unit residential and commercial properties. Construction and development financing generally involves a higher degree of credit risk than long-term financing on improved, occupied real estate. Accordingly, construction and development loans are generally priced higher than loans secured by completed structures. ASB's underwriting, monitoring and disbursement practices with respect to construction and development financing are designed to ensure sufficient funds are available to complete construction projects. As of December 31, 2006, 2005 and 2004, ASB had commercial real estate construction and development loans of \$170 million, \$149 million and \$108 million and residential construction and development loans of \$91 million, \$93 million and \$94 million, respectively. See "Loan portfolio risk elements" and "Multifamily residential and commercial real estate lending."

Multifamily residential and commercial real estate lending. ASB provides permanent financing and construction and development financing secured by multifamily residential properties (including apartment buildings) and secured by commercial and industrial properties (including office buildings, shopping centers and warehouses) for its own portfolio as well as for participation with other lenders. In 2006, 2005 and 2004, ASB originated \$102 million, \$77 million and \$153 million, respectively, of loans secured by multifamily or commercial and industrial properties. ASB enhanced its commercial real estate lending capabilities and plans to continue to increase commercial real estate lending in the future. One of the objectives of commercial real estate lending is to diversify ASB's loan portfolio as commercial real estate loans tend to have higher yields and shorter durations than residential mortgage loans.

Consumer lending. ASB offers a variety of secured and unsecured consumer loans. Loans secured by deposits are limited to 90% of the available account balance. ASB offers home equity lines of credit, secured and unsecured VISA cards, checking account overdraft protection and other general purpose consumer loans. In 2006, 2005 and 2004, ASB originated \$174 million, \$189 million and \$156 million, respectively, of consumer loans.

Commercial lending. ASB provides both secured and unsecured commercial loans to business entities. This lending activity is part of ASB's strategic transformation to a full-service community bank and is designed to diversify ASB's asset structure, shorten maturities, improve rate sensitivity of the loan portfolio and attract commercial checking deposits. In 2006, 2005 and 2004, ASB had gross commercial loan originations of \$477 million, \$436 million and \$351 million, respectively.

Loan origination fee and servicing income. In addition to interest earned on loans, ASB receives income from servicing loans, for late payments and from other related services. Servicing fees are received on loans originated and subsequently sold by ASB where ASB acts as collection agent on behalf of third-party purchasers.

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ASB generally charges the borrower at loan settlement a loan origination fee of 1% of the amount borrowed. See Loans receivable in Note 1 to HEI's Consolidated Financial Statements.

Loan portfolio risk elements. When a borrower fails to make a required payment on a loan and does not cure the delinquency promptly, the loan is classified as delinquent. If delinquencies are not cured promptly, ASB normally commences a collection action, including foreclosure proceedings in the case of secured loans. In a foreclosure action, the property securing the delinquent debt is sold at a public auction in which ASB may participate as a bidder to protect its interest. If ASB is the successful bidder, the property is classified as real estate owned until it is sold. ASB's real estate acquired in settlement of loans represented nil, less than 0.01% and 0.01% of total assets as of December 31, 2006, 2005 and 2004, respectively.

In addition to delinquent loans, other significant lending risk elements include: (1) loans which accrue interest and are 90 days or more past due as to principal or interest, (2) loans accounted for on a nonaccrual basis (nonaccrual loans), and (3) loans on which various concessions are made with respect to interest rate, maturity, or other terms due to the inability of the borrower to service the obligation under the original terms of the agreement (renegotiated loans). ASB had no loans that were 90 days or more past due on which interest was being accrued as of the dates presented in the table below. The following table sets forth certain information with respect to nonaccrual and renegotiated loans as of the dates indicated:

December 31 (dollars in thousands)	2006	2005	2004	2003	2002
Nonaccrual loans					
Real estate					
One-to-four unit residential	\$ 907	\$ 1,394	\$ 2,240	\$ 2,784	\$ 9,783
Commercial			235		983
Total real estate	907	1,394	2,475	2,784	10,766
Consumer					
Commercial	346	377	411	341	1,382
	1,144	598	3,510	2,236	3,633
Total nonaccrual loans	\$ 2,397	\$ 2,369	\$ 6,396	\$ 5,361	\$ 15,781
Nonaccrual loans to total net loans	0.1%	0.1%	0.2%	0.2%	0.5%
Renegotiated loans not included above					
Real estate					
One-to-four unit residential	\$ 2,540	\$ 731	\$ 1,243	\$ 2,148	\$
Commercial	3,274	3,446	3,653	3,877	7,582
Commercial	467	790	427	1,919	2,175
Total renegotiated loans	\$ 6,281	\$ 4,967	\$ 5,323	\$ 7,944	\$ 9,757
Nonaccrual and renegotiated loans to total net loans	0.2%	0.2%	0.4%	0.4%	0.9%

ASB's policy generally is to place loans on a nonaccrual status (i.e., interest accrual is suspended) when the loan becomes 90 days or more past due or on an earlier basis when there is a reasonable doubt as to its collectibility.

In 2003, the decrease in nonaccrual loans of \$10.4 million was primarily due to \$7.0 million lower delinquencies in residential loans as a result of improved credit quality of ASB's loan portfolio due to the strong real estate market in Hawaii. In 2004, the increase in nonaccrual loans of \$1.0 million was primarily due to an increase in commercial loans on nonaccrual status. In 2005, the decrease in nonaccrual loans of \$4.0 million was primarily due to a \$2.9 million payoff of a commercial loan and lower delinquencies in residential loans. In 2006, nonaccrual loans of \$2.4 million approximated 2005 nonaccrual loans. A reduction in nonaccrual residential loans due to lower delinquencies was offset by higher amount of commercial loans on nonaccrual status.

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Allowance for loan losses. See Allowance for loan losses in Note 1 to HEI's Consolidated Financial Statements.

The following table presents the changes in the allowance for loan losses for the years indicated:

(dollars in thousands)	2006	2005	2004	2003	2002
Allowance for loan losses, January 1	\$ 30,595	\$ 33,857	\$ 44,285	\$ 45,435	\$ 42,224
Provision (reversal of allowance) for loan losses	1,400	(3,100)	(8,400)	3,075	9,750
Charge-offs					
Residential real estate loans			40	892	2,345
Commercial real estate loans				174	441
Consumer loans	1,119	1,558	1,790	3,027	3,479
Commercial loans	766	456	2,479	2,601	1,479
Total charge-offs	1,885	2,014	4,309	6,694	7,744
Recoveries					
Residential real estate loans	200	459	346	1,244	858
Commercial real estate loans			562	426	52
Consumer loans	436	525	549	586	257
Commercial loans	482	868	824	213	38
Total recoveries	1,118	1,852	2,281	2,469	1,205
Allowance for loan losses, December 31	\$ 31,228	\$ 30,595	\$ 33,857	\$ 44,285	\$ 45,435
Ratio of allowance for loan losses, December 31, to average loans outstanding	0.85%	0.90%	1.08%	1.44%	1.60%
Ratio of provision for loan losses during the year to average loans outstanding	0.04%	NM	NM	0.10%	0.34%
Ratio of net charge-offs during the year to average loans outstanding	0.02%	<0.01%	0.06%	0.14%	0.23%

NM Not meaningful.

The following table sets forth the allocation of ASB's allowance for loan losses and the percentage of loans in each category to total loans as of the dates indicated:

December 31	2006		2005		2004		2003		2002	
	Balance	% of total	Balance	% of total	Balance	% of total	Balance	% of total	Balance	% of total
(dollars in thousands)										
Residential real estate	\$ 5,682	70.6%	\$ 8,613	72.1%	\$ 10,137	74.4%	\$ 4,031	76.9%	\$ 6,246	77.6%
Commercial real estate	7,922	11.0	7,450	10.0	5,355	9.7	6,008	7.5	6,343	6.4
Consumer	3,623	6.9	3,111	6.9	4,008	6.8	6,540	6.8	8,489	8.0
Commercial	13,801	11.5	11,139	11.0	13,986	9.1	14,758	8.8	12,118	8.0
Unallocated	200	NA	282	NA	371	NA	12,948	NA	12,239	NA
	\$ 31,228	100.0%	\$ 30,595	100.0%	\$ 33,857	100.0%	\$ 44,285	100.0%	\$ 45,435	100.0%

NA Not applicable.

In 2006, ASB's allowance for loan losses increased by \$0.6 million, compared to a decrease of \$3.3 million in 2005. Continued strength in real estate and business conditions in 2006 resulted in low net charge-offs and lower historical loss ratios, which enabled ASB to largely offset the provision for loan losses as a result of loan growth with the release of reserves on existing loans. However, ASB recorded a provision for loan losses of \$1.4 million in 2006, which was primarily due to a single commercial loan and is not reflective of a change in the overall credit quality of the loan portfolio.

In 2005, ASB's allowance for loan losses decreased by \$3.3 million compared to a decrease of \$10.4 million in 2004. Continued strength in real estate and business conditions in 2005 resulted in lower historical loss ratios and lower net charge-offs as a result of lower delinquencies which enabled ASB to record a reversal of allowance for loan losses of \$3.1 million.

In 2004, ASB's allowance for loan losses decreased by \$10.4 million compared to a decrease of \$1.2 million in 2003. Considerable strength in real estate and business conditions in 2004 resulted in lower historical loss

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ratios and lower net charge-offs enabled ASB to record a reversal of allowance for loan losses of \$8.4 million. The allowance for loan losses for each category was also impacted by external factors affecting the national and Hawaii economy, specific industries and sectors and interest rates. In prior years, the impact of these external factors was reflected in the unallocated category of the allowance for loan losses; however, beginning in 2004 these factors are largely reflected in the allowance for loan losses allocated to each specific loan portfolio.

In 2003, ASB's allowance for loan losses decreased by \$1.2 million compared to an increase of \$3.2 million in 2002. The decrease in 2003 was due to lower net charge-offs as a result of lower delinquencies. The increasing value of Hawaii real estate and continued low interest rates gave debtors the opportunity to sell their properties or refinance before defaulting. ASB also continued to improve its collection efforts. Residential, consumer and commercial real estate loan delinquencies continued to decrease during 2003 and lower loan loss reserves were required for those lines of business. The growth in the commercial loan portfolio as a result of ASB's strategic focus of diversifying its loan portfolio from single-family home mortgages to commercial loans has required additional loan loss reserves. The unallocated component of the allowance for loan losses, which takes into consideration economic trends and differences in the estimation process that are not necessarily captured in determining the allowance for loan losses for each category, increased slightly.

Investment activities

Currently, ASB's investment portfolio consists primarily of mortgage-related securities, stock of the FHLB of Seattle and federal agency obligations. ASB owns private-issue mortgage-related securities as well as mortgage-related securities issued by the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA). As of December 31, 2006, the various securities rating agencies rated all of the private-issue mortgage-related securities as investment grade. ASB did not maintain a portfolio of securities held for trading during 2006, 2005 or 2004.

As of December 31, 2006, 2005 and 2004, ASB's investment in stock of FHLB of Seattle amounted to \$97.8 million, \$97.8 million and \$97.4 million, respectively. The weighted-average yield on investments during 2006, 2005 and 2004 was 3.16%, 1.13% and 3.29%, respectively. The amount that ASB is required to invest in FHLB stock is determined by regulatory requirements and ASB's investment is in excess of that requirement. See FHLB of Seattle business and capital plan in HEI's MD&A for a discussion of dividends on ASB's investment in FHLB of Seattle Stock and recent events that have adversely affected those dividends. Also, see Regulation and other matters Bank regulation Federal Home Loan Bank System.

As of December 31, 2006, ASB owned private-issue mortgage related securities issued by Countrywide Financial with an aggregate book and market value of \$148 million.

The following table summarizes ASB's investment portfolio (excluding stock of the FHLB of Seattle, which has no contractual maturity), as of December 31, 2006, based upon contractually scheduled principal payments and expected prepayments allocated to the indicated maturity categories:

Due (dollars in millions)	In 1 year			After	Total
	or less	After 1 year through 5 years	After 5 years through 10 years	10 years	
Federal agency obligations	\$ 100	\$ 49	\$	\$	\$ 149
FNMA, FHLMC and GNMA	353	990	292	68	1,703
Private issue	177	294	43	1	515
	\$ 630	\$ 1,333	\$ 335	\$ 69	\$ 2,367
Weighted average yield	4.45%	4.25%	5.06%	5.30%	

Note: ASB does not currently invest in tax exempt obligations.

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General. Deposits traditionally have been the principal source of ASB's funds for use in lending, meeting liquidity requirements and making investments. ASB also derives funds from the receipt of interest and principal on outstanding loans receivable and mortgage-related securities, borrowings from the FHLB of Seattle, securities sold under agreements to repurchase and other sources. ASB borrows on a short-term basis to compensate for seasonal or other reductions in deposit flows. ASB also may borrow on a longer-term basis to support expanded lending or investment activities. Advances from the FHLB and securities sold under agreements to repurchase continue to be a significant source of funds, but they are a higher cost of funds than deposits.

Deposits. ASB's deposits are obtained primarily from residents of Hawaii. Net deposit inflow in 2006, 2005 and 2004, measured as the year-over-year difference in year-end deposits, was \$18.1 million, \$261 million and \$270 million, respectively.

The following table illustrates the distribution of ASB's average deposits and average daily rates by type of deposit for the years indicated. Average balances have been calculated using the average daily balances.

Years ended December 31	2006			2005			2004		
	Average	% of total	Weighted average rate %	Average	% of total	Weighted average rate %	Average	% of total	Weighted average rate %
(dollars in thousands)	balance	deposits	rate %	balance	deposits	rate %	balance	deposits	rate %
Savings	\$ 1,609,070	35.4%	0.83%	\$ 1,721,988	38.7%	0.51%	\$ 1,613,856	39.2%	0.40%
Checking	1,155,687	25.5	0.09	1,151,345	25.8	0.05	1,019,464	24.8	0.03
Money market	226,837	5.0	1.69	288,731	6.5	0.89	322,806	7.8	0.45
Certificate	1,548,698	34.1	3.58	1,291,698	29.0	3.10	1,157,944	28.2	3.36
Total deposits	\$ 4,540,292	100.0%	1.62%	\$ 4,453,762	100.0%	1.17%	\$ 4,114,070	100.0%	1.15%

As of December 31, 2006, ASB had \$529.7 million in certificate accounts of \$100,000 or more, maturing as follows:

(in thousands)	Amount
Three months or less	\$ 230,258
Greater than three months through six months	141,775
Greater than six months through twelve months	85,148
Greater than twelve months	72,552
	\$ 529,733

Deposit-insurance premiums and regulatory developments. On February 8, 2006, the Federal Deposit Insurance Reform Act of 2005 (the Reform Act) became law. One of the provisions of the Reform Act was to merge the Savings Association Insurance Fund (SAIF) and the Bank Insurance Fund (BIF) into a new fund, the Deposit Insurance Fund. This change was made effective March 31, 2006. The Financing Corporation (FICO) will continue to impose an assessment on deposits.

For a discussion of recent changes to the deposit insurance system, premiums and FICO assessments, see [Bank regulation](#) [Deposit insurance coverage](#).

Other borrowings. ASB may obtain advances from the FHLB of Seattle provided certain standards related to creditworthiness have been met. Advances are secured by a blanket pledge of certain notes held by ASB and the mortgages securing them. To the extent that advances exceed the amount of mortgage loan collateral pledged to the FHLB of Seattle, the excess must be covered by qualified marketable securities held under the control of and at the FHLB of Seattle or at an approved third party custodian. FHLB advances generally are available to meet seasonal and other withdrawals of deposit accounts, to expand lending and to assist in the effort to improve asset and liability management. FHLB advances are

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made pursuant to several different credit programs offered from time to time by the FHLB of Seattle.

As of December 31, 2006, 2005 and 2004, advances from the FHLB amounted to \$0.7 billion, \$0.9 billion and \$1.0 billion, respectively. The weighted-average rates on the advances from the FHLB outstanding as of December 31, 2006, 2005 and 2004 were 4.92%, 4.53% and 4.48%, respectively. The maximum amount outstanding at any month-end during 2006, 2005 and 2004 was \$0.9 billion, \$1.1 billion and \$1.0 billion,

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respectively. Advances from the FHLB averaged \$0.8 billion during 2006 and \$1.0 billion during each of 2005 and 2004 and the approximate weighted-average rate on the advances was 4.75%, 4.48% and 4.43%, respectively.

See Securities sold under agreements to repurchase in Note 4 of HEI's Consolidated Financial Statements.

The following table sets forth information concerning ASB's advances from the FHLB and securities sold under agreements to repurchase as of the dates indicated:

December 31 (dollars in thousands)	2006	2005	2004
Advances from the FHLB	\$ 730,000	\$ 935,500	\$ 988,231
Securities sold under agreements to repurchase	838,585	686,794	811,438
Total other borrowings	\$ 1,568,585	\$ 1,622,294	\$ 1,799,669
Weighted-average rate	4.55%	4.23%	4.01%

Competition

The banking industry in Hawaii is highly competitive. ASB is the third largest financial institution in Hawaii based on total assets and is in direct competition for deposits and loans, not only with the two larger institutions, but also with smaller institutions that are heavily promoting their services in certain niche areas, such as providing financial services to small and medium-sized businesses. ASB's main competitors are banks, savings associations, credit unions, mortgage bankers, mortgage brokers, finance companies and brokerage firms. These competitors offer a variety of financial products to retail and business customers.

The primary factors in competing for deposits are interest rates, the quality and range of services offered, marketing, convenience of locations, hours of operation and perceptions of the institution's financial soundness and safety. Competition for deposits comes primarily from other savings institutions, commercial banks, credit unions, money market and mutual funds and other investment alternatives. In Hawaii, there were 9 Federal Deposit Insurance Corporation (FDIC)-insured financial institutions, of which 2 were thrifts and 7 were commercial banks, and approximately 100 credit unions as of December 31, 2006. Additional competition for deposits comes from various types of corporate and government borrowers, including insurance companies. To meet competition, ASB offers a variety of savings and checking accounts at competitive rates, convenient business hours, convenient branch locations with interbranch deposit and withdrawal privileges at each branch and convenient automated teller machines. ASB also conducts advertising and promotional campaigns.

The primary factors in competing for first mortgage and other loans are interest rates, loan origination fees and the quality and range of lending products and services offered. Competition for origination of first mortgage loans comes primarily from mortgage banking and brokerage firms, commercial banks, other savings institutions, insurance companies and real estate investment trusts. ASB believes that it is able to compete for such loans primarily through the competitive interest rates and loan fees it charges, the types of mortgage loan programs it offers and the efficiency and quality of the services it provides its borrowers and the real estate business community.

In 2002, ASB began implementing a strategic plan to move from its traditional position as a thrift institution, focused on retail banking and residential mortgages, to a full-service community bank. To make the shift, ASB has continued to build its commercial and commercial real estate lines of business. The origination of commercial and commercial real estate loans involves risks different from those associated with originating residential real estate loans. For example, the sources and level of competition may be different and credit risk is generally higher than for mortgage loans. These different risk factors are considered in the underwriting and pricing standards established by ASB for its commercial and commercial real estate loans.

As a result of the transformation, ASB is now a full service community bank serving both consumer and commercial customers. ASB will continue to invest in projects and opportunities that will build core franchise value and add to earnings growth and returns. Additionally, the banking industry is constantly changing and ASB is continuously making the changes and investments necessary to adapt and remain competitive.

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See Certain factors that may affect future results and financial condition Bank Regulation of ASB Federal Thrift Charter in HEI s MD&A for a discussion of the Gramm-Leach-Bliley Act of 1998.

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Regulation and other matters

Holding company regulation. HEI and HECO are each holding companies within the meaning of the Public Utility Holding Company Act of 2005 and implementing regulations (2005 Act) and filed a required notification of that status on February 21, 2006. The 2005 Act makes holding companies and certain of their subsidiaries subject to certain rights of the Federal Energy Regulatory Commission (FERC) to have access to books and records relating to FERC's jurisdictional rates, and also imposes certain record retention, accounting and reporting requirements. HEI and HECO filed a FERC Form 65B seeking a waiver of these record retention, accounting and reporting requirements. A written notice dated May 26, 2006 was received from FERC confirming the effectiveness of the HEI and HECO waivers.

HEI is subject to an agreement entered into with the PUC (the PUC Agreement) when HECO became a subsidiary of HEI. The PUC Agreement, among other things, requires HEI to provide the PUC with periodic financial information and other reports concerning intercompany transactions and other matters. It prohibits the electric utilities from loaning funds to HEI or its nonutility subsidiaries and from redeeming common stock of the electric utility subsidiaries without PUC approval. Further, the PUC could limit the ability of the electric utility subsidiaries to pay dividends on their common stock. See *Restrictions on dividends and other distributions* and *Electric utility regulation* (regarding the PUC review of the relationship between HEI and HECO).

As a result of the acquisition of ASB, HEI and HEIDI are subject to OTS registration, supervision and reporting requirements as savings and loan holding companies. In the event the OTS has reasonable cause to believe that the continuation by HEI or HEIDI of any activity constitutes a serious risk to the financial safety, soundness, or stability of ASB, the OTS is authorized under the Home Owners' Loan Act of 1933, as amended, to impose certain restrictions in the form of a directive to HEI and any of its subsidiaries, or HEIDI and any of its subsidiaries. Such possible restrictions include limiting (i) the payment of dividends by ASB; (ii) transactions between ASB, HEI or HEIDI, and the subsidiaries or affiliates of ASB, HEI or HEIDI; and (iii) the activities of ASB that might create a serious risk that the liabilities of HEI and its other affiliates, or HEIDI and its other affiliates, may be imposed on ASB. See *Restrictions on dividends and other distributions*.

OTS regulations also generally prohibit savings and loan holding companies and their nonthrift subsidiaries from engaging in activities other than those which are specifically enumerated in the regulations. However, the OTS regulations provide for an exemption which is available to HEI and HEIDI if ASB satisfies the qualified thrift lender (QTL) test discussed below. See *Bank regulation* *Qualified thrift lender test*. ASB met the QTL test at all times during 2006, but the failure of ASB to satisfy the QTL test in the future could result in a need to divest ASB. If such divestiture were to be required, federal law limits the entities that might be eligible to acquire ASB.

HEI and HEIDI are prohibited, directly or indirectly, or through one or more subsidiaries, from (i) acquiring control of, or acquiring by merger or purchase of assets, another insured institution or holding company thereof, without prior written OTS approval; (ii) acquiring more than 5% of the voting shares of another savings association or savings and loan holding company which is not a subsidiary; or (iii) acquiring or retaining control of a savings association not insured by the FDIC.

Restrictions on dividends and other distributions. HEI is a legal entity separate and distinct from its various subsidiaries. As a holding company with no significant operations of its own, the principal sources of its funds are dividends or other distributions from its operating subsidiaries, borrowings and sales of equity. The rights of HEI and, consequently, its creditors and shareholders, to participate in any distribution of the assets of any of its subsidiaries is subject to the prior claims of the creditors and preferred stockholders of such subsidiary, except to the extent that claims of HEI in its capacity as a creditor are recognized.

The abilities of certain of HEI's subsidiaries to pay dividends or make other distributions to HEI are subject to contractual and regulatory restrictions. Under the PUC Agreement, in the event that the consolidated common stock equity of the electric utility subsidiaries falls below 35% of total electric utility capitalization (including in capitalization the current maturities of long-term debt, but excluding short-term borrowings), the electric utility subsidiaries would be restricted, unless they obtained PUC approval, in their payment of cash dividends to 80% of the earnings available for the payment of dividends in the current fiscal year and preceding five years, less the amount of dividends paid during that period. The PUC Agreement also provides that the foregoing dividend restriction shall not be construed to relinquish any right the PUC may have to review the dividend policies of the electric utility

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subsidiaries. As of December 31, 2006, the consolidated common stock equity of HEI's electric utility subsidiaries was 54% of their total capitalization (as calculated for purposes of the PUC Agreement). As of December 31, 2006, HECO and its subsidiaries had common stock equity of \$958 million (which was reduced to that level as a result of an accumulated other comprehensive income (AOCI) charge of \$127 million related to retirement benefit plans) of which approximately \$431 million was not available for transfer to HEI without regulatory approval.

The ability of ASB to make capital distributions to HEI and other affiliates is restricted under federal law. Subject to a limited exception for stock redemptions that do not result in any decrease in ASB's capital and would improve ASB's financial condition, ASB is prohibited from declaring any dividends, making any other capital distributions, or paying a management fee to a controlling person if, following the distribution or payment, ASB would be deemed to be undercapitalized, significantly undercapitalized or critically undercapitalized. See Bank regulation Prompt corrective action. All capital distributions are subject to a prior indication of no objection by the OTS. Also see Note 12 to HEI's Consolidated Financial Statements.

HEI and its subsidiaries are also subject to debt covenants, preferred stock resolutions and the terms of guarantees that could limit their respective abilities to pay dividends. The Company does not expect that the regulatory and contractual restrictions applicable to HEI or its direct and indirect subsidiaries will significantly affect the operations of HEI or its ability to pay dividends on its common stock.

Electric utility regulation. The PUC regulates the rates, issuance of securities, accounting and certain other aspects of the operations of HECO and its electric utility subsidiaries. See the previous discussion under Electric utility Rates and the discussions under Electric utility Results of operations Most recent rate requests and Certain factors that may affect future results and financial condition Electric utility Regulation of electric utility rates in HEI's MD&A.

Any adverse decision or policy made or adopted by the PUC, or any prolonged delay in rendering a decision, could have a material adverse effect on consolidated HECO's and the Company's financial condition, results of operations or liquidity.

The PUC has ordered the electric utility subsidiaries to develop plans for the integration of demand- and supply-side resources available to meet consumer energy needs efficiently, reliably and at the lowest reasonable cost. See the previous discussion under Electric utility Integrated resource planning and requirements for additional generating capacity.

In 1996, the PUC issued an order instituting a proceeding to identify and examine the issues surrounding electric competition and to determine the impact of competition on the electric utility infrastructure in Hawaii. In October 2003, the PUC closed the competition proceeding and opened investigative proceedings on two specific issues (competitive bidding and distributed generation (DG)) to move toward a more competitive electric industry environment under cost-based regulation. For a discussion of the D&Os issued by the PUC in the competitive bidding and DG proceedings, see Certain factors that may affect future results and financial condition Consolidated Competition Electric utility in HEI's MD&A.

Certain transactions between HEI's electric public utility subsidiaries (HECO, HELCO and MECO) and HEI and affiliated interests are subject to regulation by the PUC. All contracts (including summaries of unwritten agreements) made on or after July 1, 1988 of \$300,000 or more in a calendar year for management, supervisory, construction, engineering, accounting, legal, financial and similar services and for the sale, lease or transfer of property between a public utility and affiliated interests must be filed with the PUC to be effective, and the PUC may issue cease and desist orders if such contracts are not filed. All such affiliated contracts for capital expenditures (except for real property) must be accompanied by comparative price quotations from two nonaffiliates, unless the quotations cannot be obtained without substantial expense. Moreover, all transfers of \$300,000 or more of real property between a public utility and affiliated interests require the prior approval of the PUC and proof that the transfer is in the best interest of the public utility and its customers. If the PUC, in its discretion, determines that an affiliated contract is unreasonable or otherwise contrary to the public interest, the utility must either revise the contract or risk disallowance of the payments for ratemaking purposes. In ratemaking proceedings, a utility must also prove the reasonableness of payments made to affiliated interests under any affiliated contract of \$300,000 or more by clear and convincing evidence. An affiliated interest is defined by statute and includes officers and directors of a public utility, every person owning or holding, directly or indirectly, 10% or more of the voting securities of a public utility, and corporations which have in common with a public utility more than one-third of the directors of that public utility.

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In January 1993, to address community concerns expressed at the time, HECO proposed that the PUC initiate a review of the relationship between HEI and HECO and the effects of that relationship on the operations of HECO. The PUC opened a docket and initiated such a review and in May 1994, the PUC selected a consultant. The consultant's 1995 report concluded that on balance, diversification has not hurt electric ratepayers. Other major findings were that (1) no utility assets have been used to fund HEI's nonutility investments or operations, (2) management processes within the electric utilities operate without interference from HEI and (3) HECO's access to capital did not suffer as a result of HEI's involvement in nonutility activities and that diversification did not permanently raise or lower the cost of capital incorporated into the rates paid by HECO's utility customers. In December 1996, the PUC issued an order that adopted the report in its entirety, ordered HECO to continue to provide the PUC with status reports on its compliance with the PUC agreement (pursuant to which HEI became the holding company of HECO) and closed the investigation and proceeding. In the order, the PUC also stated that it adopted the recommendation of the federal Department of Defense (DOD) that HECO, HELCO and MECO present a comprehensive analysis of the impact that the holding company structure and investments in nonutility subsidiaries have on a case-by-case basis on the cost of capital to each utility in future rate cases and remove such effects from the cost of capital. The PUC has accepted, in subsequent HELCO and MECO rate cases, the presentations made by HELCO and MECO that there was no such impact in those cases. HECO made a similar presentation in its current 2005 test-year rate case, which was accepted by the PUC pending the final D&O. See also *Holding company regulation* above.

HECO and its electric utility subsidiaries are not subject to regulation by the Federal Energy Regulatory Commission under the Federal Power Act, except under Sections 210 through 212 (added by Title II of PURPA and amended by the Energy Policy Act of 1992), which permit the Federal Energy Regulatory Commission to order electric utilities to interconnect with qualifying cogenerators and small power producers, and to wheel power to other electric utilities. Title I of PURPA, which relates to retail regulatory policies for electric utilities, and Title VII of the Energy Policy Act of 1992, which addresses transmission access, also apply to HECO and its electric utility subsidiaries. HECO and its electric utility subsidiaries are also required to file various financial and operational reports with the Federal Energy Regulatory Commission. The Company cannot predict the extent to which cogeneration or transmission access will reduce its electrical loads, reduce its current and future generating and transmission capability requirements or affect its financial condition, results of operations or liquidity.

Because they are located in the State of Hawaii, HECO and its subsidiaries are exempt by statute from limitations set forth in the Powerplant and Industrial Fuel Act of 1978 on the use of petroleum as a primary energy source.

Bank regulation. ASB, a federally chartered savings bank, and its holding companies are subject to the regulatory supervision of the OTS and, in certain respects, the FDIC. See *Holding company regulation* above. In addition, ASB must comply with Federal Reserve Board (FRB) reserve requirements.

Deposit insurance coverage. The Federal Deposit Insurance Act, as amended by the Federal Deposit Insurance Corporation Insurance Act of 1991 (FDICIA) and the federal deposit insurance reform which became law on February 8, 2006, and regulations promulgated by the FDIC, govern insurance coverage of deposit amounts. Generally, the deposits maintained by a depositor in an insured institution are insured to \$100,000, with the amount of all deposits held by a depositor in the same capacity (even if held in separate accounts) aggregated for purposes of applying the \$100,000 limit.

Among other things, the major reform of 2006: merges the BIF and the SAIF; indexes the \$100,000 deposit insurance to inflation beginning in 2010 and every five years thereafter; gives the FDIC and the National Credit Union Administration authority to determine whether raising the standard \$100,000 deposit insurance limit is warranted; increases to \$250,000 the deposit insurance limit for certain retirement accounts; and authorizes the FDIC to assess risk-based premiums. Under the new FDIC rules assessing risk-based premiums, which became effective on January 1, 2007, ASB is classified in Risk Category I, the lowest risk group. For 2007, financial institutions in Risk Category I will have an assessment rate within the range of 5 to 7 basis points. Based upon its component ratings under the Uniform Financial Institutions Ratings System (i.e., the CAMELS rating system) and five financial ratios specified in the new FDIC rules, ASB anticipates that its assessment rate for 2007 will be approximately 5 basis points, which would result in an assessment amount of approximately \$2.4 million. This

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compares to no assessment amount for 2006 and 2005. FICO will continue to impose an assessment on deposits to service the interest on FICO bond obligations. ASB's annual FICO assessment is 1.24 cents per \$100 of deposits as of September 30, 2006. Also as a result of the federal deposit insurance reform, certain financial institutions will be entitled to a one-time assessment credit, which may be used to offset up to 90% of annual deposit insurance assessments (not including FICO assessments). The FDIC has calculated ASB's one-time assessment credit at approximately \$3 million. This one-time credit will offset 90% of ASB's 2007 assessment with the balance available to offset a portion of ASB's 2008 assessment.

Federal thrift charter. See Certain factors that may affect future results and financial condition Bank Regulation of ASB Federal Thrift Charter in HEI's MD&A.

Legislation. The Gramm-Leach-Bliley Act of 1998 (the Gramm Act) and implementing regulations imposed on financial institutions an obligation to protect the security and confidentiality of its customers' nonpublic personal information. The Gramm Act also requires public disclosure of certain agreements entered into by insured depository institutions and their affiliates in fulfillment of the Community Reinvestment Act of 1977, and the filing of an annual report with the appropriate regulatory agencies.

On December 26, 2006, the SEC and the Federal Reserve Board, following consultation with the other federal financial regulatory agencies, issued for public comment a set of proposed final rules to implement the Gramm Act's exemptions for financial institutions from the definition of broker in the Securities and Exchange Act of 1934, which rules would address issues arising out of networking arrangements whereby a financial institution refers its customers to a broker-dealer for securities services and employees of the financial institution are permitted to receive from the broker-dealer a nominal fee for such referrals. ASB does have a networking arrangement with UVEST Financial Services, but has not yet had an opportunity to evaluate the impact of the proposed rules on that arrangement. ASB will continue to monitor regulatory developments.

The International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the 2001 Act), which is part of the USA Patriot Act, imposes on financial institutions a wide variety of additional obligations with respect to such matters as collecting information, monitoring relationships and reporting suspicious activities. The 2001 Act also requires financial institutions to establish anti-money laundering programs and, with respect to correspondent and private banking accounts of non-U.S. persons, to implement appropriate due diligence policies to detect money laundering activities carried out through such accounts.

The Fair and Accurate Credit Transactions Act of 2003 (the FACT Act) amended the Fair Credit Reporting Act of 1978 to enhance the ability of consumers to combat identity theft, to increase the accuracy of consumer reports, to allow consumers to exercise greater control of the type and number of solicitations they receive, and to restrict the use and distribution of sensitive medical information.

The agencies have implemented provisions of the FACT Act to, among other things, require each financial institution, including thrifts, to develop, implement and maintain, as part of its existing information security program, appropriate measures to properly dispose of consumer information such as that derived from consumer reports.

Capital requirements. The OTS has set three capital standards for thrifts, each of which must be no less stringent than those applicable to national banks. As of December 31, 2006, ASB was in compliance with all of the minimum standards with a core capital ratio of 7.6% (compared to a 4.0% requirement), a tangible capital ratio of 7.6% (compared to a 1.5% requirement) and total risk-based capital ratio of 14.7% (based on risk-based capital of \$541.5 million, \$246.7 million in excess of the 8.0% requirement).

The OTS requires that thrifts with a composite rating of 1 under the Uniform Financial Institution Rating System (i.e., CAMELS rating system) must maintain core capital in an amount equal to at least 3% of adjusted total assets. All other institutions must maintain a minimum core capital of 4% of adjusted total assets, and higher capital ratios may be required if warranted by particular circumstances. As of December 31, 2006, ASB met the applicable minimum core capital requirement.

On January 1, 2002, new OTS regulations went into effect with respect to the regulatory capital treatment of recourse obligations, residual interests, direct credit substitutes and asset- and mortgage-backed securities. These regulations have had a slight positive impact on ASB's risk-based capital.

Current OTS risk-based capital requirements are based on an internationally agreed-upon framework for capital measurement (the 1988 Accord) that was developed by the Basel Committee on Banking Supervision (BCBS). In

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April 2003, BCBS released for comment proposed revisions to the 1988 Accord. A set of further proposed revisions was released by BCBS in June 2004. (These two sets of revisions are collectively referred to as Basel II .) On September 25, 2006, following more than three years of consultation with U.S. financial institutions on the implementation of Basel II, the federal financial institution regulatory agencies, including the OTS, issued two notices of proposed rulemaking to change U.S. risk-based capital requirements in light of Basel II. The first such notice (referred to by the agencies as the Basel II NPR) dealt with proposed changes to capital requirements for credit and operational risks. These changes are proposed to be mandatory for financial institutions with consolidated total assets of \$250 billion or more or consolidated total on-balance-sheet foreign exposure of \$10 billion or more. The second notice of proposed rulemaking concerned changes to capital requirements for market risk. Unlike the currently existing market risk rules, the proposed new rules would apply to thrifts. The new market risk rules would be mandatory for financial institutions with consolidated trading activity (in, for example, foreign exchange and commodity positions, as well as traded credit products such as credit default swaps and transfer of collateralized debt obligations) equal to at least 10% of total assets or \$1 billion.

The review of U.S. risk-based capital requirements given impetus by Basel II resulted in the agencies' issuance on December 26, 2006 of a notice of proposed rulemaking (referred to by the agencies as the Basel IA NPR) addressing the risk-based capital requirements for credit and operational risk of those financial institutions that will not come within the scope of the Basel II NPR. The Basel IA NPR gives financial institutions not subject to Basel II the option of using existing risk-based capital rules for credit and operational risk or applying the rules proposed in the Basel IA NPR. The changes proposed in the Basel IA NPR would attempt to improve the risk sensitivity of the capital rules by: increasing the number of risk weight categories for credit exposures; expanding the use of external credit ratings to weigh the risk of certain exposures; expanding the range of eligible collateral and guarantors used to mitigate credit risk; using loan-to-value ratios to risk weight most residential mortgages; increasing the credit conversion factor for certain commitments with an original maturity of one year or less; assessing a risk-based capital charge to reflect the early amortization risk in securitizations of revolving exposures; and removing the 50% limit on the risk weight for certain derivative transactions. ASB believes that the Basel IA NPR proposals would, if adopted by OTS in their current form and implemented by ASB, result in some improvement in its risk-based capital ratios. The agencies' announced intention is to adopt final rules based on the Basel II NPR and the Basel IA NPR within the same timeframe in order to allow the comparative evaluation of the two sets of risk-based capital standards. The agencies have indicated that they anticipate that full transition to Basel II will not be completed until 2011 at the earliest. ASB will continue to monitor these regulatory developments.

Affiliate transactions. Significant restrictions apply to certain transactions between ASB and its affiliates, including HEI and its direct and indirect subsidiaries. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 significantly altered both the scope and substance of such limitations on transactions with affiliates and provided for thrift affiliate rules similar to, but more restrictive than, those applicable to banks. On December 12, 2002, the OTS issued an interim final rule which applies Regulation W of the FRB to thrifts with modifications appropriate to the greater restrictions under which thrifts operate. Most of these greater restrictions were carried over into the OTS final rule, which became effective November 6, 2003. For example, ASB is prohibited from making any loan or other extension of credit to an entity affiliated with ASB unless the affiliate is engaged exclusively in activities which the FRB has determined to be permissible for bank holding companies. There are also various other restrictions which apply to certain transactions between ASB and certain executive officers, directors and insiders of ASB. ASB is also barred from making a purchase of or any investment in securities issued by an affiliate, other than with respect to shares of a subsidiary of ASB.

Financial Derivatives and Interest Rate Risk. ASB is subject to OTS rules relating to derivatives activities, such as interest rate swaps. Currently ASB does not use interest rate swaps to manage interest rate risk, but may do so in the future. Generally speaking, the OTS rules permit thrifts to engage in transactions involving financial derivatives to the extent these transactions are otherwise authorized under applicable law and are safe and sound. The rules require ASB to have certain internal procedures for handling financial derivative transactions, including involvement of the ASB Board of Directors.

OTS Thrift Bulletin 13a (TB 13a) provides guidance on the management of interest rate risks, investment securities and derivatives activities. TB 13a also describes the guidelines OTS examiners use in assigning the

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Sensitivity to Market Risk component rating under the Uniform Financial Institutions Rating System (i.e., the CAMELS rating system). TB 13a updated the OTS minimum standards for thrift institutions interest rate risk management practices and also contains guidance on thrifts investment and derivatives activities by describing the types of analysis institutions should perform prior to purchasing securities or financial derivatives.

Liquidity. OTS regulations require ASB to maintain sufficient liquidity to ensure safe and sound operations. ASB's principal sources of liquidity are customer deposits, borrowings, the maturity and repayment of portfolio loans and securities and the sale of loans into secondary market channels. ASB's principal sources of borrowings are advances from the FHLB and securities sold under agreements to repurchase from broker/dealers. ASB is approved by the FHLB to borrow up to 35% of assets to the extent it provides qualifying collateral and holds sufficient FHLB stock. As of December 31, 2006, ASB's unused FHLB borrowing capacity was approximately \$1.7 billion. ASB utilizes growth in deposits, advances from the FHLB and securities sold under agreements to repurchase to fund maturing and withdrawable deposits, repay maturing borrowings, fund existing and future loans and make investments. As of December 31, 2006, ASB had loan commitments, undisbursed loan funds and unused lines and letters of credit of \$1.1 billion. Management believes ASB's current sources of funds will enable it to meet these obligations while maintaining liquidity at satisfactory levels.

Supervision. FDICIA made a number of reforms addressing the safety and soundness of the deposit insurance system, supervision of domestic and foreign depository institutions and improvement of accounting standards. FDICIA also limited deposit insurance coverage, implemented changes in consumer protection laws and called for least-cost resolution and prompt corrective action with regard to troubled institutions.

Pursuant to FDICIA, the federal banking agencies promulgated regulations which apply to the operations of ASB and its holding companies. Such regulations address, for example, standards for safety and soundness, real estate lending, accounting and reporting, transactions with affiliates, and loans to insiders.

Prompt corrective action. FDICIA establishes a statutory framework that is triggered by the capital level of a savings association and subjects it to progressively more stringent restrictions and supervision as capital levels decline. The OTS rules implement the system of prompt corrective action. In particular, the rules define the relevant capital measures for the categories of well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

A savings association that is undercapitalized or significantly undercapitalized is subject to additional mandatory supervisory actions and a number of discretionary actions if the OTS determines that any of the actions is necessary to resolve the problems of the association at the least possible long-term cost to the SAIF. A savings association that is critically undercapitalized must be placed in conservatorship or receivership within 90 days, unless the OTS and the FDIC concur that other action would be more appropriate. As of December 31, 2006, ASB was well-capitalized.

Interest rates. FDIC regulations restrict the ability of financial institutions that are undercapitalized to offer interest rates on deposits that are significantly higher than the rates offered by competing institutions. As of December 31, 2006, ASB was well capitalized and thus not subject to these interest rate restrictions.

Qualified thrift lender test. In order to satisfy the QTL test, a thrift must maintain 65% of its assets in qualified thrift investments on a monthly average basis in 9 out of the previous 12 months. Failure to satisfy the QTL test would subject ASB to various penalties, including limitations on its activities, and would also bring into operation restrictions on the activities that may be engaged in by HEI, HEIDI and their other subsidiaries, which could effectively result in the required divestiture of ASB. At all times during 2006, ASB was in compliance with the QTL test. As of December 31, 2006, 88% of ASB's portfolio assets was qualified thrift investments. See Holding company regulation.

Federal Home Loan Bank System. ASB is a member of the FHLB System which consists of 12 regional FHLBs, and ASB's regional bank is the FHLB of Seattle. The FHLB System provides a central credit facility for member institutions. Historically, the FHLBs have served as the central liquidity facilities for savings associations and sources of long-term funds for financing housing. The FHLB may only make long-term advances to ASB for the purpose of providing funds for financing residential housing. At such time as an advance is made to ASB or renewed, it must be secured by collateral from one of the following categories: (1) fully disbursed, whole first

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mortgages on improved residential property, or securities representing a whole interest in such mortgages; (2) securities issued, insured or guaranteed by the U.S. Government or any agency thereof; (3) FHLB deposits; and (4) other real estate-related collateral that has a readily ascertainable value and with respect to which a security interest can be perfected. The aggregate amount of outstanding advances secured by such other real estate-related collateral may not exceed 30% of ASB's capital.

As mandated by the Gramm Act, the Federal Housing Finance Board (Board) regulations require each FHLB to maintain a minimum total capital leverage ratio of 5% of total assets and include risk-based capital standards requiring each FHLB to maintain permanent capital in an amount sufficient to meet credit risk and market risk. In June 2001, the FHLB of Seattle formulated a capital plan to meet these new minimum capital standards, which plan was approved by the Board. The capital plan requires ASB to own capital stock in the FHLB of Seattle in an amount equal to the total of 4% of the FHLB of Seattle's advances to ASB plus the greater of (i) 5% of the outstanding balance of loans sold to the FHLB of Seattle by ASB or (ii) 0.5% of ASB's mortgage loans and pass through securities. As of December 31, 2006, ASB was required under the capital plan to own capital stock in the FHLB of Seattle in the amount of \$47 million and owned capital stock in the amount of \$98 million, or \$51 million in excess of the requirement. Under the capital plan, stock in the FHLB of Seattle is subject to a 5-year notice of redemption. This 5-year notice period has an adverse but immaterial effect on ASB's liquidity.

Community Reinvestment. The Community Reinvestment Act (CRA) requires banks and thrifts help meet the credit needs of their communities, including low- and moderate-income areas, consistent with safe and sound lending practices. The OTS will consider ASB's CRA record in evaluating an application for a new deposit facility, including the establishment of a branch, the relocation of a branch or office, or the acquisition of an interest in another bank or thrift. ASB currently holds an outstanding CRA rating.

Other laws. ASB is subject to federal and state consumer protection laws which affect lending activities, such as the Truth-in-Lending Law, the Truth-in-Savings Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act and several federal and state financial privacy acts. These laws may provide for substantial penalties in the event of noncompliance. ASB believes that its lending activities are in compliance with these laws and regulations.

Environmental regulation. HEI and its subsidiaries are subject to federal and state statutes and governmental regulations pertaining to water quality, air quality and other environmental factors.

HECO, HELCO and MECO, like other utilities, are subject to periodic inspections by federal, state, and in some cases, local environmental regulatory agencies, including, but not limited to, agencies responsible for regulation of water quality, air quality, hazardous and other waste, and hazardous materials. These inspections may result in the identification of items needing corrective or other action. When the corrective or other necessary action is taken, no further regulatory action is expected. Except as otherwise disclosed in this report (see "Certain factors that may affect future results and financial condition" Consolidated Environmental matters in HEI's MD&A and Note 11 to HECO's Consolidated Financial Statements, which are incorporated herein by reference), the Company believes that each subsidiary has appropriately responded to environmental conditions requiring action and, as a result of such actions, such environmental conditions will not have a material adverse effect on consolidated HECO or the Company.

Water quality controls. The generating stations, substations and other utility subsidiaries facilities operate under federal and state water quality regulations and permits, including but not limited to the Clean Water Act National Pollution Discharge Elimination System (governing point source discharges, including wastewater and storm water discharges), Underground Injection Control (regulating disposal of wastewater into the subsurface), the Spill Prevention, Control and Countermeasure (SPCC) program and other regulations associated with discharges of oil and other substances to surface water.

For a discussion of section 316(b) of the federal Clean Water Act, related EPA rules and their possible application to the electric utilities, including a recent adverse development concerning these regulations, see "Environmental regulation" in Note 11 to HECO's Consolidated Financial Statements.

The Federal Oil Pollution Act of 1990 (OPA) governs actual or threatened oil releases in navigable U.S. waters (inland waters and up to three miles offshore) and waters of the U.S. exclusive economic zone (up to 200 miles to sea from the shoreline). In the event of an oil release into navigable U.S. waters, OPA establishes strict and joint

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and several liability for responsible parties for 1) oil removal costs incurred by the federal government or the state, and 2) damages to natural resources and real or personal property. Responsible parties include vessel owners and operators of on-shore facilities. OPA imposes fines and jail terms ranging in severity depending on how the release was caused. OPA also requires that responsible parties submit certificates of financial responsibility sufficient to meet the responsible party's maximum limited liability.

During 2006 and up through February 28, 2007, HECO, HELCO and MECO did not experience any significant petroleum releases. Except as otherwise disclosed herein, the Company believes that each subsidiary's costs of responding to petroleum releases to date will not have a material adverse effect on the respective subsidiary or the Company.

EPA regulations under OPA also require certain facilities that store petroleum to prepare and implement Spill Prevention, Containment and Countermeasure (SPCC) Plans in order to prevent releases of petroleum to navigable waters of the U.S. HECO, HELCO and MECO facilities subject to the SPCC program are in compliance with these requirements. In July 2002, the EPA amended the SPCC regulations to include facilities, such as substations, that use (as opposed to store) petroleum products. HECO, HELCO and MECO have determined that the amended SPCC program applies to a number of their substations. Since 2002, the EPA issued four extensions of the compliance dates for the amended regulations. The most recent extension, issued on February 17, 2006, requires that existing facilities that started operation prior to August 16, 2002, must maintain or amend, and implement SPCC plans by October 31, 2007. Regulated facilities that started operations after August 16, 2002, also must prepare and implement an SPCC Plan by October 31, 2007. HECO, HELCO and MECO are developing and implementing SPCC plans for all facilities that are subject to the amended SPCC requirements.

Air quality controls. The generating stations of the utility subsidiaries operate under air pollution control permits issued by the DOH and, in a limited number of cases, by the EPA. The entire electric utility industry has been affected by the 1990 amendments to the Clean Air Act (CAA), changes to the National Ambient Air Quality Standard (NAAQS) for ozone, and adoption of a NAAQS for fine particulate matter. Further significant impacts may occur if currently proposed legislation, rules and standards are adopted. If the Clear Skies Bill or the Clean Air Planning Act of 2006 is adopted as proposed, HECO, and to a lesser extent, HELCO and MECO will likely incur significant capital and operations and maintenance costs beginning one to two years after enactment.

Effective March 29, 2005, the EPA delisted coal-fired and oil-fired utility boilers from regulation under Title III of the CAA (the Delisting Rule). On the same date, the EPA issued a rule designed to control mercury emissions from coal-fired utility units. The preamble to the mercury control rule stated that the EPA would not require control of nickel emissions from oil-fired utility boilers. Subsequently, on October 21, 2005, the EPA issued a notice that it would reconsider the Delisting Rule (the Notice of Reconsideration). On May 31, 2006, the EPA confirmed the Delisting Rule, thereby confirming that the EPA is not requiring control of nickel emissions from the electric utilities' oil-fired utility boilers.

For a discussion of the July 1999 Regional Haze Rule amendments, see "Environmental regulation" in Note 11 to HECO's Consolidated Financial Statements.

CAA operating permits (Title V permits) have been issued for all affected generating units.

Hazardous waste and toxic substances controls. The operations of the electric utility and former freight transportation subsidiaries of HEI are subject to EPA regulations that implement provisions of the Resource Conservation and Recovery Act (RCRA), the Superfund Amendments and Reauthorization Act (SARA) and the Toxic Substances Control Act. In 2001, the DOH obtained primacy to operate state-authorized RCRA (hazardous waste) programs. The DOH's state contingency plan and the State of Hawaii Environmental Response Law (ERL) rules were adopted in August 1995.

Both federal and state RCRA provisions identify certain wastes as hazardous and set forth measures that must be taken in the transportation, storage, treatment and disposal of these wastes. Some wastes generated at steam electric generating stations possess characteristics that subject them to RCRA regulations. Since October 1986, all HECO generating stations have operated RCRA-exempt wastewater treatment units to treat potentially regulated wastes from occasional boiler waterside and fireside cleaning operations. Steam generating stations at MECO and HELCO also operate similar RCRA-exempt wastewater management systems.

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The EPA issued a final regulatory determination on May 22, 2000, concluding that fossil fuel combustion wastes do not warrant regulation as hazardous under RCRA. This determination allows for more flexibility in waste management strategies. The electric utilities' waste characterization programs continue to demonstrate the adequacy of the existing treatment systems. Waste recharacterization studies indicate that treatment facility wastestreams are nonhazardous.

RCRA underground storage tank (UST) regulations require all facilities with USTs used for storing petroleum products to comply with costly leak detection, spill prevention and new tank standard retrofit requirements. All HECO, HELCO and MECO USTs currently meet these standards and continue in operation.

The Emergency Planning and Community Right-to-Know Act under SARA Title III requires HECO, HELCO and MECO to report potentially hazardous chemicals present in their facilities in order to provide the public with information so that emergency procedures can be established to protect the public in the event of hazardous chemical releases. All HECO, HELCO and MECO facilities are in compliance with applicable annual reporting requirements to the State Emergency Planning Commission, the Local Emergency Planning Committee and local fire departments. Since January 1, 1998, the steam electric industry category has been subject to Toxics Release Inventory (TRI) reporting requirements. All HECO, HELCO and MECO facilities are in compliance with TRI reporting requirements.

The Toxic Substances Control Act regulations specify procedures for the handling and disposal of polychlorinated biphenyls (PCB), a compound found in some transformer and capacitor dielectric fluids. HECO, HELCO and MECO have instituted procedures to monitor compliance with these regulations. In addition, HECO and its subsidiaries have implemented a program to identify and replace PCB transformers and capacitors in their systems. Management believes that all HECO, HELCO and MECO facilities are currently in compliance with PCB regulations.

The ERL, as amended, governs releases of hazardous substances, including oil, in areas within the state's jurisdiction. Responsible parties under the ERL are jointly, severally and strictly liable for a release of a hazardous substance into the environment. Responsible parties include owners or operators of a facility where a hazardous substance comes to be located and any person who at the time of disposal of the hazardous substance owned or operated any facility at which such hazardous substance was disposed. The DOH issued final rules (or State Contingency Plan) implementing the ERL in August 1995.

HECO is currently one of many parties involved in an ongoing investigation regarding releases of petroleum to the subsurface in the Honolulu Harbor area. (See Note 11 to HECO's Consolidated Financial Statements.) Under the terms of the agreement for the sale of YB, HEI and TOOTS had certain environmental obligations arising from conditions existing prior to the sale of YB, including obligations with respect to the Honolulu Harbor investigation. In 2003, TOOTS paid \$250,000 to fund response activities related to the Honolulu Harbor area as a one-time cash-out payment in lieu of continuing with further response activities.

In July 2002, personnel at MECO's Maalaea Generating Station discovered a leak in an underground diesel fuel line. MECO notified DOH, instituted temporary corrective measures, and constructed a new aboveground fuel line and concrete containment trough as a permanent replacement. MECO also notified the U.S. Fish & Wildlife Service (USFWS), which manages the Kealia Pond National Wildlife Refuge located south of the Maalaea facility. MECO constructed a sump to remove fuel from the subsurface, conducted soil borings and installed groundwater monitoring wells to assess impacts of the fuel release, and, with the guidance and consent of the USFWS and the DOH, installed an interception trench in the buffer zone and in a small part of the Wildlife Refuge. Based on the results of the subsurface investigation and the operation of the interception trench, it appears that the fuel release has not affected and will not affect wildlife, sensitive wildlife habitat or the ocean, which lies approximately one-quarter mile south of the Maalaea facility. Total costs incurred as of December 31, 2006 were approximately \$1.0 million. An estimated \$0.3 million is expected to be expended during 2007-2010 to address ongoing response efforts. In 2002 through 2006, MECO reserved adequate amounts to cover expenditures to date as well as costs projected for the future. Remediation efforts have significantly reduced the volume of the product plume and product recovery has reached asymptotic levels. Based on this data, MECO developed a Monitoring and Closure Plan, which DOH approved in December 2004. Continued monitoring occasionally reveals a groundwater sample that exceeds DOH groundwater action levels. Once modeling information shows that product has been removed to the

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extent practicable and MECO obtains two years of groundwater monitoring data that meets DOH action levels, MECO anticipates the project can be terminated.

HECO, HELCO and MECO, like other utilities, periodically identify leaking petroleum-containing equipment such as USTs, piping and transformers. In a few instances, small amounts of PCBs have been identified in the leaking equipment. Each subsidiary reports releases from such equipment when and as required by applicable law and addresses impacts due to the releases in compliance with applicable regulatory requirements.

ASB may be subject to the provisions of Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and regulations promulgated thereunder. CERCLA imposes liability for environmental cleanup costs on certain categories of responsible parties, including the current owner and operator of a facility and prior owners or operators who owned or operated the facility at the time the hazardous substances were released or disposed. CERCLA exempts persons whose ownership in a facility is held primarily to protect a security interest, provided that they do not participate in the management of the facility. Although there may be some risk of liability for ASB for environmental cleanup costs in the event ASB forecloses on, and becomes the owner of, property with environmental problems, the Company believes the risk is not as great for ASB as it may be for other depository institutions that have a larger portfolio of commercial loans.

Securities ratings

See the Standard & Poor's (S&P) and Moody's Investors Service's (Moody's) ratings of HEI's and HECO's securities and discussion under Liquidity and capital resources (both Consolidated and Electric utility) in HEI's MD&A. These ratings reflect only the view of the applicable rating agency at the time the ratings are issued, from whom an explanation of the significance of such ratings may be obtained. There is no assurance that any such credit rating will remain in effect for any given period of time or that such rating will not be lowered, suspended or withdrawn entirely by the applicable rating agency if, in such rating agency's judgment, circumstances so warrant. Any such lowering, suspension or withdrawal of any rating may have an adverse effect on the market price or marketability of HEI's and/or HECO's securities, which could increase the cost of capital of HEI and HECO. Neither HEI nor HECO management can predict future rating agency actions or their effects on the future cost of capital of HEI or HECO.

Revenue bonds are issued by the Department of Budget and Finance of the State of Hawaii for the benefit of HECO and its subsidiaries, but the source of their repayment are the unsecured obligations of HECO and its subsidiaries under loan agreements and notes issued to the Department, including HECO's guarantees of its subsidiaries' obligations. The payment of principal and interest due on all revenue bonds currently outstanding are insured either by MBIA Insurance Corporation, Ambac Assurance Corporation, XL Capital Assurance, Inc. or Financial Guaranty Insurance Company and the ratings of those bonds are based on the ratings of the obligations of the bond insurer rather than HECO.

Research and development

HECO and its subsidiaries expensed approximately \$1.8 million, \$3.9 million and \$3.3 million in 2006, 2005 and 2004, respectively, for research and development (R&D). In 2006, HELCO made contributions of \$0.3 million to the Electric Power Research Institute (EPRI) and HECO and MECO did not make any contributions. In 2005 and 2004, the electric utilities' contributions to EPRI accounted for more than half of the R&D expenses. There were also expenses in the areas of energy conservation, new technologies and environmental and emissions controls.

Employees

As of December 31, 2006 and 2005, the Company had full-time employees as follows:

December 31	2006	2005
HEI	41	42
HECO and its subsidiaries	2,085	2,066
ASB and its subsidiaries	1,318	1,272
Other subsidiaries	3	3
	3,447	3,383

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The employees of HEI and its direct and indirect subsidiaries, other than the electric utilities, are not covered by any collective bargaining agreement. Of the 2,085 full time employees of HECO and its subsidiaries as of

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December 31, 2006, 58% were covered by collective bargaining agreements. See the discussion of Collective bargaining agreements in Note 11 to HECO's Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

For additional information for certain risk factors enumerated below and other risks of the Company and its operations, see Forward-Looking Statements, HEI's MD&A, Quantitative and Qualitative Disclosures about Market Risk, HEI's Consolidated Financial Statements, HECO's MD&A and HECO's Consolidated Financial Statements.

Holding Company and Company-Wide Risks

HEI is a holding company that derives its income from its operating subsidiaries and depends on the ability of those subsidiaries to pay dividends or make other distributions to HEI and on its own ability to raise capital.

HEI is a legal entity separate and distinct from its various subsidiaries. As a holding company with no significant operations of its own, HEI's cash flows and consequent ability to service its obligations and pay dividends on its common stock is dependent upon its receipt of dividends or other distributions from its operating subsidiaries and its ability to issue common stock or other equity securities and to incur additional debt. The ability of HEI's subsidiaries to pay dividends or make other distributions to HEI is, in turn, subject to the risks associated with their operations and to contractual and regulatory restrictions, including:

the provisions of an HEI agreement with the PUC, which could limit the ability of HEI's principal electric public utility subsidiary, HECO, to pay dividends to HEI in the event that the consolidated common stock equity of the electric public utility subsidiaries falls below 35% of total electric utility capitalization;

the provisions of an HEI agreement entered into with federal bank regulators in connection with its acquisition of its bank subsidiary, ASB, which require HEI to contribute additional capital to ASB (up to a maximum amount of additional capital of \$28.3 million as of December 31, 2006) upon request of the regulators in order to maintain ASB's regulatory capital at the level required by regulation;

the minimum capital and capital distribution regulations of the OTS that are applicable to ASB;

the receipt of a letter from the OTS stating it has no objection to the payment of any dividend ASB proposes to declare and pay to HEI; and

the provisions of preferred stock resolutions and debt instruments of HEI and its subsidiaries.

The Company is subject to risks associated with the Hawaii economy, volatile U.S. capital markets and changes in the interest rate environment that could result in higher retirement benefits expenses, declines in electric utility kilowatt-hour sales, declines in ASB's interest rate margins, higher delinquencies and charge-offs in ASB's loan portfolio and restrictions on the ability of HEI or its subsidiaries to borrow money.

The two largest components of Hawaii's economy are tourism and the federal government (including the military). Because the core businesses of HEI's subsidiaries are providing local electric public utility services (through HECO and its subsidiaries) and banking services (through ASB and its subsidiaries) in Hawaii, the Company's operating results are significantly influenced by Hawaii's economy, which in turn is influenced by economic conditions in the mainland U.S. (particularly California) and Asia (particularly Japan) as a result of the impact of those conditions on tourism, by the impact of interest rates on the construction and real estate industries and by the impact of world conditions (e.g., war in Iraq) on federal government spending in Hawaii.

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A decline in the Hawaii economy, or the U.S. or Asian economies, could lead to a decline in KWH sales and an increase in uncollected billings of HECO and its subsidiaries, higher delinquencies in ASB's loan portfolio and other adverse effects on HEI's businesses. If S&P or Moody's were to downgrade HEI's or HECO's long-term debt ratings because of these adverse effects, or if future events were to adversely affect the availability of capital to the Company, HEI's and HECO's ability to borrow could be constrained and their future borrowing costs would likely increase with resulting reductions in HEI's consolidated net income in future periods. Further, if HEI's or HECO's ratings were to be downgraded, HEI and HECO might not be able to sell commercial paper under current market conditions and might be required to draw on more expensive bank lines of credit or to defer capital or other expenditures.

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Changes in the U.S. capital markets can also have significant effects on the Company. For example, pension expense is affected by the market performance of the assets in the master pension trust maintained for pension plans, and by the discount rate used to determine the service and interest cost components of net periodic pension cost.

Because the earnings of ASB depend primarily on net interest income, interest rate risk is a significant risk of ASB's operations. HEI and its electric utility subsidiaries are also exposed to interest rate risk primarily due to their periodic borrowing requirements, the discount rate used to determine retirement benefits expenses and obligations and the possible effect of interest rates on the electric utilities' rates of return. Interest rates are sensitive to many factors, including general economic conditions and the policies of government and regulatory authorities. HEI cannot predict future changes in interest rates, nor be certain that interest rate risk management strategies it or its subsidiaries have implemented will be successful in managing interest rate risk.

HEI and HECO and their subsidiaries may incur higher retirement benefits expenses and have and will likely continue to recognize substantial liabilities for retirement benefits.

Retirement benefits expenses and cash funding requirements could increase in future years depending on numerous factors, including the performance of the U.S. equity markets, trends in interest rates and health care costs, plan amendments, new laws relating to pension funding and changes in accounting principles. Retirement benefits expenses based on net periodic pension and other postretirement benefit costs have been an allowable expense for rate-making, and higher retirement benefits expenses, along with other factors, may affect each electric utilities need to request a rate increase.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," an amendment of FASB Statements No. 87, 88, 106, and 132(R), which requires employers to recognize on their balance sheets the funded status of defined benefit pension and other postretirement benefit plans with an offset to AOCI in stockholders' equity (using the projected benefit obligation, rather than the accumulated benefit obligation, to calculate the funded status of pension plans). The amounts recorded in the future will be dependent on numerous factors, including the year-end discount rate assumption, asset returns experienced, any changes to actuarial assumptions or plan provisions, contributions made by the Company to the plans, and what action the PUC takes in rate cases.

By application filed on December 8, 2005 (AOCI Docket), the electric utilities had requested the PUC to permit them to record, as a regulatory asset the amount that would otherwise be charged against stockholders' equity as a result of recording a minimum pension liability as prescribed by SFAS No. 87. The electric utilities updated their application in the AOCI Docket in November 2006 to take into account SFAS No. 158. On January 26, 2007, the PUC issued a D&O in the updated AOCI docket, which denied the electric utilities' request to record a regulatory asset. Although there was not an immediate impact on net income due to this D&O, the electric utilities (as well as HEI) were required to record substantial charges against stockholders' equity, and the electric utilities' reported returns on rate base and returns on average common equity will be higher than if there had been no charge against stockholders' equity. Consolidated debt to capitalization and interest coverage ratios of the Company and the electric utilities were also adversely affected. These effects could adversely affect security ratings, and increase the difficulty or expense of obtaining future financing.

The Company is subject to the risks associated with the geographic concentration of its businesses and lack of interconnections that could result in service interruptions at the electric utilities or higher default rates on loans held by ASB.

The business of HECO and its electric utility subsidiaries is concentrated on the individual islands they serve in the State of Hawaii. The operations of HEI's electric utility subsidiaries are more vulnerable to service interruptions than are many U.S. mainland utilities because none of the systems of HECO and its subsidiaries are interconnected with the systems on the other islands they serve. Because of this lack of interconnections, it is necessary to maintain higher generation reserve margins than are typical for U.S. mainland utilities to help ensure reliable service. The peak reserve margins on Oahu are currently below desirable levels and this condition will likely continue and be exacerbated by projected load growth until additional generation is brought on line, which is not expected until 2009. Service interruptions, including in particular extended interruptions that could result from a natural disaster or terrorist activity, could adversely impact the KWH sales of some or all of the electric utility

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subsidiaries. For example, on October 15, 2006, two sequential earthquakes registering 6.7 and 6.0 on the Richter scale with an epicenter near the island of Hawaii triggered power outages throughout most of the state, and although power was restored to over 99% of Oahu customers over a period of time ranging from 4 1/2 to 18 hours, some areas were without power for more than 24 hours.

Substantially all of ASB's consumer loan customers are Hawaii residents. A significant portion of the commercial loan customers are located in Hawaii. Substantially all of the real estate underlying ASB's residential and commercial real estate loans are located in Hawaii. These assets may be subject to a greater risk of default than other comparable assets held by financial institutions with other geographic concentrations in the event of adverse economic, political or business developments or natural disasters affecting Hawaii and the ability of ASB's customers to make payments of principal and interest on their loans.

Increasing competition and technological advances could cause HEI's businesses to lose customers or render their operations obsolete.

The banking industry in Hawaii, and certain aspects of the electric utility industry, are competitive. The success of HEI's subsidiaries in meeting competition will continue to have a direct impact on HEI's consolidated financial performance. For example:

ASB, which is the third largest financial institution in the state based on total assets, is in direct competition for deposits and loans not only with two larger institutions that have substantial capital, technology and marketing resources, but also with smaller Hawaii institutions and other U.S. institutions, including credit unions, mutual funds, mortgage brokers, finance companies and investment banking firms. Larger financial institutions may have greater access to capital at lower costs, which could impair ASB's ability to compete effectively. Significant advances in technology could render the operations of ASB less competitive or obsolete.

HECO and its subsidiaries face competition from IPPs, including alternate energy providers, and customer self-generation, with or without cogeneration. The PUC issued a decision in its investigative proceeding on competitive bidding as a mechanism for acquiring or building new electric generating capacity. With the exception of certain identified projects, the utilities are now required to use competitive bidding to acquire a future generation resource unless the PUC finds competitive bidding to be unsuitable. The PUC issued a decision in its distributed generation (DG) investigative proceeding, in which it set policies for DG interconnection agreements and standby rates, and established conditions under which electric utilities can provide DG services on customer-owned sites as a regulated service. The electric utilities cannot predict the ultimate effect of the PUC's decisions in the competitive bidding and DG proceedings, the impact they will have on competition from IPPs and customer self-generation, or the rate at which technological developments facilitating non-utility generation of electricity will occur.

New technological developments, such as the commercial development of fuel cells, may render the operations of HEI's electric utility subsidiaries less competitive or outdated.

HEI's businesses could suffer losses that are uninsured due to a lack of insurance coverage or limitations on the insurance coverage the Company does have.

In the ordinary course of business, HEI and its subsidiaries purchase insurance coverages (e.g., property and liability coverages) to protect against loss of, or damage to, their properties and against claims made by third-parties and employees for property damage or personal injuries. However, the protection provided by such insurance is limited in significant respects and, in some instances, there is no coverage. Certain of the insurance has substantial deductibles or has limits on the maximum amounts that may be recovered. For example:

The electric utilities' overhead and underground transmission and distribution systems (with the exception of substation buildings and contents) have an estimated replacement cost of approximately \$3.5 billion and are not insured against loss or damage because the amount of transmission and distribution system insurance available is limited and the premiums are cost prohibitive. Similarly, the electric utilities have no business interruption insurance as the premiums for such insurance would be cost prohibitive, particularly since the utilities are not interconnected to other systems. If a hurricane or other uninsured catastrophic natural disaster were to occur, and if the PUC were not to allow the affected electric utilities to recover from ratepayers' restoration costs and revenues lost from business interruption, the lost revenues and repair expenses could

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result in a significant decrease in HEI's consolidated net income or in significant net losses for the affected periods.

ASB generally does not obtain credit enhancements such as mortgagor bankruptcy insurance but does require standard hazard and hurricane insurance and may require flood insurance for certain properties. ASB is subject to the risks of borrower defaults and bankruptcies and special hazard losses not covered by the required insurance.

Increased federal and state environmental regulation will require an increasing commitment of resources and funds and could result in construction delays or penalties and fines for non-compliance.

HEI and its subsidiaries are subject to federal and state environmental laws and regulations relating to air quality, water quality, waste management, natural resources and health and safety, which regulate the operation of existing facilities, the construction and operation of new facilities and the proper cleanup and disposal of hazardous waste and toxic substances. Compliance with these legal requirements requires HEI's utility subsidiaries to commit significant resources and funds toward environmental monitoring, installation of pollution control equipment and payment of emission fees. These laws and regulations, among other things, require that certain environmental permits be obtained in order to construct or operate certain facilities, and obtaining such permits can entail significant expense and cause substantial construction delays. Also, these laws and regulations may be amended from time to time, including amendments that increase the burden and expense of compliance. For example, emission and/or discharge limits may be tightened, more extensive permitting requirements may be imposed and additional substances may become regulated.

If HEI or its subsidiaries fail to comply with environmental laws and regulations, even if caused by factors beyond their control, that failure may result in civil or criminal penalties and fines. At the present time, HECO is a named party in an ongoing environmental investigation to determine the nature and extent of actual or potential release of hazardous substances, oil, pollutants or contaminants at or near Honolulu Harbor and management cannot predict the ultimate cost or outcome of that investigation.

Adverse tax rulings or developments could result in significant increases in tax payments and/or expense.

Governmental taxing authorities could challenge a tax return position taken by HEI or its subsidiaries and, if the taxing authorities prevail, HEI's consolidated tax payments and/or expense, including applicable penalties and interest, could increase significantly. Further, the ability of HEI and its subsidiaries to generate capital gains and utilize capital loss carryforwards on future tax returns could impact future earnings.

The Company could be subject to the risk of uninsured losses in excess of its accruals for litigation matters.

HEI and its subsidiaries are involved in routine litigation in the ordinary course of their businesses, most of which is covered by insurance (subject to policy limits and deductibles). However, other litigation may arise that is not routine or involves claims that may not be covered by insurance. Because of the uncertainties associated with litigation, there is a risk that litigation against HEI or its subsidiaries, even if vigorously defended, could result in costs of defense and judgment or settlement amounts not covered by insurance and in excess of reserves established in HEI's consolidated financial statements.

Changes in accounting principles and estimates could affect the reported amounts of the Company's assets and liabilities or revenues and expenses.

HEI's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. Changes in these principles, such as the changes related to the accounting for retirement benefits in SFAS No. 158, or the Company's application of existing accounting principles could materially affect HEI's or the electric utilities' consolidated financial position and/or results of operations. Further, in preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change include the amounts reported for investment and mortgage-related securities; property, plant and equipment; pension and other postretirement benefit obligations; contingencies and litigation; income taxes; regulatory assets and liabilities; electric utility revenues; variable interest entities; and allowance for loan losses.

In accordance with SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, HECO and its subsidiaries' financial statements reflect assets and costs based on cost-based rate-making regulations. Continued

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accounting in this manner requires that certain criteria relating to the recoverability of such costs through rates be met. If events or circumstances should change so that the criteria are no longer satisfied, the electric utilities' regulatory assets (amounting to approximately \$112 million as of December 31, 2006) may need to be charged to expense, which could result in significant reductions in the electric utilities' net income, and the electric utilities' regulatory liabilities (amounting to \$241 million as of December 31, 2006) may need to be refunded to ratepayers.

Changes in accounting principles can also impact HEI's consolidated financial statements. For example, if a PPA falls within the scope of FASB FIN No. 46 (FIN 46R), Consolidation of Variable Interest Entities and results in the consolidation of the IPP in HECO's consolidated financial statements, the consolidation could have a material effect on HECO's consolidated financial statements, including the recognition of a significant amount of assets and liabilities, and, if such a consolidated IPP were operating at a loss and had insufficient equity, the potential recognition of such losses. Also, if a PPA falls within the scope of Emerging Issues Task Force (EITF) Issue No. 01-8, Determining Whether an Arrangement Contains a Lease and results in the classification of the agreement as a capital lease, a material effect on HEI's consolidated balance sheet may result, including the recognition of significant capital assets and lease obligations.

Electric Utility Risks

Actions of the PUC are outside the control of the electric utility subsidiaries and could result in inadequate or untimely rate relief, in rate reductions or refunds or in unanticipated delays, expenses or writedowns in connection with the construction of new projects.

The rates the electric utilities are allowed to charge for their services and the timeliness of permitted rate increases are among the most important items influencing the electric utilities' financial condition, results of operations and liquidity. The PUC has broad discretion over the rates that the electric utilities charge their customers. HECO currently has a rate case based on a 2005 test year pending before the PUC. Near the end of September 2005, HECO received an interim D&O (granting \$53 million in annual base revenues) and is awaiting a final D&O. In May 2006, HELCO filed a request for a rate increase based on a 2006 test year intended largely to recover the cost of improvements to its transmission and distribution lines and the two generating units at its Keahole generating plant (CT-4 and CT-5). In December 2006, HECO filed a request for general rate increases based on a 2007 test year intended largely to recover costs incurred to maintain and improve reliability. In February 2007, MECO filed a request for general rate increase also based on a 2007 test year intended largely to recover costs incurred for the installation of Maalaea Unit M18 as well as to maintain service quality, fulfill infrastructure needs, and maintain financial integrity. The trend of increased operation and maintenance (O&M) expenses (including increased retirement benefits expenses), which management expects will continue, increased plant-in-service and other factors are likely to result in the electric utilities seeking rate relief more often than in the past. Any adverse decision by the PUC concerning the level or method of determining electric utility rates, the returns on equity or rate base found to be reasonable, the potential consequences of exceeding or not meeting such returns, or any prolonged delay in rendering a decision in a rate or other proceeding, could have a material adverse effect on HECO's consolidated financial condition, results of operations and liquidity.

The electric utilities could be required to refund to their customers, with interest, revenues received under interim rate orders if and to the extent they exceed the amounts allowed in final rate orders. As of December 31, 2006, the electric utilities had recognized an aggregate of \$79 million of such revenues with respect to interim orders regarding certain IRP costs and the interim order in the HECO rate case based on a 2005 test year.

Many public utility projects require PUC approval and various permits (e.g., environmental and land use permits) from other governmental agencies. Difficulties in obtaining, or the inability to obtain, the necessary approvals or permits, or any adverse decision or policy made or adopted, or any prolonged delay in rendering a decision, by an agency with respect to such approvals and permits, can result in significantly increased project costs or even cancellation of projects. For example, two major capital improvement projects—HECO's East Oahu Transmission Project and the expansion of HELCO's Keahole generating plant—have encountered substantial opposition and consequent delay and increased cost. In the event a project does not proceed, or if the PUC disallows cost recovery for all or part of the project, project costs may need to be written off in amounts that could result in significant reductions in HECO's consolidated net income.

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Energy cost adjustment clauses (ECACs). The rate schedules of each of HEI's electric utilities include ECACs under which electric rates charged to customers are automatically 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. In 2004 PUC decisions approving the electric utilities' fuel supply contracts, the PUC affirmed the electric utilities' right to include in their respective ECACs the stated costs incurred pursuant to their respective new fuel supply contracts, to the extent that these costs are not included in their respective base rates, and restated its intention to examine the need for continued use of ECACs in rate cases.

On June 19, 2006, the PUC issued an order in HECO's pending rate case based on a 2005 test year, indicating that the record in the pending case has not been developed for the purpose of addressing the factors in Act 162, signed into law by the Governor of Hawaii on June 2, 2006. Act 162 states that any automatic fuel rate adjustment clause requested by a public utility in an application filed with the PUC shall be designed, as determined in the PUC's discretion, to (1) fairly share the risk of fuel cost changes between the public utility and its customers, (2) provide the public utility with sufficient incentive to reasonably manage or lower its fuel costs and encourage greater use of renewable energy, (3) allow the public utility to mitigate the risk of sudden or frequent fuel cost changes that cannot otherwise reasonably be mitigated through other commercially available means, such as through fuel hedging contracts, (4) preserve, to the extent reasonably possible, the public utility's financial integrity, and (5) minimize, to the extent reasonably possible, the public utility's need to file frequent applications for general rate increases to account for the changes to its fuel costs. While the PUC already reviews the automatic fuel rate adjustment clause in rate cases, Act 162 requires that these five specific factors be addressed in the record. The PUC's order requested the parties in the rate case proceeding to meet informally to determine a procedural schedule to address the issues relating to HECO's ECAC that are raised by Act 162.

On June 30, 2006, HECO and the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii (Consumer Advocate) filed a stipulation requesting that the PUC not review the Act 162 ECAC issues in the pending rate case based on a 2005 test year since HECO's application was filed and the record in the proceeding was completed before Act 162 was signed into law, and the settlement agreement entered into by the parties in the rate case included a provision allowing the existing ECAC to be continued. On August 7, 2006, an amended stipulation was filed in substantially the same form as the June 30, 2006 stipulation, but also included the Department of Defense (DOD). Management cannot predict whether the PUC will accept the disposition of the Act 162 issue proposed in the amended stipulation or, if not, the procedural steps or procedural schedule that will be adopted to address the issues that are raised by Act 162 or the timing of the PUC's issuance of a final D&O in HECO's pending rate case based on a 2005 test year.

In December 2006, HECO (in its 2007 test year rate case) and HELCO (in its 2006 test year rate case) filed testimonies and a consultant report to address the ECAC provisions of Act 162. In February 2007, MECO filed its 2007 test year rate case application, which included testimony to address the ECAC provisions of Act 162. The testimonies and consultant report concluded that the utilities' current ECACs comply with the requirements of Act 162.

Management cannot predict the ultimate outcome or the effect of these Act 162 issues on the operation of the ECAC as it relates to the electric utilities.

Electric utility operations are significantly influenced by weather conditions.

The electric utilities' results of operations can be affected by changes in the weather. Weather conditions, particularly temperature and humidity, directly influence the demand for electricity. In addition, severe weather and natural disasters such as hurricanes, earthquakes and tsunamis, can be destructive, causing outages and property damage and requiring the utilities to incur significant additional expenses that may not be recoverable.

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Electric utility operations depend heavily on third party suppliers of fuel oil and purchased power.

The electric utilities rely on fuel oil suppliers and shippers and independent power producers to deliver fuel oil and power, respectively, in accordance with contractual agreements. Approximately 78.9% of the net energy generated or purchased by the electric utilities in 2006 was generated from the burning of oil, and purchases of power by the electric utilities provided about 38.2% of their total net energy generated and purchased for the same period. Failure or delay by oil suppliers and shippers to provide fuel pursuant to existing contracts, or failure by a major IPP to deliver the firm capacity anticipated in its PPA, could disrupt the ability of the electric utilities to deliver electricity and require the electric utilities to incur additional expenses to meet the needs of their customers that may not be recoverable. In addition, as these contractual agreements end, the electric utilities may not be able to purchase fuel and power on terms equivalent to the current contractual agreements.

Electric utility generating facilities are subject to operational risks that could result in unscheduled plant outages, unanticipated and/or increased operation and maintenance expenses and increased power purchase costs.

Operation of electric generating facilities involves certain risks which can adversely affect energy output and efficiency levels. Included among these risks are facility shutdowns or power interruptions due to insufficient generation or a breakdown or failure of equipment or processes or interruptions in fuel supply, inability to negotiate satisfactory collective bargaining agreements when existing agreements expire or other labor disputes, inability to comply with regulatory or permit requirements, disruptions in delivery of electricity, operator error and catastrophic events such as earthquakes, tsunamis, hurricanes, fires, explosions, floods or other similar occurrences affecting the electric utilities' generating facilities or transmission and distribution systems. For example, as a result of load growth on Oahu and other factors, there currently is an increased risk to generation reliability. Generation peak reserve margins are lower than considered desirable in light of circumstances. Existing units are running harder, resulting in more frequent and more extensive maintenance, at times requiring temporary shut downs of these units. HECO has taken a number of steps to mitigate the risk of outages, including securing additional purchased power, adding distributed generation at some substations and encouraging energy conservation. The marginal costs of supplying energy to meet growing demand, however, are increasing because of the decreasing peak reserve margin situation, and the trend of cost increases is not likely to ease.

The electric utilities may be adversely affected by new legislation.

Congress and the Hawaii Legislature periodically consider legislation that could have positive or negative effects on the electric utilities and their customers. For example, Congress adopted the Energy Policy Act of 2005, which will provide \$14.5 billion in tax incentives over a 10-year period designed to boost conservation efforts, increase domestic energy production and expand the use of alternative energy sources, such as solar, wind, ethanol, biomass, hydropower and clean coal technology. The incentives include tax credits and shorter depreciable lives for many assets associated with energy production and transmission. The primary impact of these incentives on the electric utilities will be the reduction in the depreciable tax life, from 20 years to 15 years, of certain electric transmission equipment placed into service after April 11, 2005. In addition to the ECAC provisions of Act 162 discussed above, the Hawaii Legislature adopted a number of measures in 2006, which may affect the electric utilities, as described below.

Renewable Portfolio Standards (RPS) law. The 2004 Hawaii Legislature amended an existing RPS law to require electric utilities to meet a RPS of 8% of KWH sales by December 31, 2005, 10% by December 31, 2010, 15% by December 31, 2015, and 20% by December 31, 2020. These standards may be met by the electric utilities on an aggregated basis and were met in 2005 when they attained a RPS of 11.7%. It may be difficult, however, for the electric utilities to attain the required renewables percentages in the future, and management cannot predict the future consequences of failure to do so (including potential penalties to be established by the PUC).

DSM programs. In 2006, the PUC was given the authority, if it deems appropriate, to redirect all or a portion of the funds currently collected by the utilities and included in their revenues through the current utility demand-side management (DSM) surcharge into a Public Benefits Fund, for the purpose of supporting customer DSM programs approved by the PUC.

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Non-fossil fuel purchased power contracts. In 2006, a law was passed that requires the PUC, in connection with its determination of just and reasonable rates in purchased power contracts, to establish a methodology that removes or significantly reduces any linkage between the price paid for non-fossil-fuel-generated electricity under future power purchase contracts and the price of fossil fuel, in order to allow utility customers to receive the potential cost savings from non-fossil fuel generation.

Net energy metering. Hawaii has a net energy metering law, which requires that electric utilities offer net energy metering to eligible customer generators (i.e., a customer generator may be a net user or supplier of energy and will make payment to or receive credit from the electric utility accordingly). The law provides a cap of 0.5% of the electric utility's peak demand on the total generating capacity produced by eligible customer-generators. The 2004 Legislature amended the net energy metering law by expanding the definition of eligible customer generator to include government entities, increasing the maximum size of eligible net metered systems from 10 kilowatts (kw) to 50 kw and limiting exemptions from additional requirements for systems meeting safety and performance standards to systems of 10 kw or less.

In 2005, the Legislature amended the net energy metering law by, among other revisions, authorizing the PUC, by rule or order, to increase the maximum size of the eligible net metered systems and to increase the total rated generating capacity available for net energy metering. In April 2006, the PUC initiated an investigative proceeding on whether the PUC should increase (1) the maximum capacity of eligible customer-generators to more than 50 kw and (2) the total rated generating capacity produced by eligible customer-generators to an amount above 0.5% of an electric utility's system peak demand. The parties to the proceeding include HECO, HELCO, MECO, Kauai Island Utility Cooperative, a renewable energy organization and a solar vendor organization. The PUC has approved a procedural schedule with panel hearings scheduled for October 2007. Depending on their magnitude, changes made by the PUC by rule or order could have a negative effect on electric utility sales. Management cannot predict the outcome of the investigative proceeding.

Bank Risks

Fluctuations in interest rates could result in lower net interest income, impair ASB's ability to originate new loans or impair the ability of ASB's adjustable-rate borrowers to make increased payments.

Interest rate risk is a significant risk of ASB's operations. ASB's net interest income consists primarily of interest income received on fixed-rate and adjustable-rate loans, mortgage-related securities and investments and interest expense consisting primarily of interest paid on deposits and other borrowings. Interest rate risk arises when earning assets mature or when their interest rates change in a time frame different from that of the costing liabilities. Changes in market interest rates, including changes in the relationship between short-term and long-term market interest rates or between different interest rate indices, can impact ASB's net interest margin. Although ASB pursues an asset-liability management strategy designed to mitigate its risk from changes in market interest rates, unfavorable movements in interest rates could result in lower net interest income.

Increases in market interest rates could have an adverse impact on ASB's cost of funds. Higher market interest rates could lead to higher interest rates paid on deposits and other borrowings.

Significant increases in market interest rates, or the perception that an increase may occur, could adversely affect ASB's ability to originate new loans and grow. An increase in market interest rates, especially a sudden increase, could also adversely affect the ability of ASB's adjustable-rate borrowers to meet their higher payment obligations. If this occurred, it could cause an increase in nonperforming assets and charge-offs. Conversely, a decrease in interest rates or a mismatching of maturities of interest sensitive financial instruments could result in an acceleration in the prepayment of loans and mortgage-related securities and impact ASB's ability to reinvest its liquidity in similar yielding assets.

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ASB's operations are affected by many disparate factors, some of which are beyond its control, that could result in lower net interest income or decreased demand for its products and services.

ASB's results of operations depend primarily on the level of net interest income generated by ASB's earning assets and costing liabilities and the supply of and demand for its products and services (i.e., loans and deposits). ASB's net income may also be adversely affected by various other factors, such as:

local and other economic and political conditions that could result in declines in employment and real estate values, which in turn could adversely affect the ability of borrowers to make loan payments and the ability of ASB to recover the full amounts owing to it under defaulted loans;

the ability of borrowers to obtain insurance and the ability of ASB to place insurance where borrowers fail to do so, particularly in the event of catastrophic damage to collateral securing loans made by ASB;

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;

increases in operating costs, due to its strategic transformation to a full-service community bank, inflation and other factors, that exceed increases in ASB's net interest, fee and other income;

the ability of ASB to maintain or increase the level of deposits, ASB's lowest cost funds; and

the ability of ASB to execute its strategy to transform itself to a full-service community bank.

Banking and related regulations could result in significant restrictions being imposed on ASB's business.

ASB is subject to examination and comprehensive regulation by the Department of Treasury, the OTS and the Federal Deposit Insurance Corporation, and is subject to reserve requirements established by the Board of Governors of the Federal Reserve System. As ASB's primary regulator, the OTS regularly conducts examinations to assess the safety and soundness of ASB's operations and activities and ASB's compliance with applicable banking laws and regulations. Because ASB is an indirect subsidiary of HEI, federal regulatory authorities have the right to examine HEI and its activities.

Under certain circumstances, including any determination that ASB's relationship with HEI results in an unsafe and unsound banking practice, these regulatory authorities have the authority to restrict the ability of ASB to transfer assets and to make distributions to its stockholders (including payment of dividends to HEI), or they could seek to require HEI to sever its relationship with or divest its ownership of ASB. Payment by ASB of dividends to HEI may also be restricted by the OTS under its prompt corrective action regulations or its capital distribution regulations if ASB's capital position deteriorates. In order to maintain its status as a QTL, ASB is required to maintain at least 65% of its assets in qualified thrift investments. Savings associations that fail to maintain QTL status are subject to various penalties, including limitations on their activities. In ASB's case, the activities of HEI and HEI's other subsidiaries would also be subject to restrictions, and a failure or inability to comply with those restrictions could effectively result in the required divestiture of ASB. In the event of a required divestiture, federal law substantially limits the entities that could acquire ASB.

ASB's strategy to expand its commercial and commercial real estate lending activities may result in higher service costs and greater credit risk than residential lending activities due to the unique characteristics of these markets.

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ASB has been aggressively pursuing a strategy that includes expanding its commercial and commercial real estate lines of business. These types of loans generally entail higher underwriting and other service costs and present greater credit risks than traditional residential mortgages.

Generally, both commercial and commercial real estate loans have shorter terms to maturity and earn higher rates than residential mortgage loans. Only the assets of the business typically secure commercial loans. In such cases, upon default, any collateral repossessed may not be sufficient to repay the outstanding loan balance. In addition, loan collections are dependent on the borrower's continuing financial stability and, thus, are more likely to be affected by current economic conditions and adverse business developments.

Commercial real estate properties tend to be unique and are more difficult to value than residential real estate properties. Commercial real estate loans may not be fully amortizing, meaning that they may have a significant principal balance or balloon payment due at maturity. In addition, commercial real estate properties, particularly

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industrial and warehouse properties, are generally subject to relatively greater environmental risks than noncommercial properties and to the corresponding burdens and costs of compliance with environmental laws and regulations. Also, there may be costs and delays involved in enforcing rights of a property owner against tenants in default under the terms of leases with respect to commercial properties. For example, tenants may seek the protection of bankruptcy laws, which could result in termination of such tenant's lease.

In addition to the inherent risks of commercial and commercial real estate lending described above, the expansion of these new lines of business present execution risks including the ability of ASB to attract personnel experienced in underwriting such loans and the ability of ASB to appropriately evaluate credit risk associated with such loans in determining the adequacy of the allowance for loan losses.

ITEM 1B. UNRESOLVED STAFF COMMENTS

HEI has not received, prior to July 4, 2006, written comments from the SEC staff regarding its periodic or current reports under the Securities Exchange Act of 1934, which remain unresolved.

HECO has not received, prior to July 4, 2006, written comments from the SEC staff regarding its periodic or current reports under the Securities Exchange Act of 1934, which remain unresolved.

ITEM 2. PROPERTIES

HEI leases office space from nonaffiliated lessors in downtown Honolulu under leases that expire in May 2011. HEI also subleases office space in a downtown Honolulu building leased by HECO under a lease that expires in November 2021, with an option to extend to November 2024. The properties of HEI's subsidiaries are as follows:

Electric utility

See "Generation statistics" and "Transmission systems" in Item 1 and "Limited insurance" in HEI's MD&A. Electric lines are located over or under public and nonpublic properties. See "HECO and subsidiaries and service areas" in Item 1 for a discussion of the nonexclusive franchises of HECO and subsidiaries. Most of the leases, easements and licenses for HECO's, HELCO's and MECO's lines have been recorded.

HECO owns and operates three generating plants on the island of Oahu at Honolulu, Waiau and Kahe. These plants, along with distributed generators (at three substation sites, at HECO's Kalaeloa pole yard and at HECO's Iwilei tank farm), have an aggregate net generating capability of 1,233.2 MW as of December 31, 2006. The three plants are situated on HECO-owned land having a combined area of 535 acres and one 3-acre parcel of land under a lease expiring December 31, 2018. In addition, HECO owns a total of 124 acres of land on which substations, transformer vaults, distribution baseyards and the Kalaeloa cogeneration facility are located.

HECO owns overhead transmission lines, overhead distribution lines, underground cables, poles (fully owned or jointly owned) and steel or aluminum high voltage transmission towers. The transmission system operates at 46,000 volts and 138,000 volts. The total capacity of HECO's transmission and distribution substations was 6,726,800 kilovoltamperes as of December 31, 2006.

HECO owns buildings and approximately 11.5 acres of land located in Honolulu which houses its operating, engineering and information services departments and a warehousing center. It also leases an office building and certain office spaces in Honolulu. The lease for the office building expires in November 2021, with an option to extend through November 2024. The leases for certain office spaces expire on various dates through November 30, 2016 with options to extend to various dates through January 31, 2020.

HECO owns 19.2 acres of land at Barbers Point used to situate fuel oil storage facilities with a combined capacity of 970,700 barrels. HECO also owns fuel oil tanks at each of its plant sites with a total maximum usable capacity of 844,600 barrels and underground fuel pipelines that transport fuel from HECO's tank farm at Campbell Industrial Park to HECO's power plants at Waiau and Kahe. HECO also owns a fuel storage facility at its Iwilei site with a maximum usable capacity of 79,203 barrels, and an underground pipeline that transports fuel from that site to its Honolulu power plant.

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HELCO owns and operates five generating plants on the island of Hawaii, two at Hilo and one at each of Waimea, Kona and Puna, along with distributed generators at substation sites. These plants have an aggregate net generating capability of 181.9 MW as of December 31, 2006 (excluding a small run-of-river hydro unit and a small windfarm). The plants are situated on HELCO-owned land having a combined area of approximately 44 acres. The distributed generators are located within HELCO-owned substation sites having a combined area of approximately 4 acres. HELCO also owns fuel storage facilities at these sites with a total maximum usable capacity of 76,041 barrels of bunker oil, and 48,812 barrels of diesel. HELCO also owns 6 acres of land in Kona, which is used for a baseyard, and one acre of land in Hilo, which houses its engineering and administrative offices. HELCO also leases 4 acres of land for its baseyard in Hilo under a lease expiring in 2030. In addition, HELCO owns a total of approximately 99 acres of land, and leases a total of approximately 9 acres of land, on which hydro facilities, substations and switching stations, microwave facilities, and transmission lines are located. The deeds to the sites located in Hilo contain certain restrictions, but the restrictions do not materially interfere with the use of the sites for public utility purposes. HELCO occupies 78 acres of land (located in Kamuela on the island of Hawaii) for the Lalamilo windfarm (with an aggregate net capability of 2.3 MW as of December 31, 2006), pursuant to a long-term agreement with the Water Commission of the County of Hawaii expiring in 2010.

MECO owns and operates two generating plants on the island of Maui, at Kahului and Maalaea, with an aggregate net generating capability of 232.0 MW as of December 31, 2006. The plants are situated on MECO-owned land having a combined area of 28.6 acres. MECO also owns fuel oil storage facilities at these sites with a total maximum usable capacity of 176,355 barrels. MECO owns two 1 MW stand-by diesel generators and a 6,000 gallon fuel storage tank located in Hana. MECO owns 65.7 acres of undeveloped land at Waena. The Waena land is currently being used for agricultural purposes by the former landowner under a license agreement dated November 19, 1996. The license agreement was originally scheduled to expire on December 31, 2004, but has been extended on a month-to-month basis until the area is required for development by MECO for utility purposes or September 30, 2007, whichever comes first.

MECO's administrative offices and engineering and distribution departments are located on 9.1 acres of MECO-owned land in Kahului.

MECO also owns and operates smaller distribution systems, generation systems (with an aggregate net capability of 22.1 MW as of December 31, 2006) and fuel storage facilities on the islands of Lanai and Molokai, primarily on land owned by MECO.

Bank

ASB owns or leases several office buildings in downtown Honolulu and owns land and an operations center in the Mililani Technology Park on the island of Oahu.

The following table sets forth the number of bank branches owned and leased by ASB by island:

December 31, 2006	Number of branches		
	Owned	Leased	Total
Oahu	8	36	44
Maui	3	5	8
Kauai	3	2	5
Hawaii	2	4	6
Molokai		1	1
	16	48	64

As of December 31, 2006, the net book value of branches and office facilities is approximately \$48 million. Of this amount, \$33 million represents the net book value of the land and improvements for the branches and office facilities owned by ASB and \$15 million represents the net book value of ASB's leasehold improvements. The leases expire on various dates through November 2036, but many of the leases have extension provisions.

Table of Contents**ITEM 3. LEGAL PROCEEDINGS**

The descriptions of legal proceedings (including judicial proceedings and proceedings before the PUC and environmental and other administrative agencies) in Item 1. Business, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and in the notes to HEI's Consolidated Financial Statements are incorporated by reference in this Item 3. Certain HEI subsidiaries (including HECO and its subsidiaries and ASB) are also involved in ordinary routine PUC proceedings, environmental proceedings and litigation incidental to their respective businesses.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**HEI and HECO:**

During the fourth quarter of 2006, no matters were submitted to a vote of security holders of the Registrants.

EXECUTIVE OFFICERS OF THE REGISTRANT (HEI)

The following persons are, or may be deemed to be, executive officers of HEI. Their ages are given as of February 28, 2007, their years of company service are given as of December 31, 2006 and their business experience is given for the past five years. Officers are appointed to serve until the meeting of the HEI Board of Directors (HEI Board) after the next Annual Meeting of Shareholders (which is scheduled for April 24, 2007) and/or until their successors have been appointed and qualified (or until their earlier resignation or removal). Company service includes service with an HEI subsidiary.

HEI Executive Officers

Constance H. Lau, age 54 (Company service: 22 years) President and Chief Executive Officer	5/06 to date
Chairman of the Board, HECO	5/06 to date
Chairman of the Board, ASB	5/06 to date
President and Chief Executive Officer, ASB	6/01 to date
Director, HEI	6/01 to 12/04, 5/06 to date

Eric K. Yeaman, age 39 (Company service: 3 years) Financial Vice President, Treasurer and Chief Financial Officer	01/03 to date
Eric K. Yeaman, prior to joining HEI, served as Chief Operating and Financial Officer of Kamehameha Schools from 4/02 to 1/03 and Chief Financial Officer of Kamehameha Schools from 7/00 to 4/02.	

Patricia U. Wong, age 50 (Company service: 16 years) Vice President Administration and Corporate Secretary	4/05 to date
Vice President	1/05 to 4/05
Vice President Corporate Excellence, HECO	3/98 to 12/04

Andrew I. T. Chang, age 67 (Company service: 21 years) Vice President Government Relations	4/91 to date
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Curtis Y. Harada, age 51 (Company service: 17 years) Controller	1/91 to date
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T. Michael May, age 60 (Company service: 14 years) President and Chief Executive Officer, HECO	9/95 to date
Director, HEI	9/95 to 12/04

Robert F. Clarke retired from HEI on May 31, 2006. Constance H. Lau was named to succeed Mr. Clarke and became President and Chief Executive Officer (CEO) of HEI effective May 2, 2006.

HEI's executive officers, with the exception of Andrew I. T. Chang, are also officers and/or directors of one or more of HEI's subsidiaries. Mr. May is not an officer of HEI, but he is deemed to be an executive officer of HEI for purposes of this Item under the definition of executive

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officer in Rule 3b-7 of the SEC's General Rules and Regulations under the Securities Exchange Act of 1934.

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There are no family relationships between any executive officer of HEI and any other executive officer or director of HEI, nor are there any arrangements or understandings between any executive officer of HEI and any person, pursuant to which such executive officer was selected.

PART II**ITEM 5. MARKET FOR REGISTRANTS' COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF SECURITIES****HEI:**

Certain of the information required by this item is incorporated herein by reference to Note 12, Regulatory restrictions on net assets and Note 16, Quarterly information (unaudited) of HEI's Consolidated Financial Statements and Item 6. Selected Financial Data and Item 12. Equity compensation plan information of this Form 10-K. Certain restrictions on dividends and other distributions of HEI are described in this report under Item 1. Business Regulation and other matters Restrictions on dividends and other distributions and that description is incorporated herein by reference. HEI's common stock is traded on the New York Stock Exchange and the total number of holders of record of HEI common stock as of February 21, 2007, was 11,902.

In 2006, HEI issued an aggregate of 27,600 shares of unregistered common stock pursuant to the HEI 1990 Nonemployee Director Stock Plan, as amended and restated effective May 2, 2006 (the HEI Nonemployee Director Plan). Under the HEI Nonemployee Director Plan, each nonemployee HEI director receives, in addition to an annual cash retainer, an annual stock grant of 1,400 shares of HEI common stock (2,000 shares for the first time grant to a new HEI director) and each nonemployee subsidiary director who is not also a nonemployee HEI director receives an annual stock grant of 1,000 shares of HEI common stock (600 shares for the first time grant to a new subsidiary director). The HEI Nonemployee Director Plan is currently the only plan for nonemployee directors and provides for annual stock grants and annual cash retainers for nonemployee directors of HEI and its subsidiaries.

In 2005, HEI issued an aggregate of 28,200 shares of unregistered common stock pursuant to the HEI Nonemployee Director Plan, as amended and restated effective March 8, 2005. In 2004, HEI issued an aggregate of 18,800 shares (split-adjusted) of unregistered common stock pursuant to the HEI 1990 Nonemployee Director Stock Plan, as amended and restated effective April 20, 2004.

HEI did not register the shares issued under the director stock plan since their issuance did not involve a sale as defined under Section 2(3) of the Securities Act of 1933, as amended. Participation by nonemployee directors of HEI and subsidiaries in the director stock plans is mandatory and thus does not involve an investment decision.

Purchases of HEI common shares were made as follows:

ISSUER PURCHASES OF EQUITY SECURITIES

Period*	(a)	(b)	(c)	(d)
	Total Number of Shares Purchased **	Average Price Paid per Share **	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs **	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 to 31, 2006	66,809	27.6318		NA
November 1 to 30, 2006	32,400	26.9562		NA
December 1 to 31, 2006	221,518	27.4882		NA
	320,727	27.4644		NA

NA Not applicable.

* Trades (total number of shares purchased) are reflected in the month in which the order is placed.