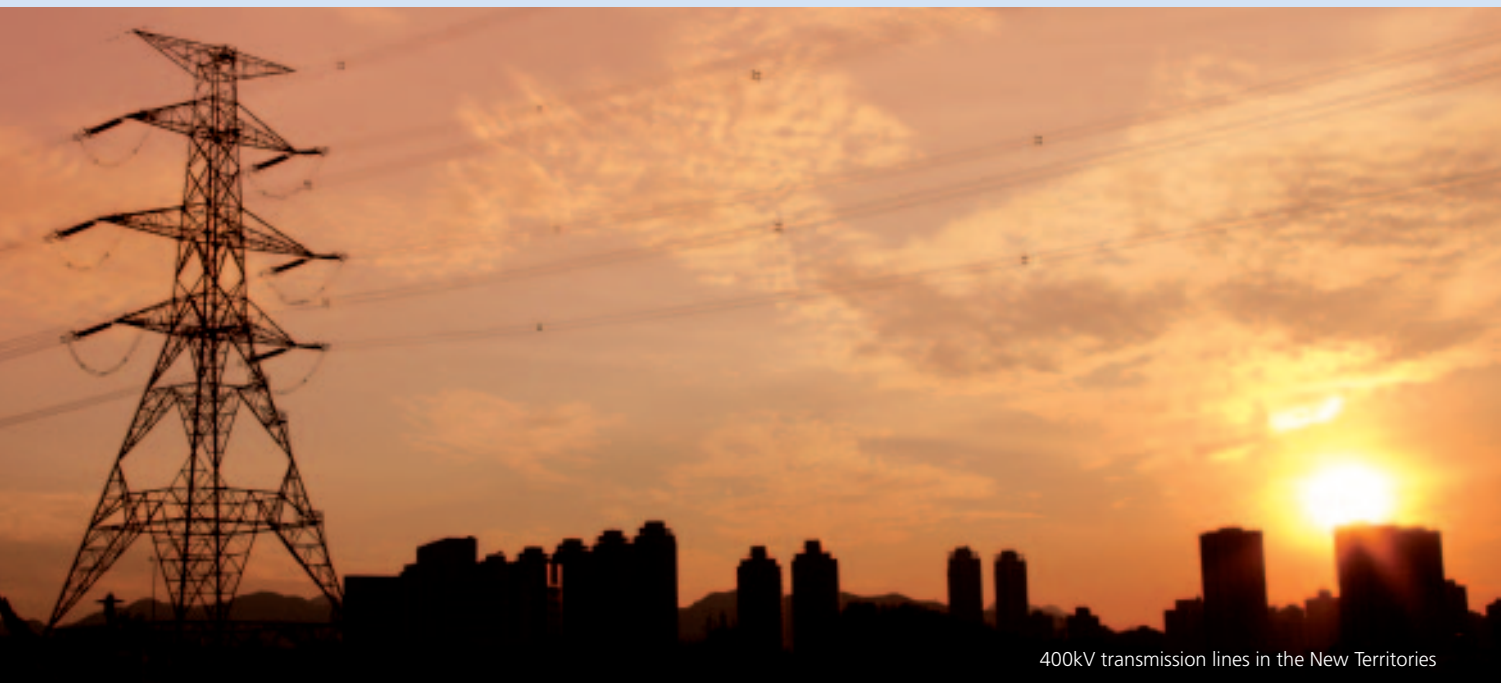


Hong Kong



400kV transmission lines in the New Territories

How did we do in 2006?

The performance of our Hong Kong electricity business in 2006 was characterised by:

- good progress on three major strategic issues
 - establishing the terms of the post-2008 regulatory regime for Hong Kong's electricity industry;
 - improving the environmental performance of the business, particularly emission levels from Castle Peak Power Station; and
 - securing a long-term LNG supply for Black Point Power Station.
- strong operating performance, notably in respect of
 - meeting the demand for electricity;
 - effective operation of generating assets;
 - timely capital investment to meet customers' needs; and
 - effective cost management.
- reasonable growth in earnings.

Post-2008 Regulatory Regime

Stage II of the Government's public consultation on the future regulation of Hong Kong's electricity industry ended on 31 March 2006. In our formal response to this consultation, CLP expressed its support for Government's policy objectives of a reliable, safe, efficient and environmentally responsible electricity supply at reasonable prices. There were four major areas in Government's proposals where CLP expressed strong and justifiable reservations: the disincentives against investment

in environmental improvement, unclear plans for future migration to a competitive market, inadequate incentives to encourage appropriate investment whilst substantially increasing CLP's risk profile, and the duration of the future regime being too short and failing to recognise the long-term nature of investment in the electricity industry.

In May 2006, the Government issued an information paper summarising the views received during the Stage II consultation. Many submissions supported CLP's views on the post-2008 regulatory regime. There was a general consensus that reliability and safety of supply were of the utmost importance and should be key considerations in the future development of the electricity market. In this regard, many submissions expressed doubts about the introduction of new supply sources from the Mainland. There were concerns that Government's proposals to lower the return to shareholders to between 7% and 11% could prevent continued investment and might affect supply reliability. Suggestions were also put to Government for the provision of incentives to encourage investment in emissions reduction facilities.

Since May, we have started discussions with Government on the future regulation of our business. In those discussions we are working co-operatively to reach an agreement on terms that balance the interests of all stakeholders and serve the long-term interests of our community.

Environmental Performance

Increased use of ultra-low sulphur coal contributed to lower emissions at Castle Peak in 2006. The average sulphur content of the coal we burned dropped from 0.36% in 2005 to 0.27% in 2006. More types of environmentally friendly coal were burned at the station and the use of such coal was extended from the Castle Peak Power Station 'B' units to all the units at Station 'A'. We improved the 'B' electrostatic precipitators to reduce emissions of particulates.

Significant progress was made in the Castle Peak 'B' emissions control project with the issue of an environmental permit by Environmental Protection Department in November. This allows site relocation work to commence. Major front-end engineering design works have been completed. Tendering for the supply of flue gas desulphurisation (FGD) equipment has entered the stage of detailed negotiation with suppliers.

We also look to improve the environmental performance of the other assets within our electricity supply system. The Wan Po Road Substation, completed in 2006, has adopted a holistic approach in sustainable development design, resulting in a facility which has reduced operating and maintenance requirements, whilst achieving a saving of 34% in energy consumption compared to more traditional substation design. We started work on developing a Sky Woodland at the Sham Mong Road Substation. On completion in 2008, this will be a unique city centre native woodland, conserving energy, bringing visual and ecological benefits to its neighbourhood and offering potential value for scientific research.

As part of our efforts to explore Hong Kong's potential for wind-powered electricity generation, the completion of preliminary engineering design and wind data collection has allowed us to go forward to seek environmental and other approvals for the construction of a commercial grade wind turbine pilot project at Hei Ling Chau. We also entered into a collaboration agreement with a U.K. wind farm developer, Wind Prospect, to conduct a feasibility study for a 180MW wind farm in the eastern waters off Hong Kong.

LNG

Black Point Power Station currently receives its natural gas from the Yacheng gas field near Hainan Island, which will not be able to sustain sufficient production early in the next decade. To secure long-term replacement sources of natural gas, planning for the construction of an LNG receiving terminal in Hong Kong began in 2003. In August 2006, a formal proposal was submitted to Government recommending an LNG terminal be built on South Soko Island. In October, an environmental impact assessment (EIA) was submitted to Government demonstrating the environmental acceptability of the project, based on nearly four years of extensive study, site selection and stakeholder engagement. Discussions with international gas suppliers have progressed throughout the year, with a view to entering into preliminary arrangements for long-term gas supply contracts in 2007.

Why is having your own LNG terminal so important to CLP – couldn't you simply buy LNG from the Guangdong Province?



Mr. Simon Powell
Head of Power
Research, CLSA
Research Limited

Our Black Point Power Station currently meets one third of CLP's (and a quarter of Hong Kong's) entire electricity needs. For this to continue, and for us to meet our emissions targets, we need to increase our use of clean-burning natural gas to some 50% and therefore we need a reliable long-term source of natural gas to replace the supply from Yacheng that Black Point has relied on since 1996.

As our gas supply is so critical, we have to make sure we get it right. Our requirements are prudent and realistic, but also quite demanding – we need to be certain when the replacement supply will be available; we need to be sure it will provide long-term supply security for Hong Kong; we need to know we will have enough to meet our needs now and for the future; we need both to attract supply and to demonstrate that it is competitive against alternatives; and we will not compromise our high environmental and safety standards – and this includes our fuel suppliers. We have concluded that the best way of meeting all these requirements is to build an LNG receiving terminal in Hong Kong, together with procuring adequate long-term supplies of LNG from the international market. We must do this with urgency given the long lead times for these projects and with the Yacheng supply expected to deplete early next decade. More details about the LNG Project are available on our website www.clpgroup.com/environment/LNG, through e-mail to lmg@clp.com.hk or from our enquiry hotline on (852) 2678 8189. 



Richard Lancaster
Commercial Director –
CLP Power Hong Kong

Meeting the Demand for Electricity

The key objective of our Hong Kong electricity business is to meet our customers' demand for electricity. In 2006, our total electricity unit sales, including those to the Chinese mainland, grew by 0.6% to 34,089GWh. The causes of the modest growth in electricity unit sales in Hong Kong are explained in the breakdown of unit sales growth by sector set out below.

Sector	2006 Number of customers (‘000)	2006 Electricity sales (GWh)	Sales Increase/ (Decrease) over 2005 (%)	Average annual sales change over 2002-2006 (%)	Notes on 2006 performance
Residential	1,937	7,469	(0.7)	2.0	Mainly due to slow growth in customer numbers, higher energy conservation awareness and cooler summer weather
Commercial	183	11,957	4.6	2.9	Caused by the reclassification from the Infrastructure and Public Services sector of accounts previously under the Housing Authority and now transferred to The Link Real Estate Investment Trust (REIT), as well as growth in property management and non-Government office sectors
Infrastructure and Public Services	84	7,482	(2.8)	2.6	Attributable to the reclassification of The Link REIT to the Commercial sector and lower consumption by Government as a result of energy conservation measures
Manufacturing	32	2,653	(3.0)	(3.9)	This sector continued to decline with a reduction in sales, particularly in the electronic, paper and textile sectors
Total local sales	2,236	29,561	0.6	1.9	
Export sales	–	4,528	0.7	23.4	Assisting Guangdong to meet its electricity demand and contributing to better regional air quality by reducing the use of polluting diesel-powered generators. Easing tariff pressure for our Hong Kong customers – the resulting profits are allocated on a 80/20 basis between customers and shareholders
Total sales	2,236	34,089	0.6	3.6	

Effective Operation of Generating Assets

Local demand for the electricity supplied by our generating plant peaked at 6,435MW in July (this was slightly lower than the historical peak of 6,475MW achieved the previous year). System demand reached an all time high of 8,318MW in July (exceeding the previous record of 7,817MW). Our reserve margin of generating capacity (the relationship between the total installed capacity available to serve our Hong Kong customers and the highest demand for electricity from those customers in the past 12 months) was around 38%. In July, when high local demand combined with strong demand from Guangdong, the system reserve margin was only 7%.

In these circumstances, our generating plant must operate reliably and maintain high levels of availability.

Station	Rating (MW)	Generation** (GWh)		Availability (%)		Operating Hours	
		2006	2005	2006	2005	2006	2005
Black Point Power Station	2,500	11,178.8	11,270.0	89.2	89.0	37,203.0	36,850.0
Castle Peak Power Station	4,108	15,229.0	14,976.9	89.7	89.1	37,006.0	34,685.0
Penny's Bay Power Station*	300	0.6	0.2	99.9	97.3	15.2	11.2

* Penny's Bay Power Station is used for peaking capacity and black start capability.

** Purchase of nuclear electricity from Daya Bay is not reflected in these figures.

The final 312.5MW generating unit at Black Point (Unit 8) was declared available for commercial operation in May 2006, adding an additional combined-cycle generating unit to our generating portfolio.

Given ExxonMobil's potential dual involvement as a developer as well as a potential supplier to the LNG terminal, how can CLP/ ExxonMobil ensure a fair competition for the LNG supply contract? Would Government be involved in this LNG supplier selection process?



Mr. Simon H. Y. Lee
Vice President,
Morgan Stanley Dean
Witter Asia Limited

ExxonMobil has been CLP's partner in the ownership of our Hong Kong generating plant since the 1960s. We are fortunate in having access to the resources and expertise of one of the leading oil and gas companies in the world – and we would be wrong to deny ourselves and our customers the benefit of their skills and commitment to Hong Kong.

Both CLP and ExxonMobil are determined to ensure that the LNG project is undertaken in a proper, honest and cost-effective way, which serves the interests of our customers. CLP has talked to 22 potential suppliers, including ExxonMobil, about long-term gas supply arrangements. CLP has appointed Ernst & Young to audit and monitor the gas procurement process and procedures to ensure these are fair to all suppliers and in customers' best interests. These procedures are also subject to close scrutiny by Government.



Richard Lancaster
Commercial Director –
CLP Power Hong Kong

Capital Investment

Our ongoing capital investment programme aims to:

- maintain and where practical, improve the security and reliability of our transmission and distribution network;
- enhance the efficiency of our supply network and customer services – improving supply quality whilst controlling the cost to our customers; and
- make timely provision to meet future increases in demand.

In line with those objectives, CLP invested HK\$5.7 billion (2005: HK\$6 billion) during 2006. Major developments included:

- the commissioning of new transmission substations at Wan Po Road and Mai Po;
- the upgrade of supply to Cheung Chau and South Lantau from 33kV to 132kV;
- the installation of the third circuit to Shekou; and
- the commissioning of four cable tunnels – these facilitate present and future development of our supply area, minimise environmental impact and enhance supply reliability by protecting cables from third party interference.

CLP has started planning the supply network in accordance with the development plan for Kai Tak. This envisages the area being regenerated as a hub for sports, recreation, tourism, business and quality housing, including major developments such as a cruise terminal and multi-purpose stadium complex.

Cost Management

We monitor closely the operating expenditure incurred in our Hong Kong electricity business. In 2006, we worked hard on cost saving and productivity enhancing initiatives.

On the generation side, a risk-based approach to maintenance has commenced, while at Castle Peak Power Station, improved start-up and shut-down processes were implemented to improve cost performance. A detailed review of our contractor strategy has been commissioned and a programme has been launched to reduce the cost of consumables.

In our network business, we have adopted various condition monitoring techniques such as dissolved gas analysis and partial discharge monitoring to support our Reliability Centred Maintenance programme. This will help reduce long-term maintenance and fault repair costs. To extend asset lives, refurbishment projects on transmission overhead line systems and transmission Gas Insulated Switchgear have been initiated. The risk of commodity price fluctuations has been reduced through risk sharing with suppliers.

Cost savings in customer services were encouraged through the optimisation of customer channels, promotion of electronic billing and payment, and selective outsourcing of metering field work.

IT maintenance and licence costs were reduced through regional framework agreements with major technology suppliers. An external consultant's report confirmed that, both as a percentage of revenue and on a per customer basis, CLP's IT expenditure has been lower than the industry average over the past 3 years, without compromising high reliability levels.

Operating Expenditure	2006 HK\$M	2005 HK\$M
Operating costs	3,328	3,106
Fuel	4,363	4,153
Purchases of nuclear electricity	5,040	5,029
Depreciation	4,117	3,746
Operating interest	718	543
	17,566	16,577

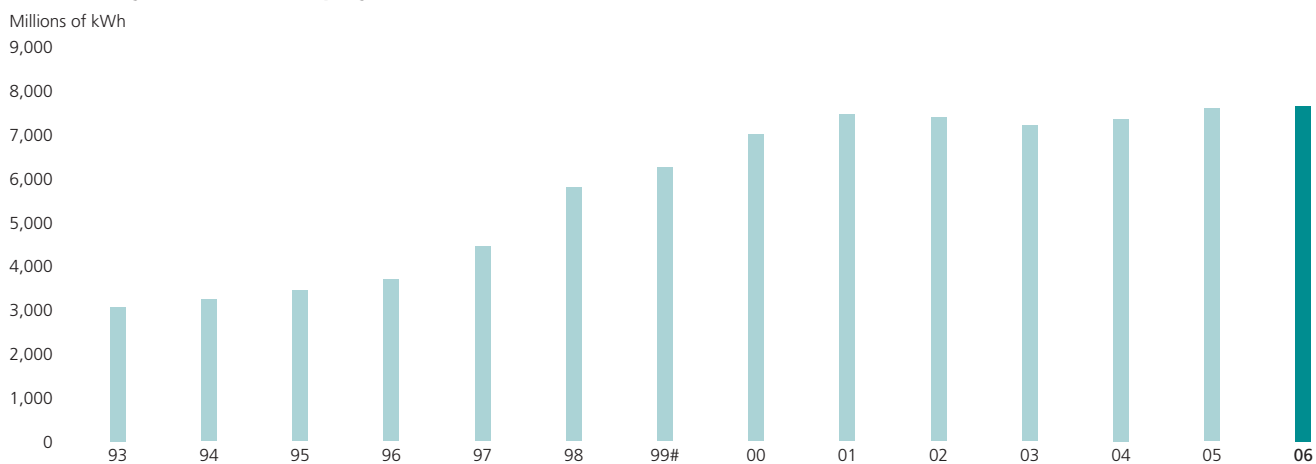
CLP's cost efficiency can be measured by productivity in terms of electricity sales per employee. Between 1993, when the current SoC began, and 2006, CLP's productivity has increased by 150%.

- (Left) Lowering the tunnel boring machine to start work at Tsz Wan Shan Cable Tunnel
- (Right) CLP Ultra Heavy Transport Team moving a 250-ton transformer



Under the SoC, all of the benefits achieved by CLP through cost control are passed directly to customers, in terms of lower tariffs. Our announcement, in December 2006, that CLP would continue its longstanding tariff freeze for the ninth successive year, is the clearest demonstration of our success in effective cost management. On 31 December 2007, a CLP customer will be paying the same price for electricity as he or she did on 1 March 1998.

Productivity (Local sales/employee*)



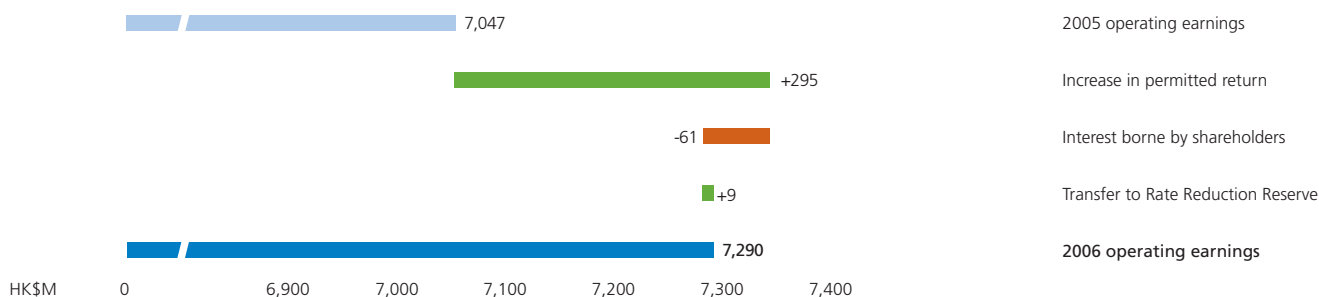
* Average of opening & closing balance

An annualised result derived from 15 months of local sales resulting from the change of financial year end from 30 September to 31 December in 1999.

Earnings

The following chart explains the contribution made by our Hong Kong electricity business in 2006, and how this compares to the previous year.

Hong Kong Operating Earnings



The earnings from our Hong Kong electricity business continued to represent the largest part of the Group's total earnings, making a contribution of HK\$7,290 million in 2006, compared to HK\$7,047 million in 2005.

The earnings from this business are determined in accordance with the requirements of the SoC. The increase of 3.4% over the previous year was attributed to ongoing capital investments to meet new demand, as well as to enhance supply quality and customer services. In general terms, this modest increase in earnings corresponds to what might be expected from the provision of electricity to a society which passed through a period of rapid development between the 1960s and 1980s and has become a more mature, service-based developed economy.

What are we going to deliver in 2007 and beyond?

Business Environment and Challenges

The Hong Kong economy has been growing strongly, even if growth has not been uniform in all sectors – for instance, the role of manufacturing industry continues to decline. Closer economic ties between Hong Kong and the Mainland have brought changes to the business environment and local expenditure patterns. We still see a steady growth in local electricity demand, albeit at a slower rate than the average over the past decade. Economic fundamentals remain strong, with growth supported by local consumption, tourist-related services and ongoing business investment.

Looking ahead, local electricity demand is expected to be driven by increasing business activities, such as in the financial services sector, and ongoing housing development. In the medium to long term, Government promotion of energy saving initiatives, both within Government itself and to the public as a whole, will play an important role in energy conservation. Taken with the continuing transfer of manufacturing capacity to the Mainland, electricity demand growth is forecast to be around 2-3% per annum. Economic development in Guangdong Province is expected to continue, accompanied by some shortages in electricity supply. However, as the supply and demand of electricity in Guangdong becomes more balanced we expect that sales to Guangdong will reduce over time.

Within the Hong Kong energy market, diesel and liquefied petroleum gas have become less attractive as a primary fuel source for some customers, due to the price of oil and environmental concerns. Price competition from piped gas may increase, although customers using electricity for many key applications will still enjoy a cost advantage.

CLP is well positioned to remain the owner and operator of the major electricity supply business in Hong Kong. We have a long established and hard-earned reputation for reliability of supply, excellence in customer service and commitment to the responsible management of safety and environmental matters. Our record of tariff management is extremely good, including when compared to other local utilities and public service providers and to the electricity industry on a world-wide basis. Our progress in efficiency enhancement and cost reduction will assist us in managing the upward cost pressures in fuel, payroll and interest expense which are likely to bear on our business in the coming years. Our Hong Kong electricity business also enjoys the benefits of a strong financial position, with a good credit rating which is supported by high standards of corporate governance with the systematic control, monitoring and documentation of all major operating activities.

Will CLP bear all the environmental costs of electricity generation post-2008, as suggested by Government and supported by some people in the community?



Mr. Heung Shu Fai
Managing Director,
Sirius Pacific
Consultants Ltd.

CLP's environmental performance, in terms of emissions per unit of electricity sold, ranks among the best in electric utilities around the world. This is a result of our commitment to bringing in clean fuel such as nuclear power and natural gas in the 90s as well as the best technology at the time of investment such as low NO_x burners. We have increased the use of ultra-low sulphur coal in Castle Peak Power Station in recent years. These measures require significant investment and long-term contractual arrangements that are an integral part of a power generation operation which deliver electricity reliably to meet customers' demand and in an environmentally friendly manner.

Such investments are reflected in the tariffs based on the principle of cost-of-service, which is a sound practice enabling investors to recover costs in order to maintain their service to customers in the long term. It would be unfair and inappropriate to punish the power companies with a lower return for their investment in facilities that contribute to emissions reduction, and in particular our coal units when they were built and maintained to standards previously approved by Government and have been improved continually for best environmental performance. Such punitive measures would work against the objective of encouraging environmental investment, aggravating the risks of worsening air quality in Hong Kong.



Betty Yuen
Group Director –
Managing Director Hong Kong



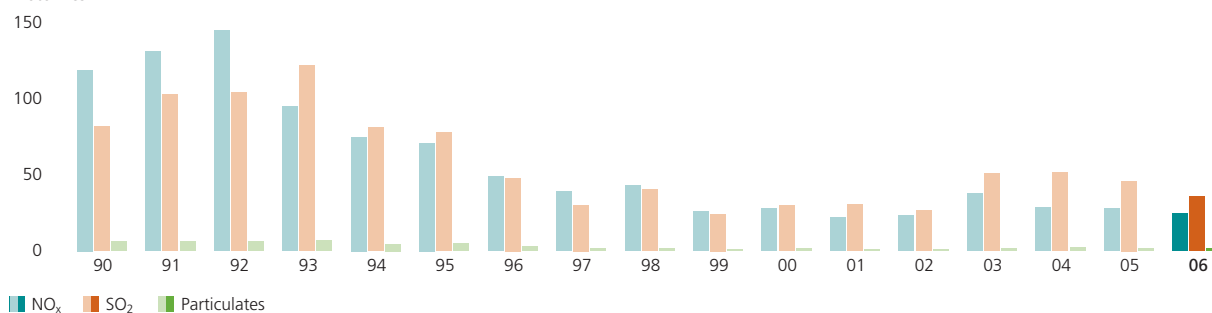
Whilst the economic and operating outlook is positive, the political arena poses nearer term challenges to our business in the form of three major strategic issues, namely, the negotiations on the post-2008 electricity regulatory regime, environmental issues associated with emissions from Castle Peak and sourcing LNG for Black Point.

On the future regulatory regime, we expect that the key deliverables from Government's viewpoint will include a reduction in permitted return, improved environmental performance and increased flexibility to introduce competition. We believe that, whilst Government may be under strong political pressure in addressing these matters, it is aware of the importance to the long-term future of Hong Kong's electricity industry, and to the reliability and security of the electricity supply to our community, of reaching a balanced outcome on these and the other issues which will need to be addressed.

The worsening air quality in Hong Kong is now at the top of the political agenda. Understandably, the community has become extremely concerned about this issue. CLP has already taken great strides to reduce the emissions from its power stations – total emissions in 2006 were actually lower than in 1990, despite a 25% increase in the electricity we generated.

CLP in Hong Kong — Significant Environmental Improvement since 1990

Total Emissions
kilotonnes



The arrival of LNG, together with increased use of ultra-low sulphur coal, completion of the emissions reduction project to retrofit Castle Peak, promotion of renewable energy (where feasible, having regard to physical, geographical and climatic constraints) and energy conservation will contribute further to improved environmental performance from the Hong Kong electricity business.

Our community deserves clear explanations as to what Government's energy and environmental policies hold for their future and how clean air goals can be achieved objectively and realistically – so that every member of the community, including the power sector, can play a part in making a difference. Piecemeal measures, conceived without proper regard for the limited extent to which poor air quality is caused by Hong Kong's power station emissions, as opposed to other sources, such as those produced in Guangdong, hinder the structured and collective effort required to bring about a significant and durable improvement. Unrealistic restrictions on the operation of our power stations can jeopardise the reliability and cost-effectiveness of electricity supply, whilst contributing little to an overall improvement in air quality.

We are fully committed to continuing to play our part in a regional effort to tackle the problem of poor air quality – as demonstrated by our excellent record in environmental management and the practical steps we have in hand towards further improvement.

Year 2007

Our major plans and activities for 2007 will include:

- completion of the SoC negotiations with Government. We expect intense and difficult negotiations on issues such as level of return, environmental performance, duration of the regulatory regime and other matters, even if we also expect that it will prove possible to agree a regulatory regime which safeguards the benefits achieved by the existing SoC and continues to balance the interest of all stakeholders in the Hong Kong electricity industry
- further progress on the Castle Peak emissions reduction project, including finalising the planning of the FGD equipment and the plan for NO_x reduction
- for the LNG project, obtaining approval of the financial plan from the Executive Council of Government, commencing front-end engineering design work of the receiving terminal, as well as putting preliminary purchasing arrangements in place for LNG to be delivered when the terminal is ready for operation and making arrangements with the Yacheng field gas suppliers necessary to transition to LNG
- continued engagement with Government, stakeholders and the wider community. All the major aspects of our Hong Kong electricity business including the regulatory regime, tariff levels, environmental performance, fuel supply and reliability are subject to political debate. It is to the advantage of CLP, and the community as a whole, that decisions on these issues are taken on the basis of a proper understanding of the nature of our industry and the consequences, including over the long term, of those decisions
- continued investment in our supply system and the enhancement of our operating skills. This will include developments in customer service, such as enhancing our service offering at our Call Centre and Customer Service Centres, easier access by customers to more of our services through internet, product offerings for individual customer groups which more closely match their needs and partnering with product vendors and contractors to bring the benefits of new technologies and end use applications to Hong Kong

Beyond 2007

In the longer term, our plans and activities are expected to involve:

- evaluating the implications of the post-2008 electricity regulatory regime and how this impacts on the manner in which we carry on our business. Within any modified regulatory framework, our objectives will be to maintain the ongoing capital investment required to meet the community's future needs, preserve the quality of supply and reasonable tariff levels which our customers have grown to expect and provide reasonable returns for our investors who fund the provision of Hong Kong's electricity infrastructure
- in 2009, beginning phase 2 of the emissions reduction programme at Castle Peak, involving four major emissions control facilities being installed in stages with a view to the programme as a whole being completed around the turn of decade
- completion of the LNG receiving terminal and availability of long-term LNG supply by 2011 to ensure a smooth transition as the Yacheng supply depletes
- with Government's necessary support and approvals, aiming towards its 2010 emissions targets through the use of low sulphur coal, accelerated use of the Yacheng gas reserves once the LNG terminal is approved, increasing the proportion of gas in our fuel mix and the retrofit of emissions reduction equipment at Castle Peak
- continuing to apply cost control and efficiency disciplines in order to support ongoing tariff management

The combination of responsible environmental performance, reliability of supply and cost competitiveness will ensure Hong Kong customers' ongoing support for CLP as their electricity supplier of choice.