

Ten-Year Scheme of Control Statement

The Hongkong Electric Company, Limited

(a) Scheme of Control

The activities of The Hongkong Electric Company, Limited ("HEC"), a wholly-owned subsidiary of the Company, are subject to a Scheme of Control ("SOC") agreed with the Hong Kong SAR Government. This SOC was renewed with effect from 1st January 1994 and is effective until 31st December 2008. During this period, each party has the right, during the year ended 31st December 1998 and the year ended 31st December 2003, to request modification of the SOC, subject to agreement being reached by all parties.

The SOC provides for HEC to earn a Permitted Return of 13.5% of average net fixed assets plus 1.5% of average net fixed assets acquired after 1st January 1979 from the additional shareholders' investment as defined in the SOC. The Permitted Return is determined after any excess capacity adjustment, in accordance with the Annex of the SOC. No excess capacity adjustment was required in 2006. Any difference between the Permitted Return and the SOC net revenue of HEC must be transferred to or (from) a Development Fund from or (to) the Profit and Loss Account of HEC. Where the SOC net revenue is less than the Permitted Return, the amount transferred from the Development Fund to the Profit and Loss Account shall not exceed the balance of the Development Fund. In calculating this SOC net revenue, interest relating to the acquisition of fixed assets (whether it has been charged to revenue or capitalised) up to 8% per annum, is added to, and a tax adjustment is made against, profit after taxation. In addition, each year 8% of the average balance of the Development Fund is transferred from the Profit and Loss Account of HEC to a Rate Reduction Reserve, the purpose of which is to rebate electricity charges to customers.

In accordance with the renewed SOC effective 1st January 1994, HEC is required to retain a SOC tax adjustment at historical tax rates. This tax adjustment shall be retained within HEC until such time as it may be required to pay the tax.

(b) Ten-Year Scheme of Control Statement for the Year Ended 31st December

HK\$ million	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Sales of electricity	12,326	12,310	11,442	11,263	11,522	10,911	10,543	9,577	9,627	8,366
Transfer from/(to) Fuel Clause Account	15	119	(443)	(726)	(724)	(740)	(801)	(745)	(623)	(479)
Other Scheme of Control revenue	42	56	51	66	56	59	54	64	62	66
Gross tariff revenue	12,383	12,485	11,050	10,603	10,854	10,230	9,796	8,896	9,066	7,953
Fuel costs	(1,780)	(1,887)	(1,301)	(983)	(972)	(917)	(823)	(842)	(973)	(1,036)
Operating costs	(1,155)	(1,190)	(1,105)	(918)	(833)	(848)	(845)	(798)	(755)	(742)
Interest	(186)	(128)	(83)	(195)	(196)	(359)	(590)	(648)	(778)	(436)
Depreciation	(1,892)	(1,832)	(1,810)	(1,782)	(1,671)	(1,572)	(1,448)	(1,348)	(1,382)	(1,152)
Profit on disposal of fixed assets	-	-	-	317	-	-	-	-	-	-
Net revenue before taxation	7,370	7,448	6,751	7,042	7,182	6,534	6,090	5,260	5,178	4,587
Scheme of Control taxation	(1,453)	(1,314)	(1,167)	(1,193)	(1,134)	(1,010)	(862)	(747)	(822)	(748)
Net revenue after taxation	5,917	6,134	5,584	5,849	6,048	5,524	5,228	4,513	4,356	3,839
Interest on borrowed capital	285	181	128	218	329	524	775	790	867	780
Interest on incremental customers' deposits	9	3	-	-	-	3	3	1	-	-
Scheme of Control net revenue	6,211	6,318	5,712	6,067	6,377	6,051	6,006	5,304	5,223	4,619
Transfer from/(to) Development Fund	-	-	-	139	(1)	111	(160)	251	(2)	218
Shortfall in Development Fund	487	288	869	228	-	-	-	-	-	-
Permitted return	6,698	6,606	6,581	6,434	6,376	6,162	5,846	5,555	5,221	4,837
Shortfall in Development Fund	(487)	(288)	(869)	(228)	-	-	-	-	-	-
Interest on borrowed capital	(285)	(181)	(128)	(218)	(329)	(524)	(775)	(790)	(867)	(780)
Interest on incremental customers' deposits	(9)	(3)	-	-	-	(3)	(3)	(1)	-	-
Transfer to Rate Reduction Reserve	-	-	-	(6)	(11)	(15)	(14)	(17)	(27)	(36)
Net return	5,917	6,134	5,584	5,982	6,036	5,620	5,054	4,747	4,327	4,021