SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10- K

✓ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

❑ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from _______ to _______

Commission file number 1- 9761

ARTHUR J. GALLAGHER & CO.

(Exact name of registrant as specified in its charter)

DELAWARE **(State or other jurisdiction of incorporation or organization)**	**36- 2151613** **(I.R.S. Employer Identification Number)**
Two Pierce Place **Itasca, Illinois** **(Address of principal executive offices)**	**60143- 3141** **(Zip Code)**

Registrant's telephone number, including area code (630) 773- 3800

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $1.00 per share	New York Stock Exchange
Common Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well- known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ✓ No ❑.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ❑ No ✓.

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (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. ✓

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non- accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b- 2 of the Exchange Act. (Check one):

Large accelerated filer ✓ Accelerated filer ❑ Non- accelerated filer ❑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b- 2 of the Exchange Act). Yes ❑ No ✓.

The aggregate market value of the voting common equity held by non- affiliates of the registrant, computed by reference to the last reported price at which the stock was sold on June 30, 2006 (the last day of the registrant's most recently completed second quarter) was $2,363,751,000.

The number of outstanding shares of the registrant's Common Stock, $1.00 par value, as of December 31, 2006 was 98,354,000.

Documents incorporated by reference:

Portions of Arthur J. Gallagher & Co.'s Annual Report to Stockholders for the year ended December 31, 2006 are incorporated by reference into this Form 10- K in response to Parts I and II to the extent described herein.

Portions of Arthur J. Gallagher & Co.'s definitive 2007 Proxy Statement are incorporated by reference into this Form 10- K in response to Parts II and III to the extent described herein.

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Arthur J. Gallagher & Co.

Annual Report on Form 10- K

For the Fiscal Year Ended December 31, 2006

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Part I

Item 1. Business.

General

Arthur J. Gallagher & Co. and its subsidiaries (collectively referred to as "Gallagher" unless the context otherwise requires) are engaged in providing insurance brokerage, risk management and related services to clients in the U.S. and abroad. Gallagher's principal activity is the negotiation and placement of insurance for its clients. Gallagher also specializes in furnishing risk management services. Risk management involves assisting clients in analyzing risks and determining whether proper protection is best obtained through the purchase of insurance or through retention of all or a portion of those risks and the adoption of corporate risk management policies and cost- effective loss control and prevention programs. Risk management services also include claims management, loss control consulting and insurance property appraisals. Gallagher believes that its ability to deliver comprehensively structured risk management and brokerage services is one of its major strengths. In addition, Gallagher has a financial services operation that manages its investment portfolio.

Gallagher operates through a network of more than 250 sales and service offices located throughout the U.S. and six countries abroad and through a network of correspondent brokers and consultants in 120 countries around the world. Some of these offices are fully staffed with sales, marketing, claims and other service personnel; others function as servicing offices for the brokerage and risk management service operations of Gallagher. Gallagher's international operations include a Lloyd's of London broker and affiliated companies in England and other facilities in Australia, Bermuda, Canada, Scotland and Singapore.

Gallagher was founded in 1927 and was reincorporated as a Delaware corporation in 1972. Gallagher's executive offices are located at Two Pierce Place, Itasca, Illinois 60143- 3141, and its telephone number is (630) 773- 3800.

Information Concerning Forward- Looking Statements

This annual report contains forward- looking statements within the meaning of that term in the Private Securities Litigation Reform Act of 1995 (the "Act") found at Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Additional written or oral forward- looking statements may be made by Gallagher from time- to- time in filings with the Securities and Exchange Commission (SEC), press releases, or otherwise. Statements contained in this report that are not historical facts are forward- looking statements made pursuant to the safe harbor provisions of the Act and the Exchange Act.

Forward- looking statements may include, but are not limited to, discussions concerning revenues, expenses, earnings, cash flow, capital structure and financial losses, as well as market and industry conditions, premium rates, financial markets, interest rates, foreign exchange rates, contingencies and matters relating to Gallagher's operations and income taxes. In addition, when used in this report, the words "anticipates," "believes," "should," "estimates," "expects," "intends," "plans" and variations thereof and similar expressions are intended to identify forward- looking statements. Such forward- looking statements are based on available current market and industry material, experts' reports and opinions and long- term trends, as well as management's expectations concerning future events impacting Gallagher.

Forward- looking statements made by or on behalf of Gallagher are subject to risks and uncertainties, including but not limited to the following: Gallagher's commission revenues are highly dependent on premiums charged by insurers, which are subject to fluctuation; lower interest rates reduce Gallagher's income earned on invested funds; alternative insurance markets continue to grow which could unfavorably impact commission and favorably impact fee revenue, though not necessarily to the same extent; Gallagher's revenues vary significantly from period- to- period as a result of the timing of policy inception dates and the net effect of new and lost business production; the insurance brokerage industry is subject to a great deal of uncertainty due to investigations into its business practices by various governmental authorities and related private litigation; the general level of economic activity can have a substantial impact on Gallagher's renewal business; Gallagher's operating results, returns on investments and financial position may be adversely impacted by exposure to various market risks such as interest rate, equity pricing, foreign exchange rates and the competitive environment; Gallagher's revenues and net earnings may continue to be subject to reduction due to the elimination of certain contingent commission arrangements on January 1, 2005 and related developments in the insurance industry; and Gallagher's effective income tax rate may be subject to increase as a result of changes in income tax laws, unfavorable interpretations of such laws or changes in crude oil prices or developments resulting in the loss or unavailability of IRC Section 29 tax credits. Gallagher's ability to grow has been enhanced through acquisitions, which may or may not be available on acceptable terms in the future and which, if consummated, may or may not be advantageous to Gallagher. Accordingly, actual results may differ materially from those set forth in the forward- looking statements. For a further discussion of certain of the matters described above see Item 1A, "Risk Factors."

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Readers are cautioned not to place undue reliance on any forward- looking statements contained in this report, which speak only as of the date set forth on the signature page hereto. Gallagher undertakes no obligation to publicly release the result of any revisions to these forward- looking statements that may be made to reflect events or circumstances after such date or to reflect the occurrence of anticipated or unanticipated events.

Operating Segments

Gallagher has identified three operating segments: Brokerage, Risk Management and Financial Services. The Brokerage Segment, for commission or fee compensation, primarily places commercial property/casualty (P/C) and employee benefit- related insurance on behalf of its customers. The Risk Management Segment provides P/C claim third- party administration, loss control and risk management consulting and insurance property appraisals. Third party administration is principally the management and processing of claims for self- insurance programs of Gallagher's clients or clients of other brokers. The Financial Services Segment is responsible for managing Gallagher's investment portfolio.

The two major sources of operating revenues for Gallagher are commissions from brokerage operations and service fees from brokerage and risk management operations. Information with respect to all sources of revenue, by operating segment, for each of the three years in the period ended December 31, 2006, is as follows (in millions):

	2006		2005		2004	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Commissions						
Brokerage	$ 849.5	56%	$ 784.3	53%	$ 726.8	51%
Retail contingent commissions						
Brokerage	2.5	0%	28.8	2%	33.8	2%
Fees						
Brokerage	188.5	12%	169.8	11%	146.2	10%
Risk Management	397.3	26%	367.7	25%	343.8	24%
Investment income and other						
Brokerage	30.2	2%	17.9	1%	13.4	1%
Risk Management	4.0	0%	2.9	0%	1.7	0%
Financial Services	62.0	4%	112.5	8%	171.3	12%
Total revenues	$ 1,534.0	100%	$ 1,483.9	100%	$ 1,437.0	100%

See Note 20 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which are incorporated herein by reference, for additional financial information, including earnings from continuing operations before income taxes and identifiable assets, by operating segment, for 2006, 2005 and 2004.

During 2006, 2005 and 2004, Gallagher's total revenues and expenses each increased sequentially from quarter- to- quarter within the calendar years, except for total revenues in fourth quarter 2006, due to investment losses recognized in the Financial Services Segment, first quarter 2005, which was negatively impacted by litigation and retail contingent commission related charges, and fourth quarter 2005, due to the reduction in retail contingent commissions and charges related to retail contingent commission related matters and claims handling obligations. However, commission and fee revenues and the related expenses can vary from quarter- to- quarter as a result of the timing of policy inception dates that historically are heaviest in third and fourth quarters. Alternatively, salaries and employee benefits, rent, depreciation and amortization expenses generally tend to be more uniform throughout the year. In addition, the timing of acquisitions will also impact the trends in Gallagher's quarterly operating results. See Note 19 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which are incorporated herein by reference, for unaudited quarterly operating results for 2006 and 2005.

Brokerage

The Brokerage Segment comprises three operating divisions: the Brokerage Services- Retail Division (BSD), Specialty Marketing and International (SMI) and Gallagher Benefit Services (GBS).

BSD primarily places insurance for and services commercial, industrial, institutional, governmental, religious and personal accounts throughout the U.S. SMI places insurance for and services commercial, industrial, institutional, governmental, religious and personal accounts throughout the U.S. and abroad. BSD and SMI act as agents in soliciting, negotiating and effecting contracts of insurance through insurance companies worldwide, as brokers in procuring contracts of insurance on behalf of insureds, and as administrators in setting up and managing self- insured programs. In addition, SMI places insurance on behalf of other brokers. BSD and SMI both have the capability to handle insurable risks and related coverages for a wide variety of P/C products. SMI also places surplus lines coverages, which are coverages for various specialized risks not available from insurance companies licensed by the states in which the risks are located. In addition, SMI's reinsurance intermediary operations place reinsurance coverages for its insurance company clients.

GBS specializes in the management of employee benefit programs through fully insured and self- insured programs. GBS provides services in connection with the design, financing, implementation, administration and communication of compensation and employee benefit programs (including pension and profit- sharing plans, group life, health, accident and disability insurance programs and income tax deferral plans), and provides other professional services in connection therewith.

The primary source of Gallagher's compensation for its Brokerage Segment is commissions paid by insurance companies which are usually based upon a percentage of the premium paid by insureds. Commission rates are dependent on a number of factors including the type of insurance, the particular insurance company and the capacity in which Gallagher acts. In some cases, Gallagher is compensated for brokerage or advisory services directly by fees from clients. Historically, Gallagher also has received contingent commissions which are based on the estimated profit the underwriting insurance company earns and/or the overall volume of business placed by Gallagher in a given period of time. Occasionally, Gallagher shares commissions with other brokers who have participated with Gallagher in placing insurance or servicing insureds. GBS receives a fee for acting in the capacity of advisor and administrator with respect to employee benefit programs and receives commissions in connection with the placement of insurance under such programs. As previously reported, on May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to certain investigations conducted by the IL State Agencies involving contingent commission arrangements. As stipulated in the AVC, on January 12, 2006, Gallagher paid $26.9 million into a fund (the Fund) to be distributed to certain eligible policyholder clients. As of December 31, 2006, $8.6 million remained in the Fund, which is available to satisfy existing and future AVC related claims and other potential settlement obligations as allowed by the AVC. In addition, under the AVC, Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.- domiciled retail contingent compensation as defined in the AVC. On October 26, 2004, Gallagher announced that it would not enter into any new volume- based or profit- based contingent commissions agreements as a retail broker effective January 1, 2005. However, as allowed under the AVC, Gallagher has continued to accept contingent compensation from non- retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired up to three years from the acquisition date. See Note 17 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements for a discussion of the material terms of the AVC. In 2005, Gallagher began to experience reduced contingent commission revenue and it is expected that future contingent commission revenues will continue to be substantially reduced. The reduction in retail contingent commissions, as discussed above, has continued to have a substantial negative impact on Gallagher's pretax earnings in 2006 and is expected to continue to have such effect on future earnings.

Risk Management

The Risk Management Segment consists of Gallagher's wholly- owned subsidiary, Gallagher Bassett Services, Inc. (GB).

GB provides a full range of risk management services including claims management, risk control consulting services, information management, and property appraisals on a totally integrated or select, stand- alone basis. GB provides these services for Gallagher's clients through a network of service offices located throughout the U.S., Canada, England, Scotland and Australia.

GB primarily markets its risk management services directly to clients on an unbundled basis independent of Gallagher's brokerage operations. GB also markets these services to BSD and SMI clients who use P/C risk management related services.

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In connection with its risk management services, GB provides claims administration services related to "self- insurance" programs for large institutions, risk sharing pools and associations, and large commercial and industrial customers. Self- insurance, as administered by GB, is a program in which the client assumes a manageable portion of its insurance risks, usually (although not always) placing the less predictable and larger loss exposures with an insurance carrier that specializes in these less predictable exposures.

GB's revenues for risk management services are substantially in the form of fees. These fees are typically negotiated in advance on an annual basis based upon the type and estimated volume of the services to be performed.

GB received a subpoena from the Office of the Attorney General of the State of New York on December 2, 2004 and the Office of the Attorney General of the State of Connecticut on July 24, 2006. On August 21, 2006, GB received a similar subpoena from the Office of the Attorney General of the State of Illinois. The subpoenas request information in connection with separate investigations being conducted by each state and none of the subpoenas relate to Gallagher's brokerage operations. Gallagher is fully cooperating with these investigations.

Financial Services

The Financial Services Segment is primarily responsible for Gallagher's investment portfolio, which includes tax advantaged investments, real estate partnerships, an alternative investment fund manager, notes receivable from investees and, prior to January 25, 2007, an investment in an airplane leasing company that leases two cargo airplanes to the French Postal Service. Financial Services manages Gallagher's invested assets in order to maximize the long- term after- tax return to Gallagher. See Note 3 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which are incorporated herein by reference, for a summary of Gallagher's investments.

Gallagher's overall non- fiduciary investment strategy going forward will be primarily focused on tax advantaged investments. Gallagher has used the limited partnership or limited liability company forms of legal ownership to fund many of its investments in order to obtain favorable tax treatment with respect to gains, losses and distributions, while limiting its liability. Based on the ownership structure of these investments, management believes that Gallagher's exposure to losses related to these investments is limited to the combination of its net carrying value, letters of credit, financial guarantees and funding commitments. In the event that certain of these limited partnerships or limited liability companies were to default on their debt obligations and Gallagher's net carrying value became impaired, the amount to be written- off could have a material effect on Gallagher's consolidated financial position or operating results. In some cases, Gallagher may be at risk for tax credits taken in previous years, which may also be material to its operations. See Note 3 and Note 17 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which are incorporated herein by reference, for a summary of outstanding letters of credit, financial guarantees and funding commitments and Note 8 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements for a summary of outstanding debt and contingent commitments. In addition, see Note 3 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements for a summary of Gallagher's tax credit exposure.

International Operations

Total revenues by geographic area for each of the three years in the period ended December 31, 2006 are as follows (in millions):

	2006		2005		2004	
	Amount	**% of Total**	**Amount**	**% of Total**	**Amount**	**% of Total**
United States	$ 1,335.9	87%	$ 1,323.8	89%	$ 1,289.7	90%
Foreign, principally United Kingdom, Australia and Bermuda	198.1	13%	160.1	11%	147.3	10%
Total revenues	$ 1,534.0	100%	$ 1,483.9	100%	$ 1,437.0	100%

The Brokerage Segment's international operations comprise the following: a Lloyd's of London broker and an insurance and reinsurance brokerage and risk management operation in the United Kingdom; an insurance and reinsurance brokerage operation, a captive management operation and two "rent- a- captive" insurance and segregated account company facilities in Bermuda; reinsurance intermediary operations in Australia and Singapore; and a network of correspondent brokers and consultants in 120 countries around the world.

Arthur J. Gallagher (UK) Limited (AJG UK) is a wholly- owned London- based subsidiary of Gallagher. It provides brokerage and other services to clients primarily located outside the United Kingdom. The principal activity of AJG UK is to negotiate and place insurance and reinsurance with London underwriters and insurance companies worldwide. In addition, AJG UK is a Financial Services Authority (FSA) registered broker and an approved Lloyd's of London broker. AJG UK's brokerage services encompass most classes of business within the general categories of aviation, marine, reinsurance (treaty and facultative) and P/C. The focus of AJG UK's business development has been with non- United Kingdom brokers, agents and insurers rather than domestic United Kingdom retail business. Its clients are primarily insurance and reinsurance companies, underwriters at Lloyd's of London, Gallagher's non- United Kingdom subsidiaries, other independent agents and brokers and major business corporations requiring direct insurance and reinsurance placements.

Connor Hale Kerslake Limited (CHK) is a wholly- owned London- based subsidiary of Gallagher. CHK acts primarily as a wholesale broker, placing business with Lloyd's of London and the London Company market for other insurance brokers. Substantially all of CHK's business is derived from Ireland.

Risk Management Partners Ltd. (RMP) is a wholly- owned London- based subsidiary of Gallagher that markets customized insurance and risk management products and services to United Kingdom public entities through offices in England and Scotland. RMP was formed in 1994 and Gallagher believes that RMP is now the third largest provider of insurance brokerage related services to the public entity market in the United Kingdom.

Arthur J. Gallagher & Co. (Bermuda) Limited is a wholly- owned subsidiary of Gallagher that provides clients with direct access to the risk- taking capacity of foreign insurers for both direct and reinsurance placements. It also acts as a wholesaler to Gallagher's marketing efforts by accessing global insurance and reinsurance companies in the placement of U.S. and foreign risks. In addition, it provides services relating to the formation and management of offshore captive insurance companies.

Gallagher has ownership interests in two Bermuda- based insurance companies that operate segregated account "rent- a- captive" facilities: Artex Insurance Company, a partially owned joint- venture, and Protected Insurance Company, a wholly- owned subsidiary. Rent- a- captives enable clients to receive the benefits of owning a captive insurance company without certain disadvantages of ownership. Captive insurance companies are created for clients to insure their risks and capture underwriting profit and investment income, which is then available for use by the insured generally for reducing future costs of their insurance programs.

Arthur J. Gallagher Australasia Holdings Pty Ltd is a wholly- owned subsidiary of Gallagher that is headquartered in Sydney, Australia. This subsidiary provides insurance and reinsurance placements for international or local Australian companies, and specialty programs and coverages for Australian and other clients through underwriting facilities with Lloyd's of London and local underwriters.

Arthur J. Gallagher Asia Pte Ltd is a 51% owned joint- venture of AJG UK that is based in Singapore. It specializes in treaty and facultative reinsurance placements for insurance companies located throughout Asia. These placements are made directly with reinsurance companies or through Gallagher's subsidiaries and encompass several lines of business.

The Brokerage Segment also has strategic alliances with a variety of international brokers in countries where Gallagher does not have a physical presence. Through a network of correspondent brokers and consultants in 120 countries globally, Gallagher is able to fully serve its clients' coverage and service needs in virtually any geographic area where their operations are located.

The Risk Management Segment's international operations principally comprise risk management companies in the United Kingdom and Australia.

Gallagher Bassett International Ltd. (UK) (GB UK), a wholly- owned subsidiary of GB, provides risk management services for foreign operations, as well as U.S. operations that are foreign controlled. Headquartered in London with additional offices in England and Scotland, GB UK works with insurance companies, reinsurance companies, overseas brokers, and risk managers of overseas organizations. Services include consulting, claims management, information management, loss control and property valuations.

Gallagher Bassett Services Pty Ltd is a wholly- owned subsidiary of GB that is headquartered in Brisbane, Australia with additional facilities located throughout Australia. This subsidiary is principally engaged in providing claims adjusting and risk management services in Australia. Services include consulting, claims management, crisis management, information management, loss control and property valuations.

Gallagher also has risk management service facilities in Canada that are not material to Gallagher's Risk Management Segment.

See Note 18 and Note 20 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which are incorporated herein by reference, for additional financial information related to Gallagher's foreign operations, including earnings from continuing operations before income taxes and identifiable assets, by operating segment, for 2006, 2005 and 2004.

Markets and Marketing

A large portion of the commission and fee business of Gallagher is derived from all types of business institutions, not- for- profit organizations, associations and municipal and other governmental entities. Gallagher's clients include U.S. and multi- national corporations engaged in a broad range of commercial and industrial businesses. Gallagher also places insurance for individuals. Gallagher services its clients through its network of more than 250 sales and service offices in the U.S. and six countries abroad. No material part of Gallagher's business is dependent upon a single customer or on a few customers. The loss of any one customer would not have a materially adverse effect on Gallagher. In 2006, the largest single customer represented approximately 1% of total revenues and the ten largest customers represented approximately 6% of total revenues.

Gallagher believes that its ability to deliver comprehensively structured risk management and brokerage services, including the placement of insurance and reinsurance, is one of its major strengths. Gallagher also believes that its risk management business enhances and attracts insurance brokerage business due to the nature and strength of business relationships that it forms with clients when providing a variety of risk management services on an ongoing basis.

Gallagher requires its employees serving in a sales or marketing capacity, including all executive officers of Gallagher, to enter into agreements with Gallagher restricting disclosure of confidential information and solicitation of clients and prospects of Gallagher upon their termination of employment. The confidentiality and non- solicitation provisions of such agreements terminate in the event of a hostile change in control of Gallagher, as defined therein.

Competition

According to *Business Insurance* magazine (July 17, 2006 edition), Gallagher is the fourth largest insurance broker worldwide based on total revenues. The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals on a global basis who actively compete with Gallagher in every area of its business. Gallagher competes with three firms that are as large or significantly larger than Gallagher in global risk management and brokerage markets. In addition, there are various other competing firms that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large or larger than the particular local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients.

Gallagher is also in competition with certain insurance companies that write insurance directly for their customers. Government benefits relating to health, disability, and retirement are also alternatives to private insurance and hence indirectly compete with the business of Gallagher.

Regulation

In every state and foreign jurisdiction in which Gallagher does business, Gallagher and/or an employee is required to be licensed or receive regulatory approval in order for Gallagher to conduct business. In addition to licensing requirements applicable to Gallagher, most jurisdictions require that individuals who engage in brokerage and certain insurance service activities be personally licensed.

Gallagher's insurance brokerage and risk management operations depend on its continued good standing under the licenses and approvals pursuant to which it operates. Licensing laws and regulations vary from jurisdiction to jurisdiction. In all jurisdictions, the applicable licensing laws and regulations are subject to amendment or interpretation by regulatory authorities. Generally such authorities are vested with relatively broad and general discretion as to the granting, renewing and revoking of licenses and approvals.

As previously discussed, on May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into the AVC with the IL State Agencies to resolve all of the issues related to investigations conducted by the IL State Agencies. Under the AVC, Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.- domiciled retail contingent compensation as defined in the AVC. See Note 17 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements for a discussion of the material terms of the AVC.

Business Combinations

In 2006, Gallagher acquired substantially all the net assets or common stock of ten insurance brokerage firms and a premium finance company (ten asset purchases and one stock purchase) in exchange for its common stock and/or cash and accounted for them as business combinations. See Note 4 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which is incorporated herein by reference, for a summary of the 2006 acquisitions, the amount and nature of the consideration paid and the dates of acquisition.

Since December 31, 2006, Gallagher has completed two acquisitions, which are as follows:

On January 5, 2007, Gallagher acquired substantially all of the net assets of Financial Profiles, Inc., a corporation engaged in the benefits insurance business, in exchange for 305,000 shares of Gallagher's common stock, cash of $9.0 million and a contingent earnout obligation of $9.5 million that, if any is earned, will be paid in cash or stock, at Gallagher's election.

On January 25, 2007, Gallagher acquired substantially all of the net assets of InterNational Insurance Group, Ltd., a corporation engaged in the insurance brokerage business, in exchange for shares of Gallagher's common stock with an aggregate fair value of $1.5 million plus the assumption of approximately $1.2 million of debt.

In addition, on January 24, 2007, Gallagher entered into a Share Purchase Agreement to acquire all of the outstanding capital stock of Lowndes Lambert Group Canada Ltd., a group of corporations engaged in the insurance brokerage business in Canada. The transaction is subject to customary closing conditions and is anticipated to be closed in mid- February 2007.

Gallagher believes that the net effect of these acquisitions has been and will be to expand the volume of general services rendered by Gallagher and the geographical areas in which Gallagher renders such services and not to change substantially the nature of the services performed by Gallagher.

Gallagher is considering and intends to consider from time- to- time, additional acquisitions and divestitures on terms that it deems advantageous. Gallagher at this time is engaged in preliminary discussions with a number of candidates for possible future acquisitions. No assurances can be given that any additional acquisitions or divestitures will be consummated, or, if consummated, will be advantageous to Gallagher.

Employees

As of December 31, 2006, Gallagher employed approximately 8,750 employees, none of whom is represented by a labor union. Gallagher continuously reviews benefits and other matters of interest to its employees and considers its relations with its employees to be satisfactory.

Available Information

Gallagher makes available free of charge on its website at www.ajg.com its annual report on Form 10- K, quarterly reports on Form 10- Q, current reports on Form 8- K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after electronically filing or furnishing such material to the Securities and Exchange Commission.

Gallagher's Governance Guidelines, Audit Committee Charter, Compensation Committee Charter and Nominating/Governance Committee Charter are also available on our website or upon written or verbal request. Requests for copies of any of these documents should be directed in writing to Investor Relations, Arthur J. Gallagher & Co., Two Pierce Place, Itasca, Illinois 60143- 3141, or by telephone to (630) 773- 3800.

Item 1A. Risk Factors.

Volatility or declines in premiums or other adverse trends in the insurance industry may seriously undermine Gallagher's profitability.

Gallagher derives much of its revenue from commissions and fees for brokerage and risk management services. Gallagher does not determine the insurance premiums on which its commissions are generally based. Moreover, insurance premiums are cyclical in nature and may vary widely based on market conditions. For example, for an extended period of years through late 2000, heavy competition for market share among insurance carriers, increased underwriting capacity and improved economies of scale following consolidations resulted in flat or reduced premium rates (a "soft" market), which in turn put downward pressure on Gallagher's commission revenue in many lines and in many geographic areas. After this period of time, the insurance industry transitioned to a "hard" market, in which premium rates were stable or increasing. This trend was accentuated by the events of September 11th, following which insurance coverage in many lines became less available and premium rates increased, in some cases dramatically. More recently, during the period from 2004 to 2006, the market softened again in many lines and in many geographic areas. However, the abnormally high level of hurricane activity and other natural disasters in those years has hardened the market in certain geographic areas and business lines. Because of these market fluctuations for insurance products, which Gallagher cannot predict or control, its brokerage revenues and profitability can be volatile.

In addition, there have been and may continue to be various trends in the insurance industry toward alternative insurance markets including, among other things, greater levels of self- insurance, captives, rent- a- captives, risk retention groups and non- insurance capital markets- based solutions to traditional insurance. While Gallagher historically has been able to participate in certain of these activities on behalf of its customers, and obtain fee revenue for such services, there can be no assurance that Gallagher will realize revenues and profitability as favorable as those realized from its traditional brokerage activities.

Gallagher's results may be adversely affected if it is unable to successfully implement a new business compensation model.

In October 2004, Gallagher announced that, effective January 1, 2005, it would not enter into any new volume- based or profit- based contingent commissions agreements as a retail broker. In connection with the elimination of contingent commissions, Gallagher established a new business compensation model and commission structure that it implemented in 2005 and continues to refine. There can be no assurance that it will generate incremental commission revenues equivalent to those previously received from contingent commissions. The inability to generate adequate revenues from Gallagher's new business compensation model and commission structure may significantly undermine Gallagher's operating results and profitability.

Gallagher is subject to a number of investigations and legal proceedings concerning contingent compensation, other industry practices and certain conduct, which, if determined unfavorably to Gallagher, could adversely affect its financial strength and results of operations.

Private parties have filed civil litigation against Gallagher under a variety of legal theories relating, among other things, to broker compensation practices. Gallagher is named as a defendant in a purported class action lawsuit pending in the Circuit Court of Cook County, Illinois, which challenges the propriety of alleged "undisclosed contingent commissions" paid pursuant to certain compensation arrangements between Gallagher and various insurance carriers. Additionally, Gallagher is one of a number of insurance brokerage and insurance company defendants in a Federal Multi- District class action litigation (MDL) pending before the U.S. District Court for the District of New Jersey against commercial insurers and brokers relating to industry- wide contingent commission matters, and is party to various other litigation matters. On December 29, 2006, Gallagher reached an agreement to resolve all claims in the MDL. Gallagher admitted no wrongdoing, but chose to conclude its involvement, rather than prolong what would have been a costly and burdensome lawsuit. The MDL settlement, which is subject to court approval, provides for Gallagher to distribute $28.0 million to current and former clients and others that used a broker to purchase retail insurance from 1994 to 2005. Gallagher will also pay $8.9 million in plaintiffs' attorney fees. In the event the MDL settlement is not approved by the court, Gallagher may incur significant additional legal costs and face potential liability in connection with the MDL.

Additionally, the insurance industry in general, and Gallagher individually, continue to be the subjects of a significant level of scrutiny by various regulatory bodies, including State Attorneys General and the departments of insurance for various states, with respect to contingent commission arrangements. On May 18, 2005, Gallagher and its subsidiaries and affiliates, except for Gallagher Bassett Services, Inc., entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to investigations conducted by the IL State Agencies, pursuant to which it paid $26.9 million into a fund to be distributed to eligible retail customers by March 31, 2006, and agreed to undertake certain business changes. As stipulated in the AVC, on January 12, 2006, Gallagher paid $26.9 million into a fund to be distributed to certain eligible policyholder clients. As of December 31, 2006, $8.6 million remained in the Fund which is available to satisfy existing and future AVC related claims and other potential settlement obligations as allowed by the AVC. For a more detailed discussion of these matters refer to Note 17 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements.

The ultimate outcome of the matters referred to above and similar matters cannot be ascertained and liabilities in indeterminate amounts may be imposed on Gallagher. Gallagher's future results of operations or cash flows for any particular quarterly or annual period could be materially affected by an unfavorable resolution of these matters. In addition, even if Gallagher does not experience significant monetary costs, there has been and may continue to be adverse publicity associated with these matters that could result in reputational harm to Gallagher or to the insurance brokerage industry in general that may adversely affect Gallagher's business.

Gallagher faces significant competitive pressures in each of its businesses.

The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals on a global basis who actively compete with Gallagher in one or more areas of its business. Gallagher competes with three firms that are as large or significantly larger than Gallagher in global risk management and brokerage markets. In addition, there are various other competing firms that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large or larger than the particular local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients. Losing business to competitors offering similar products at lower prices or having other competitive advantages would adversely affect Gallagher's business.

In addition, the increase in competition due to new legislative or industry developments could adversely affect Gallagher. These developments include:

- an increase in capital- raising by insurance underwriting companies, which could result in new capital in the industry which in turn may lead to a soft market and lower insurance premiums and commissions;

- the selling of insurance by insurance companies directly to insureds without the involvement of a broker or other intermediary;

- changes in Gallagher's business compensation model as a result of regulatory developments;

- the establishment of programs in which state- sponsored entities provide health insurance or, in certain cases, property insurance in catastrophe- prone areas or other alternative markets types of coverage;

- an increase in competition from newly- formed or existing insurance brokers who have not agreed to limit their use of contingent commission arrangements, thereby giving them a competitive advantage over those brokers, such as Gallagher, which have agreed to limit the use of such arrangements; and

- the creation of in- house servicing capabilities by insurance companies or by certain insurance consumers which compete with the third party administration and other administration, servicing and risk management products offered by Gallagher's Risk Management Segment.

New competition as a result of these or other competitive or industry developments could cause the demand for Gallagher's products and services to change, which could in turn adversely affect Gallagher's results of operations and financial condition.

Gallagher faces a variety of risks in its Gallagher Bassett Services operations which are distinct from those it faces in its brokerage operations.

Gallagher's Risk Management Segment, which accounted for approximately 26% of Gallagher's total 2006 revenues, operates primarily through its subsidiary, Gallagher Bassett Services, Inc. (GB). GB is a third party administrator and risk consultant that provides a range of risk management services, including claims management, risk control consulting services, information management and property appraisals. While GB's business has less exposure to the hard and soft market cycles described above to which Gallagher's brokerage business is exposed, GB faces a variety of other risks which are unique to its operations, including:

- the risk that the favorable trend among insureds toward outsourcing of various types of claims administration and risk management services will reverse or slow, causing GB to experience reduced revenues or a reduced rate of revenue growth;
- the risk that contracting terms will become less favorable or that the margins on GB's services will be decreased due to increased competition, regulatory constraints or other developments;
- the risk that GB cannot satisfy regulatory requirements on third party administrators or that regulatory developments will impose additional burdens, costs or business restrictions that make GB's business less attractive; and
- the risk that GB cannot control its labor and technology costs in such a manner as to remain competitive in the marketplace for claims administration and risk management services and to conclude its existing contracts (other than those that provide cost- plus or other margin protection) in a cost- efficient and profitable manner.

Gallagher's business, results of operations, financial condition or liquidity may be materially adversely affected by errors and omissions and the outcome of certain actual and potential claims, lawsuits and proceedings.

Gallagher may be subject to various actual and potential claims, lawsuits and other proceedings relating principally to alleged errors and omissions in connection with the placement of insurance and reinsurance in the ordinary course of business. Because Gallagher often assists clients with matters involving substantial amounts of money, including the placement of insurance coverage and the handling of related claims, errors and omissions claims against Gallagher may arise which allege potential liability for all or part of the amounts in question. Claimants may seek large damage awards and these claims may involve potentially significant legal costs.

Gallagher purchases insurance to provide protection from errors and omissions claims that may arise in the ordinary course of business, subject to self- insured deductibles and limits. As of December 31, 2006, the amounts of Gallagher's deductible and limit for claims were $5.0 million and $165.0 million, respectively. Gallagher's business, results of operations, financial condition and liquidity may be adversely affected if, in the future, its insurance coverage proves to be inadequate or unavailable or there is a general increase in the number or amounts of claims to which Gallagher is exposed. Gallagher's future ability to obtain professional indemnity insurance in the amounts and with the deductibles and limits it desires may be adversely impacted by general developments in the market for such insurance or Gallagher's own claims experience. In addition, claims, lawsuits and other proceedings may harm Gallagher's reputation or divert management resources away from operating its business.

Gallagher historically has engaged in a large number of acquisitions of insurance brokers and agencies. Gallagher may not be able to continue to implement such an acquisition strategy in the future and there are risks associated with such acquisitions.

In the past several years, Gallagher has completed numerous acquisitions of insurance brokers and agencies and may continue to make such acquisitions in the future. Gallagher's acquisition program has been an important part of its historical growth and Gallagher believes that similar acquisition activity will be critical to maintaining comparable growth in the future. Failure to successfully identify and complete acquisitions likely will result in Gallagher achieving slower growth. Various factors may affect Gallagher's ability to attract acquisition targets, including Gallagher's inability to continue certain contingent commission compensation structures, particularly in light of the fact that certain other companies in the insurance brokerage industry are not limited in this manner. Moreover, even if Gallagher is able to identify appropriate acquisition targets, it may not be able to execute acquisition transactions on favorable terms or integrate such targets following acquisition in a manner which allows Gallagher to realize the anticipated benefits of such acquisitions, thereby negatively affecting Gallagher's results of operations or leading to unanticipated contingent liabilities and losses.

Gallagher is subject to insurance industry regulation worldwide. If Gallagher fails to comply with regulatory requirements or if regulations change in a way that adversely affects Gallagher's operations, Gallagher may not be able to conduct its business or may be less profitable.

Many of Gallagher's activities are subject to regulatory supervision. Failure to comply with some of these regulations could lead to disciplinary action that may include requiring clients to be compensated for loss, the imposition of penalties and the revocation of Gallagher's authorization to operate. In addition, changes in legislation or regulations and actions by regulators, including changes in administration and enforcement policies, could from time- to- time require operational changes which could result in lost revenues or higher costs or hinder Gallagher's ability to operate its business.

Gallagher's future success depends, in part, on its ability to attract and retain experienced and qualified personnel.

Gallagher believes that its future success depends, in part, on its ability to attract and retain experienced personnel, including its senior management, brokers and other key personnel. The insurance brokerage industry has experienced intense competition for the services of leading brokers, and Gallagher has lost key brokers to competitors in the past. The loss of any of its senior managers, brokers or other key personnel, or its inability to identify, recruit and retain such personnel, could materially and adversely affect Gallagher's business, operating results and financial condition.

Gallagher has significant non- U.S. operations which expose it to certain additional risks, including the risk of exchange rate fluctuations and geopolitical risk.

A significant portion of Gallagher's operations is conducted outside the U.S. Accordingly, Gallagher is subject to legal, economic and market risks associated with operating in foreign countries. Operating in these countries may present risks that are different from, or greater than, risks to Gallagher of doing comparable business in the U.S.

Some of Gallagher's foreign subsidiaries receive revenues or incur obligations in currencies that differ from their functional currencies. Gallagher must also translate the financial results of its foreign subsidiaries into U.S. dollars. Although Gallagher had a foreign currency hedging strategy in 2006, such risks cannot be eliminated entirely, and significant changes in exchange rates may adversely affect Gallagher's results of operations.

Gallagher also operates in certain countries where the risk of political and economic uncertainty is relatively greater than that present in the U.S. and more established countries. Gallagher's operations in these countries may be temporarily or permanently disrupted by adverse geopolitical or economic conditions in these locations. For example, Gallagher uses third- party service providers located in India for certain back office services. To date, the dispute between India and Pakistan involving the Kashmir region, incidents of terrorism in India and general geopolitical uncertainties have not adversely affected Gallagher's infrastructure in India. However, such factors could potentially affect Gallagher's infrastructure or ability to utilize third- party providers in the future. Should Gallagher's access to these services be disrupted, Gallagher's business, operating results and financial condition could be adversely affected.

Gallagher is exposed to various risks relating to losses on investments held by its Financial Services business.

Gallagher's Financial Services business holds a variety of investments, including (i) an interest in a holding company that holds interests in private investment management firms, (ii) early- stage loans and partnership interests relating to low income housing developments, (iii) investments in partnerships formed to develop energy that qualifies for tax credits under Internal Revenue Code (IRC) Section 29 and (iv) certain other real estate and other investments. These investments are subject to risk of impairment due to a variety of causes, including general overall economic conditions, the effects of changes in interest rates, various regulatory issues, credit risk, potential litigation, failure to monetize in an effective and/or cost-efficient manner and poor operating results. Any of these consequences may diminish the value of Gallagher's invested assets and adversely affect its net worth and profitability.

Gallagher has historically benefited from Section 29 tax credits. The disallowance or termination of Section 29 tax credits, or the loss of all or part of its Section 29 tax credits due to phase out of such credits, would decrease Gallagher's revenues, increase its costs, increase its effective tax rate and decrease its income.

Under current law, IRC Section 29 tax credits are not available for synthetic fuel sold after December 31, 2007, and, if the law is not extended, Gallagher's effective federal income tax rate in 2008 will likely adjust upward to fall within a range of approximately 40.0% to 42.0%. In addition, there have been initiatives from time- to- time to consider the early repeal or modification of IRC Section 29, and the IRS is continuing to audit taxpayers claiming IRC Section 29- tax credits related to synthetic fuel facilities with respect to a variety of issues. In addition, through December 31, 2007, IRC Section 29 has a phase- out provision that is triggered when domestic crude oil reaches certain "Phase- out Prices" as determined by the IRS. It is not possible for Gallagher to calculate exactly what oil prices will average (as determined by the IRS) for all of calendar year 2006 nor forecast what they will be in 2007. Accordingly, for purposes of recognizing revenues and expenses related to IRC Section 29- related investments for 2006, Gallagher assumed an average 2006 calendar year New York Mercantile Exchange (NYMEX) Price of $66.12. This average produces an IRC Section 29 phase- out of approximately 36% and was determined by using actual daily closing prices from January 1 to December 29, 2006. For calendar year 2007, Gallagher estimates that the commonly reported crude oil price (NYMEX price) would need to average approximately $62.00 per barrel for calendar 2007 for any phase- out to begin and average approximately $78.00 per barrel for calendar 2007 for a complete phase- out. The average daily NYMEX Price for 2007 through January 25 was $54.23 per barrel.

To partially mitigate the financial risk of a phase- out, which reduces the value of the tax credits earned and reduces the installment sale gains from Gallagher's IRC Section 29- Syn/Coal investments, Gallagher entered into arrangements in both 2006 and 2007 with unaffiliated third parties which constitute call spreads on oil futures to create financial hedges that were designed to generate gains to Gallagher in the event of certain levels of increased oil prices. These hedges are not intended to be "perfect hedges" for accounting purposes, but are intended to mitigate a substantial portion of the negative impact to Gallagher of increased oil prices. Any oil price derivative gains are designed to offset a portion of the expenses associated with operating Gallagher's IRC Section 29- Syn/Coal facilities in the event of a phase- out of IRC Section 29 tax credits, which phase- outs are based on oil prices averaging certain levels for calendar years 2006 and 2007.

There can be no assurance that future oil prices will be below future phase- out levels. Should Gallagher or its partners anticipate that oil prices may cause a significant Phase- out of the IRC Section 29 tax credits in 2007, some or all of Gallagher's IRC Section 29 operations could be curtailed, resulting in Gallagher earning fewer tax credits, realizing a higher effective tax rate for federal income tax purposes and triggering indemnification payment obligations under various agreements which Gallagher has with its investment partners. For further information about the negative effects these contingencies could have on Gallagher's results of operations, see the discussion on IRC Section 29 tax credits included in Management's Discussion and Analysis of Financial Condition and Results of Operations, which is included in Gallagher's 2006 Financial Statements under the caption entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

Item 2. Properties.

Gallagher's executive offices and certain subsidiary and branch facilities are located at Two Pierce Place, Itasca, Illinois, where Gallagher leases approximately 308,000 square feet of space, or approximately 60% of the building. The lease commitment on this property expires February 28, 2018. Gallagher has a 60% ownership interest in a real estate limited partnership that, prior to December 7, 2006, owned the Two Pierce Place property. On December 7, 2006, the partnership sold its ownership interest in Gallagher's home office land and building and extinguished related debt of $75.2 million. Related to this sale, Gallagher received cash of $7.9 million and recognized a $4.2 million pretax loss. Prior to December 7, 2006, this investment was consolidated into Gallagher's Consolidated Financial Statements. See Notes 3, 8 and 17 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which are incorporated herein by reference for additional information with respect to this ownership interest and related lease commitment.

Gallagher generally operates in leased premises. Certain of Gallagher's office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain annual escalation clauses generally related to increases in an inflation index. See Note 17 to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements, which is incorporated herein by reference, for information with respect to Gallagher's lease commitments at December 31, 2006.

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Item 3. Legal Proceedings.

Information regarding legal proceedings of Gallagher is included in Note 17 (Litigation) to the Consolidated Financial Statements of Gallagher's 2006 Financial Statements and is incorporated herein by reference.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during Gallagher's fourth quarter ended December 31, 2006.

Item 4A. Executive Officers of the Registrant.

The executive officers of Gallagher are as follows:

Name	Age	Position and Year First Elected
J. Patrick Gallagher, Jr.	55	Chairman since 2006, President since 1990, Chief Executive Officer since 1995
Elizabeth J. Brinkerhoff	63	Vice President since 1993
Richard C. Cary	44	Controller since 1997, Chief Accounting Officer since 2001, Acting Chief Financial Officer September 2002 to April 2003
James W. Durkin, Jr.	57	Vice President since 1985, President of GBS since 1985
James S. Gault	55	Vice President since 1992, President and Chief Operating Officer of BSD since June 2002
Douglas K. Howell	45	Vice President since March 2003 and Chief Financial Officer since April 2003
David E. McGurn, Jr.	54	Vice President since 1993, President of SMI since 2001
Richard J. McKenna	60	Vice President since 1994, President of GB since 2000
John C. Rosengren	60	Vice President and General Counsel since 1995, Secretary since 2002

With the exception of Mr. Howell, each such person has been principally employed by Gallagher in management capacities for more than the past five years. All executive officers are elected annually and serve at the pleasure of the Board of Directors.

Prior to joining Gallagher on March 3, 2003, Mr. Howell was employed as Senior Vice President and Chief Financial Officer of 21st Century Insurance Group (NYSE:TW) from April 2001 to February 2003 and prior thereto as Senior Vice President and Chief Financial Officer of GuideOne Insurance Group since 1997.

Part II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Gallagher's common stock is listed on the New York Stock Exchange, trading under the symbol "AJG." The following table sets forth information as to the price range of Gallagher's common stock for the two- year period January 1, 2005 through December 31, 2006 and the dividends declared per common share for such period. The table reflects the range of high and low sales prices per share as reported on the New York Stock Exchange composite listing.

	High	Low	Dividends Declared per Common Share
Quarterly Periods			
2006			
First	$ 31.77	$ 27.65	$ .30
Second	28.32	24.75	.30
Third	28.14	24.42	.30
Fourth	30.42	26.44	.30
2005			
First	$ 32.85	$ 28.55	$ .28
Second	29.15	26.48	.28
Third	29.78	26.54	.28
Fourth	31.94	28.16	.28

As of December 31, 2006, there were approximately 900 holders of record of Gallagher's common stock.

Issuer Purchases of Equity Securities
(in thousands, except per share data)

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
October 1 to October 31, 2006	-	$ -	-	4,600.0
November 1 to November 30, 2006	592.0	29.26	592.0	4,008.0
December 1 to December 31, 2006	104.0	29.93	104.0	3,904.0
Total	696.0	$ 29.36	696.0	

(1) As set forth in its public filings, Gallagher has a common stock repurchase plan that was adopted by the Board of Directors on May 10, 1988 and has been periodically amended (last amendment was on July 21, 2005) since that date to authorize additional shares for repurchase. Under the provisions of the repurchase plan, as of December 31, 2006, Gallagher continues to have the capacity to repurchase approximately 3.9 million shares. On January 18, 2007, Gallagher announced the continuation of the repurchase plan bringing the cumulative total repurchase authorization to 5.0 million shares. There is no expiration date for the plan and Gallagher is under no commitment or obligation to repurchase any particular amount of common stock under the plan. At its discretion Gallagher may suspend the repurchase plan at any time.

Information relating to the compensation plans under which equity securities of Gallagher are authorized for issuance is included in the disclosure set forth under the caption "Equity Compensation Plan Information" in Gallagher's 2007 Proxy Statement and is incorporated herein by reference.

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Item 6. Selected Financial Data.

The following selected consolidated financial data for each of the five years in the period ended December 31, 2006 have been derived from Gallagher's Consolidated Financial Statements. Such data should be read in conjunction with Gallagher's Consolidated Financial Statements and related notes thereto, which have been incorporated by reference in Item 8 of this annual report.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In millions, except per share and employee data)				
Consolidated Statement of Earnings Data:					
Commissions	$ 852.0	$ 813.1	$ 760.6	$ 705.5	$ 621.8
Fees	585.8	537.5	490.0	418.7	352.2
Investment income and other	96.2	133.3	186.4	96.9	46.6
Total revenues	1,534.0	1,483.9	1,437.0	1,221.1	1,020.6
Total expenses before litigation and contingent commission matters and claims handling obligations	1,371.9	1,267.1	1,199.7	1,028.3	836.0
Litigation and contingent commission matters and claims handling obligations	9.0	219.6	-	-	-
Earnings (loss) before income taxes	153.1	(2.8)	237.3	192.8	184.6
Provision (benefit) for income taxes	24.6	(31.4)	47.8	46.9	55.2
Earnings from continuing operations	128.5	28.6	189.5	145.9	129.4
Earnings (loss) on discontinued operations, net of income taxes	-	2.2	(1.0)	0.3	0.5
Net earnings	$ 128.5	$ 30.8	$ 188.5	$ 146.2	$ 129.9
Per Share Data:					
Diluted earnings from continuing operations per share (1)	$ 1.31	$ .30	$ 2.00	$ 1.57	$ 1.41
Diluted net earnings per share (1)	1.31	.32	1.99	1.57	1.41
Dividends declared per common share (2)	1.20	1.12	1.00	.72	.60
Share Data:					
Shares outstanding at year end	98.4	95.7	92.1	90.0	88.5

Weighted average number of common shares outstanding	97.1	94.1	91.5	90.0	87.3
Weighted average number of common and common equivalent shares outstanding	98.4	96.1	94.5	93.3	91.9
Consolidated Balance Sheet Data:					
Total assets	$ 3,420.1	$ 3,389.5	$ 3,233.3	$ 2,900.4	$ 2,463.5
Long- term debt less current portion	25.9	107.6	140.0	122.1	128.3
Total stockholders' equity	864.1	769.1	761.0	619.1	528.2
Return on beginning tangible net worth (3)	37%	8%	48%	37%	42%
Employee Data:					
Number of employees at year end	8,757	8,135	7,840	6,808	6,664
Total revenue per employee (4)	$ 175,000	$ 182,000	$ 183,000	$ 179,000	$ 153,000
Earnings from continuing operations before litigation and contingent commission matters and and claims handling obligations per employee (4) (5)	$ 15,000	$ 21,000	$ 24,000	$ 21,000	$ 19,000

(1) Based on the weighted average number of common and common equivalent shares outstanding during the year.

(2) Based on the total dividends declared on a share of common stock outstanding during the entire year.

(3) Represents net earnings divided by total stockholders' equity, less net balance of goodwill and amortizable intangible assets, as of the beginning of the year.

(4) Based on the number of employees at year end.

(5) Represents earnings from continuing operations before the after tax impact of litigation and contingent commission matters and claims handling obligations related charges.

Certain Non- GAAP Financial Measures. The line item in the preceding selected financial data table entitled "Earnings from continuing operations before litigation and contingent commission matters and claims handling obligations per employee" may be considered a "non- GAAP financial measure" within the meaning of SEC regulations because it is derived from Gallagher's consolidated financial information but is not required to be presented in financial statements that are prepared in conformity with U.S. generally accepted accounting principles (GAAP). Consistent with SEC regulations, a description of such information is provided in the table above and a reconciliation of certain of such items to GAAP is provided herein. Charges in 2006 related to retail contingent commission related matters totaled $9.0 million (or $5.4 million after tax). Charges in 2005 related to litigation related matters, retail contingent commission related matters and claims handling obligations totaled $131.0 million (or $84.2 million after tax), $73.6 million (or $44.2 million after tax) and $15.0 million (or $9.8 million after tax), respectively. There were no such items in 2002 to 2004. These amounts, which Gallagher believes are non- recurring, were added back to earnings from continuing operations in 2006 and 2005 in order to calculate earnings from continuing operations before litigation and contingent commission related matters and claims handling obligations per employee.

Gallagher believes the items included above provide meaningful additional information, which may be helpful to investors in assessing certain aspects of Gallagher's operating performance and financial condition that may not be otherwise apparent from GAAP. Industry peers provide similar supplemental information, although they may not use the same or comparable terminology and may not make identical adjustments. This non- GAAP information should be used in addition to, but not as a substitute for, the GAAP information.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Information regarding Management's Discussion and Analysis of Financial Condition and Results of Operations is included in Gallagher's 2006 Financial Statements under the caption entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference. All of such information should be read in conjunction with Gallagher's Consolidated Financial Statements and related notes thereto, which have been incorporated by reference in Item 8 of this annual report.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Information regarding Quantitative and Qualitative Disclosures about Market Risk is included in Gallagher's 2006 Financial Statements under the caption entitled "Quantitative and Qualitative Disclosures about Market Risk" and is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

Gallagher's Consolidated Financial Statements, the related notes thereto and Report of Independent Registered Public Accounting Firm are included in Gallagher's 2006 Financial Statements and are incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

There were no changes in or disagreements with accountants on accounting and financial disclosure.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures.

As of December 31, 2006, Gallagher's management, including Gallagher's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), have conducted an evaluation of the effectiveness of its disclosure controls and procedures pursuant to Rule 13a- 15(b) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that Gallagher's disclosure controls and procedures were effective as of December 31, 2006.

Design and Evaluation of Internal Control Over Financial Reporting.

Pursuant to Section 404 of the Sarbanes- Oxley Act of 2002, Gallagher included a report of management's assessment of the design and effectiveness of its internal controls as part of this Annual Report on Form 10- K for the fiscal year ended December 31, 2006. Gallagher's independent registered public accounting firm also attested to, and reported on, management's assessment of the effectiveness of internal control over financial reporting. Management's report and the independent registered public accounting firm's attestation report are included in Gallagher's 2006 Financial Statements under the captions entitled "Management's Report on Internal Control Over Financial Reporting" and "Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting" and are incorporated herein by reference.

Changes in Internal Control Over Financial Reporting.

There has been no change in Gallagher's internal control over financial reporting during fourth fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, Gallagher's internal control over financial reporting.

Item 9B. Other Information.

Not applicable.

Part III

Item 10. Directors, Executive Officers of the Registrant and Corporate Governance.

Information regarding directors and nominees for directors of Gallagher is included under the caption entitled "Election of Directors" in the 2007 Proxy Statement and is incorporated herein by reference. Information regarding executive officers of Gallagher is included under the caption entitled "Executive Officers of the Registrant" in Part I of this annual report. Information regarding Gallagher's Audit Committee is included under the caption entitled "Board of Directors and Committees - Audit Committee" in the 2007 Proxy Statement and is incorporated herein by reference.

The Board of Directors has determined that Gary P. Coughlan qualifies as an Audit Committee financial expert, as such term is defined in rules of the Securities and Exchange Commission implementing requirements of the Sarbanes- Oxley Act of 2002. Gallagher's Audit Committee is a separately designated committee of the Board of Directors and is comprised of the following independent directors: William L. Bax, T. Kimball Brooker, Gary P. Coughlan and James R. Wimmer.

Gallagher has adopted a Code of Business Conduct and Ethics that applies to all of Gallagher's employees and directors, including its principal executive officer, principal financial officer and principal accounting officer. Gallagher's Code of Business Conduct and Ethics covers all areas of professional conduct including, but not limited to, conflicts of interest, disclosure obligations, insider trading, confidential information, as well as compliance with all laws, rules and regulations applicable to Gallagher's business.

A copy of Gallagher's Code of Business Conduct and Ethics is posted on its website at www.ajg.com. In the event that an amendment to, or a waiver from, a provision of Gallagher's Code of Business Conduct and Ethics that applies to any of Gallagher's officers or directors is necessary, Gallagher intends to post such information on its website.

Gallagher undertakes to provide without charge to any person, upon written or verbal request of such person, a copy of Gallagher's Code of Business Conduct and Ethics. Requests should be directed in writing to Investor Relations, Arthur J. Gallagher & Co., Two Pierce Place, Itasca, Illinois 60143-3141, or by telephone to (630) 773- 3800.

There have been no material changes to the procedures by which stockholders may recommend nominees to Gallagher's Board of Directors since Gallagher's disclosure of such procedures under the caption entitled "Corporate Governance - Nomination of Directors" in the 2006 Proxy Statement.

Item 11. Executive Compensation.

Information regarding executive compensation of Gallagher's directors and executive officers is included in the 2007 Proxy Statement under the caption entitled "Compensation of Executive Officers and Directors," and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information regarding beneficial ownership of the Common Stock by certain beneficial owners and by management of Gallagher is included under the caption entitled "Principal Holders of Securities" in the 2007 Proxy Statement and is incorporated herein by reference.

Information regarding the number of shares of Common Stock available under Gallagher's equity compensation plans is included under the caption entitled "Equity Compensation Plan Information" in the 2007 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information relating to relationships and related transactions is included under the heading "Certain Relationships and Related Transactions, and Director Independence" in the 2007 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services.

Information regarding principal accountant services is included in the 2007 Proxy Statement under the caption entitled "Principal Accountant Fees and Services," and is incorporated herein by reference.

Part IV

Item 15. Exhibits and Financial Statement Schedules.

The following documents are filed as a part of this report:

1. Consolidated Financial Statements from Gallagher's 2006 Financial Statements which are incorporated herein by reference:

   (a) Consolidated Statement of Earnings for each of the three years in the period ended December 31, 2006.

   (b) Consolidated Balance Sheet as of December 31, 2006 and 2005.

   (c) Consolidated Statement of Cash Flows for each of the three years in the period ended December 31, 2006.

   (d) Consolidated Statement of Stockholders' Equity for each of the three years in the period ended December 31, 2006.

   (e) Notes to Consolidated Financial Statements.

   (f) Report of Independent Registered Public Accounting Firm on Financial Statements.

   (g) Management's Report on Internal Control Over Financial Reporting.

   (h) Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting.

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2. Consolidated Financial Statement Schedules required to be filed by Item 8 of this Form:

   (a) Schedule II - Valuation and Qualifying Accounts.

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or the Notes thereto.

3. Exhibits:

Included in this Form 10- K.

13.0	Gallagher's 2006 Financial Statements.
21.0	Subsidiaries of Gallagher, including state or other jurisdiction of incorporation or organization and the names under which each does business.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.0	Powers of Attorney.
31.1	Rule 13a- 14(a) Certification of Chief Executive Officer.
31.2	Rule 13a- 14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

Not included in this Form 10- K.

3.1	Restated Certificate of Incorporation of Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1996, File No. 1- 9761).
3.1.1	Certificate of Amendment of Restated Certificate of Incorporation of Arthur J. Gallagher & Co., Amended as of May 18, 2000 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2000, File No. 1- 9761).
3.1.2	Certificate of Amendment of Restated Certificate of Incorporation of Arthur J. Gallagher & Co., Amended as of May 23, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2001, File No. 1- 9761).
3.2	By- Laws of Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form S- 1 Registration Statement No. 33- 10447).
3.3	Rights Agreement between Gallagher and Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago) (incorporated by reference to Exhibits 1 and 2 to Gallagher's Form 8- A Registration Statement filed May 12, 1987, File No. 0- 13480).
3.4	Assignment and Assumption Agreement of Rights Agreement by and among Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago), Harris Trust and Savings Bank and Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form S- 8 Registration Statement No. 33- 38031).
3.5	Amendment No. 1 to Exhibit 3.3 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1996, File No. 1- 9761).
3.6	Amendment No. 2 to Exhibit 3.3 (incorporated by reference to Exhibit 4.4 to Gallagher's Form 8- A/A Registration Statement filed on April 20, 2004, File No. 1- 9761).
3.7	Amendment to Exhibit 3.3 (incorporated by reference to Exhibit 4.5 to Gallagher's Form 8- A/A Registration Statement filed on April 20, 2004, File No. 1- 9761).

4.1	Instruments defining the rights of security holders (relevant portions contained in the Restated Certificate of Incorporation and By- Laws of Gallagher and the Rights Agreement in Exhibits 3.1, 3.2, and 3.3, respectively, hereby incorporated by reference).
10.1	Assurance of Voluntary Compliance between the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois and Arthur J. Gallagher & Co., dated May 18, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 8- K Current Report dated May 18, 2005, File No. 1- 9761).
10.5	Lease Agreement between Arthur J. Gallagher & Co. and Itasca Center III Limited Partnership, a Texas limited partnership, dated July 26, 1989 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1989, File No. 1- 9761).
10.5.1	Amendments No. 1 to No. 15 to the Lease Agreement between Arthur J. Gallagher & Co. and HGC/Two Pierce Limited Partnership, an Illinois limited partnership, as successor to Itasca Center III Limited Partnership, a Texas limited partnership, dated May 20, 1991 to October 15, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2005, File No. 1- 9761).
10.5.2	Amendment No. 16 to the Lease Agreement between Arthur J. Gallagher & Co. and Wells REIT- Two Pierce Place, LLC, a Delaware limited liability company, dated December 7, 2006 (incorporated by reference to the same exhibit number to Gallagher's Form 8- K Current Report dated December 7, 2006, File No. 1- 9761).
10.7	Letter dated December 31, 1983 from Arthur J. Gallagher & Co. to Bank of America Illinois (formerly Continental Illinois National Bank and Trust Company of Chicago) regarding Common Stock Purchase Financing Program including exhibits thereto and related letters (incorporated by reference to the same exhibit number to Gallagher's Form S- 1 Registration Statement No. 2- 89195).
10.7.1	Amendment to Exhibit No. 10.7 dated September 11, 1985 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1985, File No. 0- 13480).
10.8	Multicurrency Credit Agreement dated as of October 5, 2005 among Arthur J. Gallagher & Co., the Guarantors Party thereto, the Lenders party thereto, Harris N.A., as Administrative Agent, Citibank, N.A., as Syndication Agent, and Barclays Bank PLC, as Documentation Agent (incorporated by reference to the Exhibit 10.1 to Gallagher's Form 8- K Current Report dated October 5, 2005, File No. 1- 9761).
*10.10	Board of Directors' Resolution from meeting on January 26, 1984 relating to consulting and retirement benefits for certain directors (incorporated by reference to the same exhibit number to Gallagher's Form S- 1 Registration Statement No. 2- 89195).
*10.11	Form of Indemnity Agreement between Gallagher and each of its directors and corporate officers (incorporated by reference to Attachment A to Gallagher's Proxy Statement dated April 10, 1987 for its Annual Meeting of Stockholders, File No. 0- 13480).
*10.14	Form of Change in Control Agreement between Gallagher and each of its Executive Officers (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1998, File No. 1- 9761).
*10.15	Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 1999, File No. 1- 9761).
*10.15.1	First Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2005, File No. 1- 9761).
*10.15.2	Second Amendment to the Arthur J. Gallagher & Co. Supplemental Savings and Thrift Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2005, File No. 1- 9761).
*10.16	Arthur J. Gallagher & Co. Deferred Equity Participation Plan and Deferred Equity Trust Agreement dated March 22, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.16.1	First Amendment to the Arthur J. Gallagher & Co. Deferred Equity Participation Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2005, File No. 1- 9761).

*10.18	Promissory Note dated March 15, 2001 in the principal amount of $2,382,900 from Michael J. Cloherty, payable to Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.19	Employment Agreement dated January 1, 1999 between Gallagher and James J. Braniff III (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.20	Secured Promissory Note dated June 19, 1996 in the principal amount of $1,155,000 from James J. Braniff III, payable to Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.21	Promissory Note dated February 1, 1999 in the principal amount of $100,000 from James J. Braniff III, payable to Gallagher (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2000, File No. 1- 9761).
*10.22	Arthur J. Gallagher & Co. Brokerage Services Division Management Bonus Plan Amended and Restated as of March 21, 2002 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended March 31, 2002, File No. 1- 9761).
*10.22.1	Employment Agreement dated September 3, 2002 between Gallagher and Michael J. Cloherty (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended September 30, 2002, File No. 1- 9761).
*10.25	Arthur J. Gallagher & Co. United Kingdom Incentive Stock Option Plan, Amended and restated as of January 22, 1998 and approved by the Inland Revenue on June 12, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.26	Arthur J. Gallagher & Co. 1988 Incentive Stock Option Plan, Amended and restated as of May 19, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.26.1	Amendment No. 1 to the Arthur J. Gallagher & Co. Restated 1988 Incentive Stock Option Plan, Amended as of January 19, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.27	Arthur J. Gallagher & Co. 1988 Nonqualified Stock Option Plan, Amended and restated as of January 22, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.27.1	Amendment No. 1 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 20, 2000 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2000, File No. 1- 9761).
*10.27.2	Amendment No. 2 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 18, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2001, File No. 1- 9761).
*10.27.3	Amendment No. 3 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 17, 2002 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2002, File No. 1- 9761).
*10.27.4	Amendment No. 4 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 23, 2003 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2003, File No. 1- 9761).
*10.27.5	Amendment No. 5 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 22, 2004 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).

*10.27.6	Amendment No. 6 to the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan, Amended as of January 19, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.28	Arthur J. Gallagher & Co. 1989 Non- Employee Directors' Stock Option Plan, Amended and restated as of January 22, 1998 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 1998, File No. 1- 9761).
*10.28.1	Amendment No. 2 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 20, 2000 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2000, File No. 1- 9761).
*10.28.2	Amendment No. 3 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 18, 2001 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2001, File No. 1- 9761).
*10.28.3	Amendment No. 4 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 17, 2002 (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2002, File No. 1- 9761).
*10.28.4	Amendment No. 5 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of January 23, 2003 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2003, File No. 1- 9761).
*10.28.5	Amendment No. 6 to the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan, Amended as of May 17, 2005 . (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended June 30, 2005, File No. 1- 9761).
*10.29	Arthur J. Gallagher & Co. Restricted Stock Plan (incorporated by reference to Exhibit 4.6 to Gallagher's Form S- 8 Registration Statement, No. 333- 106539).
*10.30	Arthur J. Gallagher & Co. Employee Stock Purchase Plan (incorporated by reference to Exhibit A of Gallagher's Proxy Statement dated April 7, 2003 for its Annual Meeting of Stockholders, File No. 1- 9761).
*10.30.1	Amendment No. 1 to the Arthur J. Gallagher & Co. Employee Stock Purchase Plan, Amended as of January 19, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.31	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1988 Incentive Stock Option Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.32	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1988 Nonqualified Stock Option Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.33	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan (Retainer Grant) Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.34	Form of Agreement for Stock Option Grants under the Arthur J. Gallagher & Co. Restated 1989 Non- Employee Directors' Stock Option Plan (Discretionary Grant) Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2004, File No. 1- 9761).
*10.35	Form of Agreement for Restricted Stock Awards under the Arthur J. Gallagher & Co. Restricted Stock Plan (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended September 30, 2006, File No. 1- 9761).
10.36	Purchase and Sale Agreement Dated as of March 22, 2005, entered into by and among AJG Financial Services, Inc., a wholly- owned subsidiary of Arthur J. Gallagher & Co., Three E Corporation and SOF- HARMONY, L.L.C. (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended March 31, 2005, File No. 1- 9761).

10.37 Settlement Agreement and Mutual Release Dated as of May 1, 2005 by and between Headwaters Incorporated (formerly known as Covol Technologies, Inc.), Square D Company, Arthur J. Gallagher & Co. and AJG Financial Services, Inc. (incorporated by reference to the same exhibit number to Gallagher's Form 10- Q Quarterly Report for the quarterly period ended March 31, 2005, File No. 1- 9761).

10.38 Operating Agreement of Chem- Mod LLC dated as of June 23, 2004, by and among NOx II, Ltd., an Ohio limited liability company, AJG Coal, Inc., a Delaware corporation, and IQ Clean Coal LLC, a Delaware limited liability company (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2005, File No. 1- 9761).

10.39 Option Agreement among Carolyn Kelly, NOx II, Ltd., an Ohio limited liability company, and AJG Financial Services, Inc., a wholly-owned subsidiary of Arthur J. Gallagher & Co. dated October 17, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2005, File No. 1- 9761).

10.40 Operating Agreement of Chem- Mod International LLC dated as of July 8, 2005, between NOx II International, Ltd., an Ohio limited liability company and AJG Coal, Inc., a Delaware corporation, together with Amendment No. 1 dated August 2, 2005 (incorporated by reference to the same exhibit number to Gallagher's Form 10- K Annual Report for 2005, File No. 1- 9761).

10.41 Purchase and Sale Agreement by and between HGC/Two Pierce Limited Partnership, an Illinois limited partnership, and Wells Operating Partnership, L.P., a Delaware limited partnership, dated November 30, 2006 (incorporated by reference to the same exhibit number to Gallagher's Form 8- K Current Report dated December 7, 2006, File No. 1- 9761).

10.42 Share Purchase Agreement by and between AJG Capital, Inc., an Illinois corporation, and Aviacargo 27125/27347, LLC, a Delaware limited liability company, and Erste Finance Malta Limited Partnership, a Maltese limited liability company, relating to shares in respect of Aviacargo Leasing Limited, dated January 25, 2007 (incorporated by reference to the same exhibit number to Gallagher's Form 8- K Current Report dated January 25, 2007, File No. 1- 9761).

All other exhibits are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or Notes thereto.

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* Such exhibit is a management contract or compensatory plan or arrangement required to be filed as an exhibit to this form pursuant to item 601 of Regulation S- K.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 2nd day of February, 2007.

ARTHUR J. GALLAGHER & CO.

By /s/ J. PATRICK GALLAGHER, JR.

J. Patrick Gallagher, Jr.
Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on the 2nd day of February, 2007 by the following persons on behalf of the Registrant in the capacities indicated.

Name	Title
/s/ J. PATRICK GALLAGHER, JR. J. Patrick Gallagher, Jr.	Chairman, President and Director (Principal Executive Officer)
/s/ DOUGLAS K. HOWELL Douglas K. Howell	Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ RICHARD C. CARY Richard C. Cary	Controller (Principal Accounting Officer)
*WILLIAM L. BAX William L. Bax	Director
*T. KIMBALL BROOKER T. Kimball Brooker	Director
*GARY P. COUGHLAN Gary P. Coughlan	Director
*ILENE S. GORDON Ilene S. Gordon	Director
*ELBERT O. HAND Elbert O. Hand	Director
*DAVID S. JOHNSON David S. Johnson	Director
*KAY W. MC CURDY Kay W. Mc Curdy	Director
*JAMES R. WIMMER James R. Wimmer	Director

*By: /s/ JOHN C. ROSENGREN
John C. Rosengren, Attorney- in- Fact

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Schedule II

Arthur J. Gallagher & Co.
Valuation and Qualifying Accounts

	Balance at Beginning of Year	Additions Charged to Earnings	Adjustments	Balance at End of Year
		(In millions)		
Year ended December 31, 2006				
Allowance for doubtful accounts	$ 6.7	$ 2.6	$ (1.8)(1)	$ 7.5
Allowance for estimated policy cancellations	4.9	-	-	4.9
Accumulated amortization of goodwill	6.8	-	- (2)	6.8
Accumulated amortization of expiration lists and noncompete agreements	51.3	24.6	(2.4)(3)	73.5
Year ended December 31, 2005				
Allowance for doubtful accounts	$ 3.0	$ 4.2	$ (0.5)(1)	$ 6.7
Allowance for estimated policy cancellations	4.5	0.4	-	4.9
Accumulated amortization of goodwill	7.1	-	(0.3)(2)	6.8
Accumulated amortization of expiration lists and noncompete agreements	33.4	20.7	(2.8)(3)	51.3
Year ended December 31, 2004				
Allowance for doubtful accounts	$ 2.7	$ 1.8	$ (1.5)(1)	$ 3.0
Allowance for estimated policy cancellations	3.0	1.5	-	4.5
Accumulated amortization of goodwill	6.8	-	0.3(2)	7.1
Accumulated amortization of expiration lists and noncompete agreements	16.4	18.5	(1.5)(3)	33.4

(1) Bad debt write- offs net of recoveries.
(2) Elimination of fully amortized goodwill, intangible asset/amortization reclassifications and disposal of acquired businesses.
(3) Elimination of fully amortized expiration lists and non- compete agreements, intangible asset/amortization reclassifications and disposal of acquired businesses.

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Arthur J. Gallagher & Co.

Annual Report on Form 10- K

For the Fiscal Year Ended December 31, 2006

Exhibit Index

13.0	Gallagher's 2006 Financial Statements.
21.0	Subsidiaries of Gallagher, including state or other jurisdiction of incorporation or organization and the names under which each does business.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.0	Powers of Attorney.
31.1	Rule 13a- 14(a) Certification of Chief Executive Officer.
31.2	Rule 13a- 14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

Exhibit 13.0

Arthur J. Gallagher & Co.
2006 Financial Statements
Index

Management's Discussion and Analysis of Financial Condition and Results of Operations
Introduction

The following discussion and analysis should be read in conjunction with Gallagher's consolidated financial statements and the related notes thereto that are included elsewhere herein.

Gallagher provides insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional, governmental and personal accounts throughout the U.S. and abroad. Commission revenue is primarily generated through the negotiation and placement of insurance for its clients. Fee revenue is primarily generated by providing other risk management services including claims management, information management, risk control services and appraisals in either the property/casualty (P/C) market or human resource/employee benefits market. In addition, Gallagher receives fee revenue related to negotiated fee in lieu of commission arrangements for placement of insurance for its clients in either the P/C market or human resource/employee benefits market. Investment income and other revenue is generated from Gallagher's investment portfolio, which includes fiduciary funds, tax advantaged investments, real estate partnerships and other investments. Gallagher is headquartered in

Itasca, Illinois, has operations in seven countries and does business in 120 countries globally through a network of correspondent brokers and consultants.

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain statements relating to future results which are forward- looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. See "Cautionary Language Regarding Forward- Looking Statements" on the last page of the 2006 Annual Report.

Insurance Market Overview

Fluctuations in premiums charged by P/C insurance carriers (Carriers) have a direct and potentially material impact on the insurance brokerage industry. Commission revenues are generally based on a percentage of the premiums paid by insureds and normally follow premium levels. Insurance premiums are cyclical in nature and may vary widely based on market conditions. Various factors, including competition for market share among insurance carriers, increased underwriting capacity and improved economies of scale following consolidations, can result in flat or reduced P/C premium rates (a "soft" market). A soft market tends to put downward pressure on commission revenues. Various countervailing factors, such as heavier than anticipated loss experience and capital shortages, can result in increasing P/C premium rates (a "hard" market). A hard market tends to favorably impact commission revenues. Hard and soft markets may be broad- based or more narrowly focused across individual product lines or geographic areas.

For an extended period of years through late 2000 the P/C industry was in a soft market. This pricing pressure, together with a period of natural catastrophes and other losses, resulted in billions of dollars of underwriting losses in the P/C insurance market in the late 1990s and early in 2000. These losses, coupled with subsequent downward pressure on insurance companies' investment returns due to declining equity markets and interest rates, resulted in a general market hardening in the three- year period from late 2000 through 2003. This market hardening was accentuated in 2001 by the events of September 11th, following which insurance coverage in many lines became less available and premium rates increased, in some cases dramatically. These developments had a positive impact on Gallagher's 2002 and 2003 operating results.

In 2004 and 2005, the market softened again in many lines and in many geographic areas. However, even with an abnormally high level of hurricane activity and other natural disasters in those years, the market generally continued to soften in 2006. For example, the first quarter 2006 survey by the Council of Insurance Agents & Brokers (CIAB) indicated that commercial P/C rates were flat or fell slightly during first quarter 2006, with renewal premiums for half of all account sizes holding steady or dropping between 1.0% and 10.0% in first quarter 2006. The CIAB represents the leading domestic and international insurance brokers who write approximately 80.0% of the commercial P/C premiums in the U.S. According to an analysis of CIAB's first quarter 2006 data by Lehman Brothers Equity Research, the average commercial P/C account renewing in first quarter 2006 experienced a rate decline of 2.7%. An analysis of CIAB's second quarter 2006 data indicated that commercial premium rates declined by an average of 3.0% for all sizes of accounts, and all individual P/C lines experienced a decrease except commercial property, which increased 9.0%. An analysis of CIAB's third quarter 2006 data indicated that commercial premium rates declined by an average of 5.3% for all sizes of accounts. According to the CIAB, commercial insurance premiums continued to decline in all but catastrophe- exposed areas during fourth quarter 2006, with insurers willing to lower premium rates and place fewer restrictions on coverages in order to obtain new business. An analysis of CIAB's fourth quarter 2006 data by Lehman Brothers indicated an average rate decline of 9.6% in commercial premium rates for all sizes of accounts. The average decline was 12.1% for large accounts and 6.3% for small accounts, the largest rate of decline for both categories since the CIAB surveys began in 1999.

In a period of rising insurance costs, there is resistance among certain insureds, who are the buyers of insurance (Gallagher's brokerage clients), to pay increased premiums and the higher commissions generated by these premiums. Such resistance often causes some buyers to raise their deductibles and/or reduce the overall amount of insurance coverage they purchase. As the market softens, or costs decrease, these trends have historically reversed. During the most recent hard market period, some buyers switched to negotiated fee in lieu of commission arrangements to compensate Gallagher for placing their risks.

Other buyers moved toward the alternative insurance market, which includes self- insurance, captives, rent- a- captives, risk retention groups and capital market solutions to transfer risk. According to industry estimates, these mechanisms now account for nearly 50% of the total commercial P/C market in the U.S. Gallagher's brokerage units are very active in these markets as well, which could have a favorable effect on Gallagher's Risk Management Services Segment. While the gradual movement toward these alternative markets has reduced commission revenue to Gallagher, Gallagher anticipates that new sales and renewal increases in the areas of risk management, claims management, captive insurance and self- insurance services may be major factors in Gallagher's fee revenue growth in 2007.

Inflation tends to increase the levels of insured values and risk exposures, thereby resulting in higher overall premiums and higher commissions. However, the impact of hard and soft market fluctuations historically has had a greater impact on changes in premium rates, and therefore on Gallagher's revenues, than inflationary pressures.

Historically, Gallagher has utilized acquisitions to grow its Brokerage Segment's commission and fee revenues. Acquisitions allow Gallagher to expand into desirable geographic locations and further extend its presence in the retail and wholesale insurance brokerage services industry. Gallagher expects that its Brokerage Segment's commission and fee revenues will continue to grow from acquisitions. Gallagher is considering, and intends to continue to consider from time- to- time, additional acquisitions on terms that it deems advantageous. At any particular time, Gallagher generally will be engaged in discussions with multiple acquisition candidates. However, no assurances can be given that any additional acquisitions will be consummated, or, if consummated, that they will be advantageous to Gallagher.

Contingent Commissions and Other Industry Developments

The insurance industry has come under a significant level of scrutiny by various regulatory bodies, including State Attorneys General and the departments of insurance for various states, with respect to contingent compensation arrangements and other matters. The Attorney General of the State of New York (the New York AG) issued subpoenas to various insurance brokerage firms and Carriers beginning in April 2004. The investigation by the New York AG, among other things, led to its filing a complaint on October 14, 2004 against Marsh & McLennan Companies, Inc. and its subsidiary, Marsh Inc. (collectively, Marsh), stating claims for, among other things, fraud and violations of New York State antitrust and securities laws. In light of these allegations, Marsh announced on October 15, 2004 that it was suspending its use of contingent commission agreements. On October 26, 2004, Marsh announced that it would permanently eliminate the practice of receiving any form of contingent compensation from Carriers. Within the week following Marsh's initial announcement, two other large insurance brokerage firms, Willis Group and Aon Corporation, each announced that it would discontinue contingent commission agreements and unwind such arrangements by the end of 2004. Although the New York AG's complaint against Marsh focused primarily upon arrangements with P/C Carriers, subpoenas were served on a number of group life and disability and traditional health Carriers, as well as the insurance brokerage firms who assist in the placement of such types of insurance. At the press conference announcing its complaint against Marsh, the New York AG indicated that its investigation would look across various lines of insurance. In connection with its investigation of the insurance industry, the New York AG brought criminal charges against company executives and employees at various brokers and Carriers, some of which have resulted in guilty pleas being entered.

As previously reported, on May 18, 2005, Gallagher's brokerage related subsidiaries and affiliates entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to certain investigations conducted by the IL State Agencies involving contingent commission arrangements. As stipulated in the AVC, on January 12, 2006, Gallagher paid $26.9 million into a fund (the Fund) to be distributed to certain eligible policyholder clients. As of December 31, 2006, $8.6 million remained in the Fund which is available to satisfy existing and future AVC related claims and other potential settlement obligations as allowed by the AVC. In addition, under the AVC Gallagher agreed to implement, to the extent not previously undertaken, certain business changes, including agreeing not to accept U.S.- domiciled retail contingent compensation as defined in the AVC. On October 26, 2004, Gallagher announced that it would not enter into any new volume- based or profit- based contingent commissions agreements as a retail broker effective January 1, 2005. However, as allowed under the AVC, Gallagher has continued to accept contingent compensation from non- retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired up to three years from the acquisition date. See Note 17 to the Consolidated Financial Statements for a discussion of the material terms of the AVC. Accordingly, beginning in 2005 and more significantly in 2006, Gallagher began to experience reduced contingent commission revenue and it is expected that future contingent commission revenues will continue to be substantially reduced. The reduction in retail contingent commissions, as discussed above, has continued to have a substantial negative impact on Gallagher's pretax earnings in 2006 and is expected to have such effect on future earnings.

In 2004, the New York State Insurance Department commenced an investigation and issued requests for information to various brokers and Carriers, including one of Gallagher's New York brokerage subsidiaries, concerning contingent commission arrangements. In addition to the IL State Agencies, various other State Attorneys General and other state departments of insurance have also issued subpoenas to Gallagher or initiated investigations relating to Gallagher concerning contingent commissions and other business practices. Gallagher is fully cooperating with each of these investigations.

In addition, the departments of insurance for various states have proposed new regulations, and other state insurance departments have indicated that they will propose new regulations, that address contingent commission arrangements, including prohibitions on the payment of money by Carriers in return for business and enhanced disclosure of contingent commission arrangements to insureds. On December 29, 2004, the National Association of Insurance Commissioners announced that it had adopted model legislation to implement new disclosure requirements related to broker compensation arrangements.

In response to these industry developments, in October 2004, Gallagher retained independent counsel to perform an internal review of certain of its business practices. Such independent counsel completed its internal review and found no evidence that Gallagher had engaged in any price fixing or bid rigging of the type alleged in the New York AG's October 14, 2004 complaint against Marsh, nor had it engaged in any improper tying arrangements.

Gallagher, along with other major insurance brokerage firms, is also a defendant in various lawsuits brought by private litigants which relate to these practices. Certain of these lawsuits were included in a Multi- District Litigation (MDL) proceeding before the U.S. District Court for the District of New Jersey. On December 29, 2006 Gallagher reached an agreement to resolve all claims in the MDL. Gallagher admitted no wrongdoing, but chose to conclude its involvement, rather than prolong what could have been a costly and burdensome lawsuit. The MDL settlement, which is subject to court approval, provides for Gallagher to distribute $28.0 million to current and former clients and others that used a broker to purchase retail insurance from 1994 to 2005. Gallagher will also pay $8.9 million in plaintiffs' attorney fees. In the event the MDL settlement is not approved by the court, Gallagher may incur significant additional legal costs and face potential liability in connection with the MDL. Gallagher established a provision for this matter in 2005, and as a result, substantially all of the costs associated with the MDL settlement had been reserved for previously.

Gallagher Bassett Services, Inc. (GB), a third party administrator and a wholly- owned subsidiary of Gallagher, has received subpoenas from the Offices of the Attorney General of the State of New York, Connecticut and Illinois. The subpoenas request information in connection with separate investigations being conducted by each state and none of the subpoenas relate to Gallagher's brokerage operations. Gallagher is fully cooperating with these investigations.

In 2005, Gallagher recorded pretax charges totaling $73.6 million ($44.2 million after tax) in connection with the regulatory and legal actions by the State Attorneys General and private litigants related to contingent commissions and various other historical business practices, as described above. In first quarter 2005, Gallagher incurred $35.0 million of the charge, which was primarily related to costs associated with the AVC and other investigations and inquiries from other governmental authorities related to contingent commissions and various other historical business practices. In fourth quarter 2005, Gallagher incurred the remainder of the charge, or $38.6 million, which was primarily related to costs associated with investigations and inquiries from governmental authorities related to contingent commissions and various other historical business practices, and pending civil litigation. Gallagher continues to be the subject of a number of state investigations concerning various historical business practices in the insurance industry. In fourth quarter 2006, Gallagher recorded an additional pretax charge of $9.0 million to increase its reserve for the costs to be incurred to administratively conclude the MDL settlement and to resolve other regulatory matters and investigations. The remaining amount accrued as of December 31, 2006 represents Gallagher's best estimate of the amount required to resolve the state investigations, which includes all of the costs related to the funding and administration of the MDL, plus an accrual for legal costs incurred or to be incurred to resolve these matters. See Note 17 to the Consolidated Financial Statements for additional discussion relating to these matters.

Gallagher's contingent commissions for 2006, 2005 and 2004 were $7.3 million, $35.2 million and $39.5 million, respectively. The contingent commissions recognized in 2005 by Gallagher generally relate to contingent commission agreements in force during 2004, but received in 2005. The contingent commissions recognized in 2006 by Gallagher generally relate to contingent commission agreements in force related to 2005 and 2006 acquisitions and to non- retail business. As allowed under the AVC, Gallagher has continued to accept contingent compensation from non- retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired for up to three years from the acquisition date.

The amount of contingent commission revenue in 2006, 2005 and 2004 in which Gallagher participated as a retail broker and which involved volume- based or profit- based contingent commission agreements is as follows (in millions):

	1st Q	2nd Q	3rd Q	4th Q	Total
2004	$ 15.9	$ 7.8	$ 1.9	$ 8.2	$ 33.8
2005	16.7	9.4	2.0	0.7	28.8
2006	1.0	0.9	0.2	0.4	2.5

The decrease in contingent commissions in each quarter in the year ended December 31, 2006 compared to 2005 is indicative of the decline in such revenue for Gallagher. This reduced level of contingent commission revenues is expected to continue in 2007 and future periods and to have a substantial negative impact on Gallagher's pretax earnings.

Critical Accounting Policies

Gallagher's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP), which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Gallagher believes the following significant accounting policies may involve a higher degree of judgment and complexity. See Note 1 to the Consolidated Financial Statements for other significant accounting policies.

Revenue Recognition

Commission revenues are recognized at the latter of the billing or the effective date of the related insurance policies, net of an allowance for estimated policy cancellations. Commission revenues related to installment premiums are recognized periodically as billed. Contingent commissions and commissions on premiums directly billed by insurance carriers are recognized as revenue when the data necessary to reasonably determine such amounts has been obtained by Gallagher. Typically, these types of commission revenues cannot be reasonably determined until the cash or the related policy detail is received by Gallagher from the insurance carrier. A contingent commission is a commission paid by an insurance carrier that is based on the overall profit and/or volume of the business placed with that insurance carrier. Commissions on premiums billed directly by insurance carriers to the insureds generally relate to a large number of small premium P/C transactions and a substantial portion of the revenues generated by Gallagher's employee benefit operations. Under these direct bill arrangements the billing and policy issuance process is controlled entirely by the insurance carrier. The income effects of subsequent premium adjustments are recorded when the adjustments become known.

Fee revenues generated from the Brokerage Segment primarily relate to fees negotiated in lieu of commissions, which are recognized in the same manner as commission revenues. Fee revenues generated from the Risk Management Segment relate to third party claims administration, loss control and other risk management consulting services, which are provided over a period of time, typically one year. These fee revenues are recognized ratably as the services are rendered. The income effects of subsequent fee adjustments are recorded when the adjustments become known.

Premiums and fees receivable in the consolidated balance sheet are net of allowances for estimated policy cancellations and doubtful accounts. The allowance for estimated policy cancellations is established through a charge to revenues, while the allowance for doubtful accounts is established through a charge to other operating expenses. Both of these allowances are based on estimates and assumptions using historical data to project future experience. Gallagher periodically reviews the adequacy of these allowances and makes adjustments as necessary. The use of different estimates or assumptions could produce different results.

Fair Value of Investments

For investments that do not have quoted market prices, Gallagher utilizes various valuation techniques to estimate fair value and proactively looks for indicators of impairment. Factors, among others, that may indicate that an impairment could exist include defaults on interest and/or principal payments, reductions or changes to dividend payments, sustained operating losses or a trend of poor operating performance, recent refinancings or recapitalizations, unfavorable press reports, untimely filing of financial information, significant customer or revenue loss, litigation, tax audits, losses by other companies in a similar industry, overall economic conditions, management and expert advisor changes and significant changes in strategy. In addition, in cases where the ultimate value of an investment is directly dependent on Gallagher for future financial support, Gallagher assesses its willingness and intent to provide future funding.

If an indicator of impairment exists, Gallagher compares the investment's carrying value to an estimate of its fair value. To estimate the fair value of loans, Gallagher discounts the expected future cash flows from principal and interest payments. This requires Gallagher to exercise significant judgment when estimating both the amount and the timing of the expected cash flows. To estimate the fair value of its equity investments, Gallagher compares values established in recent recapitalizations or appraisals conducted by third parties. In some cases, no such recapitalizations or appraisals exist and Gallagher must perform its own valuations. This also requires Gallagher to exercise significant judgment. Even if impairment indicators exist, no write- down may be required if the estimated fair value is not less than the current carrying value or the decline in value is determined to be temporary and Gallagher has the ability and intent to hold the investment for a period of time sufficient for the value to recover. When Gallagher determines an impairment is other- than- temporary, and therefore that a write- down is required, it is recorded as a realized loss against current period earnings.

Both the process to review for indicators of impairment and, if such indicators exist, the method to compute the amount of impairment incorporate quantitative data and qualitative criteria including the receipt of new information that can dramatically change the decision about the valuation of an investment in a short period of time. The determination of whether a decline in fair value is other- than- temporary is necessarily a matter of subjective judgment. The timing and amount of realized losses reported in earnings could vary if management's conclusions were different.

Due to the inherent risk of investments, Gallagher cannot give assurance that there will not be impairments in the future should economic and other conditions change.

Intangible Assets

Intangible assets represent the excess of cost over the value of net tangible assets of acquired businesses. Gallagher classifies its intangible assets as either goodwill, expiration lists or non- compete agreements. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements), while goodwill is not subject to amortization. Allocation of intangible assets between goodwill, expiration lists and non- compete agreements and the determination of estimated useful lives are based on valuations Gallagher receives from qualified independent appraisers. The calculations of these amounts are based on estimates and assumptions using historical and pro forma data and recognized valuation methods. The use of different estimates or assumptions could produce different results. Intangible assets are carried at cost, less accumulated amortization in the consolidated balance sheet.

While goodwill is not amortized, it is subject to periodic reviews for impairment. Gallagher reviews intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. Such impairment reviews are performed at the division level with respect to goodwill and at the business unit level for amortizable intangible assets. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings. In 2006 and 2004, Gallagher determined that an indicator of impairment existed related to the amortizable intangible assets of one of its 2003 and 2001 acquisitions, respectively. Based on the results of these impairment reviews, Gallagher wrote- off $1.0 million and $1.8 million of amortizable intangible assets in 2006 and 2004, respectively. No such indicators were noted in 2005. The determinations of impairment indicators and fair value are based on estimates and assumptions related to the amount and timing of future cash flows and future interest rates. The use of different estimates or assumptions could produce different results.

Business Combinations and Dispositions

See Notes 4 and 5 to the Consolidated Financial Statements for a discussion of the 2006 business combinations and 2005 dispositions, respectively. In addition, see Note 3 to the Consolidated Financial Statements for a discussion of disposition activities with respect to certain of Gallagher's consolidated investments.

Results of Operations

In the discussion that follows regarding Gallagher's results of operations, Gallagher provides organic growth percentages with respect to its commission and fee revenues. This information may be considered a "non- GAAP financial measure" because it is derived from Gallagher's consolidated financial information but is not required to be presented in financial statements that are prepared in conformity with GAAP. Rules and regulations of the Securities and Exchange Commission (SEC) require supplemental explanations and reconciliations of all "non- GAAP financial measures." When Gallagher refers to organic growth percentages with respect to its commission and fee revenues in its discussion of results of operations, Gallagher excludes the first twelve months of net commission and fee revenues generated from the acquisitions and the net commission and fee revenues related to operations disposed of in each year presented. These commissions and fees are excluded from organic revenues in order to determine the revenue growth that is associated with the operations that were part of Gallagher in both the current and prior year. In addition, organic growth excludes contingent commission revenues. These commissions are excluded from organic revenues in order to determine the revenue growth that is associated with the revenue sources that will be continuing in 2006 and beyond. Management has historically utilized organic revenue growth as an important indicator when assessing and evaluating the performance of its Brokerage and Risk Management Segments. Management also believes that the use of this measure allows financial statement users to measure, analyze and compare the growth from its Brokerage and Risk Management Segments in a meaningful and consistent manner. A reconciliation of organic revenue growth percentages to the reported revenue growth percentages for the Brokerage and Risk Management Segments is presented in the paragraphs immediately following each table in which such percentages are presented.

Gallagher has changed its segment allocation method for income taxes. Previously, Gallagher had applied its overall effective tax rate for the consolidated group to each reporting segment. In 2006, Gallagher began allocating the provision for income taxes to the Brokerage and Risk Management Segments as if those segments were preparing income tax provisions on a separate company basis. As a result, the provision for income taxes for the Financial Services Segment now reflects the entire benefit to Gallagher of the IRC Section 29- related credits because that is the segment which produces the credits. Historical results have been reclassified to conform to the current presentation. Gallagher anticipates reporting an effective tax rate of approximately 40.0% to 42.0% in both its Brokerage Segment and its Risk Management Segment for the foreseeable future.

In the discussion that follows regarding Gallagher's results of operations, Gallagher provides the following ratios with respect to its operating results: pretax profit margin before the impact of pretax retail contingent commission related matters, claims handling obligations and medical and pension plan changes, compensation expense ratio and operating expense ratio. Pretax profit margin before the impact of pretax retail contingent commission related matters, claims handling obligations and medical and pension plan changes represents pretax earnings (loss) from continuing operations before the impact of pretax retail contingent commission related matters, claims handling obligations and medical and pension plan changes divided by total revenues, excluding retail contingent commissions. The compensation expense ratio is derived by dividing compensation expense, after excluding the impact of medical and pension plan changes, by total revenues, excluding retail contingent commissions. The operating expense ratio is derived by dividing operating expense, after excluding retail contingent commission related matters and claims handling obligations, by total revenues, excluding retail contingent commissions.

Brokerage

The Brokerage Segment comprises three operating divisions: the Brokerage Services- Retail Division (BSD), Specialty Marketing and International (SMI) and Gallagher Benefit Services (GBS). The Brokerage Segment, for commission or fee compensation, places commercial P/C and employee benefit- related insurance on behalf of its customers. Financial information relating to Gallagher's Brokerage Segment is as follows (in millions):

	2006	Percent Change	2005	Percent Change	2004
Commissions	$ 849.5	8%	$ 784.3	8%	$ 726.8
Retail contingent commissions	2.5	(91%)	28.8	(15%)	33.8
Fees	188.5	11%	169.8	16%	146.2
Investment income and other	30.2	69%	17.9	34%	13.4
Total revenues	1,070.7	7%	1,000.8	9%	920.2
Compensation	640.4	8%	590.9	12%	527.5
Medical and pension plan changes	4.6	167%	(6.9)	NMF	-
Operating	220.3	1%	219.1	24%	176.1
Depreciation	15.0	10%	13.6	5%	12.9
Amortization	24.1	19%	20.3	17%	17.3
Retail contingent commission related matters	9.0	NMF	73.6	NMF	-
Claims handling obligations	-	NMF	15.0	NMF	-
Total expenses	913.4	(1%)	925.6	26%	733.8
Earnings from continuing operations before income taxes	157.3	109%	75.2	(60%)	186.4
Provision for income taxes	64.5	NMF	42.3	(45%)	76.4
Earnings from continuing operations	$ 92.8	182%	$ 32.9	(70%)	$ 110.0
Growth - revenues	10%		10%		9%
Organic growth in commissions and fees	6%		2%		2%
Compensation expense ratio	60%		61%		60%
Operating expense ratio	21%		23%		20%
Pretax profit margin before retail contingent commission related matters and claims handling obligations and medical and pension plan changes	16%		13%		21%
Effective tax rate	41%		56%		41%
Identifiable assets at December 31	$ 2,580.6		$ 2,498.5		$ 2,354.5

The increase in commissions for 2006 was principally due to revenues associated with acquisitions that were made in the last twelve months ($33.7 million) and organic growth from existing operations. The increase in commissions in 2006 included new business production of $113.0 million, which was offset by renewal rate decreases and lost business of $80.0 million. The increase in fees for 2006 compared to 2005 resulted from new business production and renewal rate increases of approximately $29.0 million, which were offset by lost business of $13.0 million. The increase in commissions for 2005 was principally due to revenues associated with acquisitions that were made during the preceding twelve months ($64.0 million). This increase was partially offset by a net decrease in commissions from existing operations of $6.0 million (new business production of $117.0 million, which was offset by renewal rate decreases and lost business of $123.0 million). The increase in fees for 2005 compared to 2004 resulted from new business production and renewal rate increases of approximately $36.0 million, which were offset by lost business of $12.0 million. The organic growth in commission and fee revenues was 6% in 2006, 2% in 2005 and 2% in 2004. The following commission and fee revenues related to contingent commissions and acquisitions (that were made during 2005) were excluded in deriving the organic growth percentages: $41.0 million in 2006, $99.2 million in 2005 and $93.5 million in 2004.

Investment income and other, which primarily represents interest income earned on cash and restricted funds, increased in 2006 and 2005 primarily due to increases in short- term interest rates and increases in the amount of cash available to invest due to growth in operations, which were partially offset by the increased use of cash to repurchase common stock in 2006 as compared to 2005. Also contributing to the increase in 2006 were $4.5 million of one- time gains related to the sales of small books of business. The decrease in shares repurchased in 2005 as compared to 2006 and 2004 was primarily due to anticipated cash needs in the latter part of 2005 and into 2006.

The increase in compensation expense in 2006 compared to 2005 was primarily due to an increase in the average number of employees, salary increases, increases in incentive compensation linked to Gallagher's overall operating results ($35.8 million in the aggregate), an increase in expense related to stock- based compensation ($6.2 million), an increase in severance costs ($1.7 million), an increase in employee benefit plan costs ($4.5 million) and the adverse impact of foreign currency translation ($1.3 million). Also contributing to the increase in 2006 were the defined benefit pension plan curtailment gain of $6.9 million that was recognized as an offset to compensation expense in 2005 and a $4.6 million one- time medical plan termination charge recorded in 2006, which was incurred when Gallagher changed its medical plan administrator during fourth quarter 2006. These items are presented in a separate line in the table above. The increase in employee headcount in 2006 primarily relates to the addition of employees associated with the acquisitions that were made during the preceding twelve months. The increase in compensation expense in 2005 compared to 2004 was primarily due to an increase in the average number of employees, salary increases ($34.5 million in the aggregate), compensation related to new hires in the retail operations ($7.6 million), new hires and charges related to staffing changes made in Gallagher's U.S. and U.K. reinsurance operations ($18.7 million), severance costs ($1.4 million) and an increase in expense related to stock- based compensation ($2.6 million). These increases were partially offset by the defined benefit pension plan curtailment gain that was recognized in second quarter 2005 ($6.9 million) and the favorable impact of foreign currency translation ($1.4 million). The increase in employee headcount in 2005 primarily relates to the addition of employees associated with the acquisitions that were made during 2005.

Operating expenses were relatively flat in 2006 compared to 2005. Increases related to acquisitions completed during the preceding twelve months and inflationary increases in operating expenses and $1.9 million of lease termination costs due to the previously announced lease rationalization initiative. These were substantially offset by a decrease in business insurance costs ($4.4 million), a decrease in bad debt expense ($2.2 million), the favorable impact of foreign currency translation ($2.6 million) and expense savings related to sourcing and other cost containment initiatives put in place in the latter part of 2005. The increase in operating expenses in 2005 over 2004 was due primarily to increases in professional services fees ($5.2 million), an increase in rent and utility costs associated with leased office space and office expansion ($2.4 million), an increase in business insurance costs ($5.2 million), operating costs related to the staffing changes made in Gallagher's London and reinsurance operations ($3.5 million), uncollectible international receivables ($2.4 million), lease termination costs ($2.1 million) and the adverse impact of foreign currency translation ($4.1 million). The increase in professional fees was primarily related to legal fees and consulting fees for sourcing and other cost containment initiatives. Also contributing to the increase in operating expenses in 2005 were expenses associated with the acquisitions completed during 2005.

The increases in depreciation expense in 2006 compared to 2005 and in 2005 compared to 2004 were due primarily to the purchases of furniture, equipment and leasehold improvements related to office expansions and moves and expenditures made related to computer systems made during 2006 and 2005, respectively. Also contributing to the increase in 2006 and 2005 was the depreciation expense associated with the acquisitions completed in 2006, 2005 and 2004.

The increases in amortization in 2006 compared to 2005 and in 2005 compared to 2004 were due primarily to amortization expense of intangible assets associated with acquisitions completed in 2006, 2005 and 2004. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements). Also contributing to the increase in amortization expense in 2006 was the $1.0 million impairment of amortizable intangible assets in 2006 related to one of Gallagher's 2003 acquisitions.

In 2005, Gallagher recorded pretax charges totaling $73.6 million ($44.2 million after tax) in connection with the regulatory and legal actions by the State Attorneys General and private litigants related to contingent commissions and various other historical business practices, as described more fully in Note 17 to the Consolidated Financial Statements and "Management's Discussion and Analysis Contingent Commissions and Other Industry Developments". In first quarter 2005, Gallagher incurred $35.0 million ($21.0 million after tax) of the charge, which was primarily related to costs associated with the AVC and other investigations and inquiries from other governmental authorities related to contingent commissions and various other historical business practices. In fourth quarter 2005, Gallagher incurred an additional charge of $38.6 million ($23.2 million after tax), which was primarily related to costs associated with investigations and inquiries from governmental authorities related to contingent commissions and various other historical business practices, and the pending civil litigation. Gallagher continues to be the subject of a number of state investigations concerning various historical business practices in the insurance industry. In fourth quarter 2006, Gallagher recorded the remainder of the pretax charge of $9.0 million to increase its reserve for the costs to be incurred to administratively conclude the MDL settlement and to resolve other regulatory matters and investigations. The remaining amount accrued as of December 31, 2006 represents Gallagher's best estimate of the amount required to resolve the state investigations, which includes all of the costs related to the funding and administration of the MDL, plus an accrual for legal costs incurred or to be incurred to resolve these matters.

Claims handling obligations in 2005 represent a pretax charge of $15.0 million ($9.8 million after tax) recorded by Gallagher in 2005 related to obligations to provide future claims handling and certain administrative services for reinsurance brokerage clients. During 2005 and the latter part of 2004, in connection with recent legal interpretations and accounting guidance issued by the Institute of Chartered Accountants in the U.K., many global insurance brokerage firms reassessed their obligations to provide future claims handling and certain administrative services for reinsurance brokerage clients. This guidance, which is referred to as FRS 5, was issued in 2004 and is specifically directed to insurance brokers engaged in the industry practice of providing clients future claims handling and administrative services. Based on a detailed review of its reinsurance brokerage operations in both the U.S. and U.K. that was completed in 2005, its current accounting practices for these operations and recent legal interpretations, Gallagher determined that under certain circumstances it is obligated to provide future claims handling and certain administrative services based on its current business practices. Thus, Gallagher recorded a non- cash pretax charge of $15.0 million to reflect the change in the estimated costs to provide these future services to former clients.

The Brokerage Segment's effective tax rate in 2006, 2005 and 2004 was 41.0%, 56.0% and 41.0%, respectively. The effective income tax rate reported in 2005 was adversely impacted by the annualized effect of foreign dividend repatriations that occurred in 2005. See the Results of Operations for the Financial Services Segment for a discussion on the overall effective income tax rate in 2006, 2005 and 2004.

Risk Management

The Risk Management Segment provides P/C claim third- party administration, loss control and risk management consulting and insurance property appraisals. Third- party administration is principally the management and processing of claims for self- insurance programs of Gallagher's clients or clients of other brokers. Financial information relating to Gallagher's Risk Management Segment is as follows (in millions):

	2006	Percent Change	2005	Percent Change	2004
Fees	$ 397.3	8%	$ 367.7	7%	$ 343.8
Investment income	4.0	38%	2.9	71%	1.7
Total revenues	401.3	8%	370.6	7%	345.5
Compensation	233.0	11%	209.0	12%	187.3
Medical and pension plan changes	2.9	NMF	(3.1)	NMF	-
Operating	102.1	16%	88.2	(4%)	91.8
Depreciation	9.5	23%	7.7	(1%)	7.8
Amortization	0.5	25%	0.4	0%	0.4
Total expenses	348.0	15%	302.2	5%	287.3
Earnings from continuing operations before income taxes	53.3	(22%)	68.4	18%	58.2
Provision for income taxes	21.3	(24%)	28.1	24%	22.7
Earnings from continuing operations	$ 32.0	(21%)	$ 40.3	14%	$ 35.5
Growth - revenues	8%		7%		18%
Organic growth in fees	8%		7%		18%
Compensation expense ratio	58%		56%		54%
Operating expense ratio	25%		24%		27%
Pretax profit margin	14%		18%		17%
Effective tax rate	40%		41%		39%
Identifiable assets at December 31	$ 308.2		$ 284.4		$ 231.2

The increase in fees for 2006 compared to 2005 was due primarily to new business production, which aggregated to $56.0 million in 2006 and was offset by lost business and renewal rate decreases of $27.0 million. The increase in fees for 2005 compared to 2004 was due primarily to new business production, renewal rate increases and high retention rates on existing business, all of which aggregated to $41.0 million in 2005 and was offset by lost business of $17.0 million. The organic growth in fee revenues was 8% in 2006, 7% in 2005 and 18% in 2004. Historically, the Risk Management Segment has made few acquisitions, and these acquisitions have not been material to this Segment's operations. Thus, there typically is no material difference between GAAP revenues and organic revenues for this Segment.

Investment income, which primarily represents interest income earned on Gallagher's cash and cash equivalents, increased in 2006 and 2005 primarily due to increases in short- term interest rates and increases in the amount of cash available to invest due to growth in operations, which were partially offset by an increased use of cash to repurchase common stock in 2006. The decrease in shares repurchased in 2005 as compared to 2006 and 2004 was primarily due to anticipated cash needs in the latter part of 2005 and into 2006.

The increase in compensation expense in 2006 compared to 2005 was due to an increase in the average number of employees and salary increases ($15.1 million in the aggregate), increases in employee benefit plan costs ($6.1 million), an increase in stock- based compensation expense in 2006 ($2.3 million) and the adverse impact of foreign currency translation ($0.5 million). Also contributing to the increase in 2006 was the defined benefit pension plan curtailment gain of $3.1 million that was recognized as an offset to compensation expense in 2005 and a $2.9 million one- time medical plan termination charge recorded in 2006, which was incurred when Gallagher changed its medical plan administrator during fourth quarter 2006. These items are presented in a separate line in the table above. The increase in employee headcount relates to the hiring of additional staff to support claims activity related to new business generated. The increase in compensation expense in 2005 compared to 2004 was due to an increase in the average number of employees and salary increases ($23.4 million in the aggregate), the adverse impact of foreign currency translation ($0.5 million) and an increase in stock- based compensation expense in 2005 ($0.4 million). These increases were partially offset by the defined benefit pension plan curtailment gain of $3.1 million that was recognized in second quarter 2005 and a decrease in employee benefit expenses ($2.6 million). The increase in employee headcount relates to the hiring of additional staff to support claims activity related to new business generated.

The increase in operating expenses in 2006 from 2005 was due primarily to increases in business insurance costs ($1.8 million), lease costs ($3.2 million), professional services fees ($2.3 million), travel and entertainment expenses ($1.4 million) and office expenses ($2.6 million), which were partially offset by the favorable impact of foreign currency translation ($0.6 million) in 2006. The decrease in operating expenses in 2005 from 2004 was due primarily to the overall impact of sourcing and other cost containment initiatives implemented in the latter part of 2004 ($2.3 million) and a decrease in professional services fees ($5.4 million) in 2005, which were partially offset by increases in other operating expenses and an asset write-off in the international operations of $0.5 million.

The increase in depreciation expense in 2006 from 2005 was due to the timing of purchases of furniture, equipment and leasehold improvements related to office expansions and moves and expenditures made related to computer systems. Depreciation expense was relatively unchanged in 2005 compared to 2004. Changes in depreciation expense from year- to- year are due primarily to the timing of purchases of furniture, equipment and leasehold improvements related to office expansions and moves.

Amortization expense was relatively unchanged in 2006 compared to 2005 and in 2005 compared to 2004. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements).

The Risk Management Segment's effective tax rate in 2006, 2005 and 2004 was 40.0%, 41.0% and 39.0%, respectively. See the Results of Operations for the Financial Services Segment for a discussion on changes in the overall effective income tax rate in 2006 compared to 2005 and 2005 compared to 2004.

Financial Services

The Financial Services Segment is responsible for managing Gallagher's investment portfolio. See Note 3 to the Consolidated Financial Statements for a summary of Gallagher's investments as of December 31, 2006 and 2005 and a detailed discussion on the nature of the investments held. Financial information relating to Gallagher's Financial Services Segment is as follows (in millions):

	2006	Percent Change	2005	Percent Change	2004
Investment income (loss):					
Asset Alliance Corporation (AAC) related investments	$ (0.9)	67%	$ (2.7)	(175%)	$ 3.6
Low income housing investments	(1.7)	NMF	0.2	(91%)	2.3
IRC Section 29 Syn/Coal facilities:					
Three unconsolidated facilities	32.2	(42%)	55.5	27%	43.7
Two consolidated facilities	49.3	15%	42.8	34%	31.9
Other alternative energy investments	(1.3)	NMF	0.8	(53%)	1.7
Home office land and building	4.9	(25%)	6.5	(2%)	6.6
Airplane leasing company	3.5	(15%)	4.1	24%	3.3
Impact of FIN 46 from consolidated investments	-	NMF	-	(100%)	69.9
Real estate, venture capital and other investments	1.1	(35%)	1.7	NMF	0.2
Total investment income	87.1	(20%)	108.9	(33%)	163.2
Investment gains (losses)	(25.1)	NMF	3.6	(56%)	8.1
Total revenues	62.0	(45%)	112.5	(34%)	171.3
Investment expenses:					
IRC Section 29 Syn/Coal facilities:					
Three unconsolidated facilities	18.4	16%	15.8	108%	7.6
Two consolidated facilities	74.1	1%	73.4	27%	57.9
Impact of FIN 46 on investment expenses	-	NMF	-	(100%)	67.2
Compensation, professional fees and other	11.2	(29%)	15.7	(36%)	24.4
Total investment expenses	103.7	(1%)	104.9	(33%)	157.1
Interest	8.5	(27%)	11.6	22%	9.5
Depreciation	7.3	(36%)	11.4	23%	9.3
Impact of FIN 46 on depreciation	-	NMF	-	(100%)	2.7
Litigation related matters	-	NMF	131.0	NMF	-
Total expenses	119.5	(54%)	258.9	45%	178.6
Earnings (loss) from continuing operations before income taxes	(57.5)	61%	(146.4)	NMF	(7.3)
Provision (benefit) for income taxes	(61.2)	40%	(101.7)	(98%)	(51.3)
Earnings (loss) from continuing operations	$ 3.7	108%	$ (44.7)	NMF	$ 44.0
Identifiable assets at December 31	$ 531.3		$ 606.6		$ 656.9

Investment income from AAC related investments primarily represents income associated with Gallagher's debt, preferred and common stock investments in AAC. Gallagher accounts for the common stock portion of its investment using equity method accounting and accounts for the interest and dividend income on its debt and preferred stock investments as it is earned. AAC related income (loss) in 2006 was more favorable than the 2005 loss incurred due primarily to Gallagher's equity accounting portion of a 2005 AAC loss adjustment related to the sales and impairment of its investments in three of its private investment management firms. AAC's 2006 loss included an adjustment from 2005 that AAC recognized in second quarter 2006 for taxes related to the sales and impairment of AAC's investment in three of its private investment management firms. Gallagher's portion of the charge using equity method accounting was $2.2 million. The decrease in AAC related income (loss) in 2005 compared to 2004 was due to a decline in AAC's operating results in 2005, which included a charge that AAC recognized in fourth quarter 2005 related to the sales and impairment of its investments in three of its private investment management firms. Gallagher's portion of the charge using equity method accounting was $3.1 million.

Investment income from low income housing (LIH) investments primarily represents income associated with Gallagher's equity investment in a LIH developer that is accounted for using equity method accounting and interest income from bridge loans made by Gallagher related to LIH developments. Gallagher's interest in the LIH developer was sold in fourth quarter 2006. The decrease in 2006 is substantially due to Gallagher's equity accounting portion of bad debt write- offs ($1.6 million) of the LIH developer that Gallagher recorded in third quarter 2006. The decrease in LIH income in 2005 compared to 2004 was primarily due to the timing of project sale transactions of the LIH developer that generated equity income to Gallagher in 2004.

Investment income from IRC Section 29- related Syn/Coal facilities consists of two pieces: income from three unconsolidated facilities and income from two consolidated facilities. Income from the three unconsolidated facilities relates to the installment sale gains from the sales of Gallagher's interests in limited partnerships that operate IRC Section 29- related Syn/Coal facilities that occurred in 2001, 2002 and 2004. The decrease in income from these investments in 2006 resulted from the estimated reduction in installment sale gains due to the assumed IRC Section 29 phase- out level based on 2006 oil prices. The increase in 2005 compared to 2004 was due to higher Syn/Coal production. Income from the two consolidated facilities relates to Gallagher's 98% and 99% equity interests in two IRC Section 29- related Syn/Coal production facilities that are held by Gallagher to generate IRC Section 29- related Syn/Coal Credits. The increase in income from these investments in 2006 was due to higher production in 2006 than in 2005. The increase in 2005 compared to 2004 was due to partial year ownership and operations in 2004.

Income from other alternative energy investments primarily relates to Gallagher's equity interest in a company and related partnerships that own the rights to waste- to- energy gas emissions (Biogas) from landfills and the wells, infrastructure and a pipeline to capture, distribute and sell Biogas. The decrease in income from these investments in 2006 was due to a $0.7 million decrease in the earnings, using equity method accounting, from the entity that operates the Biogas projects and the pipeline, a $0.4 million reduction in interest income from the same entity due to a conversion of a substantial portion of debt to equity in 2005, a $0.5 million reduction in fees primarily as a result of a catch- up payment received by Gallagher in 2005 as part of the Headwaters Royalty settlement and a $0.5 million reduction in equity accounting income which ceased after the sale of a Biogas project in second quarter 2005. The decrease in income in 2005 compared to 2004 was primarily due to a $1.5 million decrease in the earnings, using equity method accounting, from the entity that operates the Biogas projects and the pipeline and a $0.7 million decrease in Biogas installment sale income, which were offset by a catch- up payment received by Gallagher as part of the Headwaters Royalty settlement.

Investment income from the home office land and building relates to rental income recognized due to Gallagher's 60% ownership interest in a limited partnership that owns the land and building that Gallagher leases for its executive offices and several of its subsidiary operations. Gallagher's indirect interest in the home office land and building was sold in fourth quarter 2006. The decrease in income in 2006 from this investment was primarily due to the limited partnership receiving an early termination fee from an unrelated tenant in first quarter 2005 and another unrelated tenant moving out of the building related to a lease termination in January 2006. Income in 2005 compared to 2004 did not change significantly.

Investment income from the airplane leasing company relates to rental income recognized due to Gallagher's 90% ownership interest in an airplane leasing company that leases two cargo airplanes to the French Postal Service. Gallagher sold its interests in the airplane leasing company on January 25, 2007. The decrease in income from this investment in 2006 was primarily due to the renegotiation of the lease arrangement with the French Postal Service in December 2005. The increase in income in 2005 compared to 2004 was a result of rental income payments being correlated to interest rates, which were rising in 2005.

The impact of FIN 46 from consolidated investments was a result of Gallagher's adoption of FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities". Effective July 1, 2003, Gallagher early adopted FIN 46, which required Gallagher to consolidate a Syn/Coal partnership in which it had a 5% ownership interest at the time of consolidation. Prior to July 1, 2003, this partnership was not consolidated because it was not controlled by Gallagher through a majority voting interest. Gallagher recognized investment income of $69.9 million in 2004 related to the consolidation of the Syn/Coal partnership. During third quarter 2004, Gallagher sold a 4% ownership interest in this investment, which eliminated the requirement to consolidate the investment under the FIN 46 rules. This investment is now accounted for using equity method accounting.

Income from real estate, venture capital and other investments principally relates to Gallagher's portion of the earnings of these entities accounted for using equity method accounting and changes in market value of public company stock. The decrease in income from these investments in 2006 compared to 2005 is primarily due to a decrease in market value of Gallagher's holdings in the stock of a public company ($0.4 million) and a decrease in income to Gallagher under the equity method of accounting for one of the venture capital funds ($0.6 million). The increase in 2005 compared to 2004 is primarily due to an increase in market value of Gallagher's holdings in the stock of a public company ($1.0 million) and a distribution received on a real estate venture ($0.7 million).

Investment gains (losses) primarily include realized gains and losses that occurred in the respective years related to impairments, dispositions and recoveries of venture capital investments and clean energy investments.

During 2006, Gallagher recognized a net investment loss of $25.1 million, the main components of which were as follows: a $2.2 million loss as a result of a fair market value adjustment for the option costs of clean energy related ventures C- Quest Technologies LLC and C- Quest Technologies International LLC, a $2.4 million loss as a result of the write- offs of its equity investments in the C- Quest entities, an $8.5 million loss on an oil price derivative instrument related to IRC Section 29- related investments, a $4.2 million loss on the sale of its 60% interest in the home office land and building, a $3.0 million loss on the sale of its interests in the LIH developer, a $2.7 million loss on the pending sale of its interests in the airplane leasing company and a $2.4 million loss related to the write- down of two waste- to- energy (Biomass) partnerships. The remaining $0.3 million net gain is from other transactions, none of which is greater than $0.2 million.

During 2005, Gallagher recognized a net $3.6 million investment gain related to assets impaired in prior years, the main components of which were as follows: $0.6 million gain on the sale of a shopping center investment, a $2.5 million loss as a result of the write- downs of substantial portions of Gallagher's ownership interests in multi- pollutant reduction ventures Chem- Mod LLC and Chem- Mod International LLC, a $2.1 million dividend from its investment in Allied World Assurance Holdings, Ltd, a $1.3 million gain on the sale of a Biogas project and a $1.2 million gain on a recovery from a Biogas project that had previously been impaired. The remaining $0.9 million net gain is from other transactions, none of which is greater than $0.5 million.

During 2004, Gallagher recognized a net $8.1 million investment gain related to assets impaired in 2003, the main components of which were as follows: a $2.0 million reversal of a loss contingency reserve, a $1.0 million recovery of previously accrued interest income, a $3.0 million recovery of unsecured notes receivable, a $0.5 million gain from a distribution on an investment previously impaired and a $0.7 million gain related to distributions received from a venture capital fund. The remaining $0.9 million net gain is from other transactions, none of which was greater than $0.6 million.

Investment expenses primarily include the operating expenses of the IRC Section 29- related Syn/Coal facilities, including expenses related to the Headwaters Incorporated (Headwaters) royalty. See discussion on litigation related matters below. The investment expenses in 2006 related to the three unconsolidated facilities increased compared to 2005 primarily due to professional fee expenses. The expenses increased in 2005 compared to 2004 due to an increase in production volume. The investment expenses related to the two consolidated facilities was relatively unchanged in 2006 compared to 2005. The increase in 2005 compared to 2004 was due to an increase in production volume.

Investment expenses were also impacted by the adoption of FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities." See discussion on FIN 46 above.

The decrease in investment expenses in 2006 related to compensation, professional fees and other expenses was due to a reduction in incentive compensation and related benefits ($1.8 million), a decrease in corporate overhead ($2.8 million), a decrease in franchise taxes ($0.7 million) and a decrease in professional fees ($1.1 million), which were offset by an increase in operating expenses of the home office facility ($1.2 million). The decrease in 2005 was primarily due to a decrease in incentive compensation and related benefits ($5.8 million) and a decrease in corporate overhead ($2.9 million).

The decrease in interest expense in 2006 compared to 2005 was due to selling a Biogas project in 2005 which had debt ($1.1 million) plus a reduction in interest ($2.0 million) on the Headwaters Royalty settlement paid in first quarter 2006. The increase in 2005 was due primarily to interest on the Headwaters Royalty settlement ($2.0 million) and an increase in interest expense related to the debt of the airplane leasing company due to rising interest rates ($0.5 million).

The decrease in depreciation expense in 2006 compared to 2005 was primarily due to a decrease in depreciation expense of the home office facility ($2.9 million) and at one of the IRC Section 29- related Syn/Coal facilities ($1.0 million). The increase in depreciation expense in 2005 compared to 2004 was primarily due to an increase for the two consolidated facilities ($1.9 million) as Gallagher only owned one of the facilities for a partial year in 2004. The impact of FIN 46 on depreciation only affected 2004.

Litigation related matters in 2005 represented a pretax charge of $131.0 million ($84.2 million after tax) recorded by Gallagher in first quarter 2005. On February 11, 2005, a jury in the Fourth District Court for the State of Utah awarded damages against Gallagher's subsidiary, AJG Financial Services, Inc. (AJGFS), and in favor of Headwaters Incorporated (Headwaters) in the amount of $175.0 million. AJGFS and Headwaters entered into a definitive agreement effective as of May 1, 2005 to settle this and all other litigation between the companies for $50.0 million, which was paid to Headwaters in May 2005. Additionally, AJGFS and Headwaters modified their existing licensing agreement allowing AJGFS to utilize Headwaters' technology on two of AJGFS' synthetic fuel facilities in exchange for (i) $70.0 million, which was paid to Headwaters on January 4, 2006 and (ii) an annual royalty to Headwaters in 2005, 2006 and 2007. The first quarter 2005 litigation charge provides for amounts related to this settlement, including the $120.0 million of settlement costs, together with litigation, bonding and other costs of approximately $11.0 million. In connection with the Headwaters licensing agreement, Gallagher recorded $15.4 million and $14.6 million of royalty expense in 2006 and 2005, respectively, which was included in investment expenses, based on the IRC Section 29- related Syn/Coal production volume and an assumed 36% phase- out. At full production and no phase- out, the maximum annual royalty in 2007 would be equal to $20.0 million of

AJGFS' estimated annual pre- royalty, pretax earnings of $40.0 million from these two facilities. However, the royalties paid to Headwaters in 2007 will again be less than the maximum annual royalty discussed above if oil prices remain at levels in excess of the phase- out levels.

Gallagher anticipates reporting an effective tax rate of approximately 40.0% to 42.0% in both its Brokerage Segment and its Risk Management Segment for the foreseeable future, regardless of historical or future oil prices. In general, the overall effective income tax rate for Gallagher reflects the tax credits generated by investments in limited partnerships that operate alternative energy projects (IRC Section 29) and low income housing, which are partially offset by state and foreign taxes. Gallagher's annual effective tax rate, on a consolidated basis for 2006, was 16.1%, which reflects a partial phase- out of IRC Section 29- related tax credits and adjustments related to uncertain tax positions. During fourth quarter 2006, Gallagher resolved a number of Federal income tax matters related to prior years and revised estimates of its tax reserves. The effective income tax rate reported in 2005 was impacted by the marginal income tax (benefit) effect of the two previously discussed litigation related charges that Gallagher recorded in first quarter 2005. Due to the size and nature of the litigation charges, Gallagher recorded an income tax benefit in 2005 using an effective marginal income tax rate of 40.0% for the Brokerage related litigation charge and 35.7% for the Financial Services related litigation charge. The level of tax credits generated from the production of the IRC Section 29- related Syn/Coal facilities in 2004 resulted in an effective tax rate of 20.0%, which is below the statutory rate.

IRC Section 29 tax credits will expire on December 31, 2007 and, if the law is not extended, Gallagher's consolidated effective tax rate in 2008 is expected to be in the 40.0% to 42.0% range. In addition, through December 31, 2007, IRC Section 29 has a phase- out provision that is triggered when the "Market Wellhead Price" of domestic crude oil reaches certain "Phase- out Prices" as determined by the IRS. The Market Wellhead Prices of domestic crude and the Phase- out Prices as determined by the Internal Revenue Service (IRS) for the last six years are as follows:

	Market Wellhead	Phase- out Price (2)	
Calendar Year	**Price (1)**	**Starts At**	**Fully Phased- Out At**
2000	$ 26.73	$ 48.07	$ 60.34
2001	21.86	49.15	61.70
2002	22.51	49.75	62.45
2003	27.56	50.14	62.94
2004	36.75	51.35	64.47
2005	50.45	53.20	66.78
2006 (estimated based on first ten months 2006)	59.75(3)	55.00	69.00

(1) Market Wellhead Price is the IRS' estimate of the calendar year average wellhead price per barrel for all domestic crude oil, the price of which is not subject to regulation by the U.S. The IRS historically estimates this price based on the monthly average wellhead price of domestic crude oil as published by the Department of Energy as Domestic First Purchase Prices.

(2) Phase- out Prices for 2000 to 2005 as established by the IRS. These Phase- out Prices are based on an inflation adjustment factor. This factor represents the change since calendar year 1979 of the first revision of the implicit price deflator for the gross national product of the U.S. as computed and published by the U.S. Department of Commerce. The IRS will not publish the Phase- out Prices for calendar year 2006 until April 2007. The 2006 Phase- out Prices represent management's best estimate using the latest public information available. There can be no assurance that management's estimated Phase- out Prices will approximate what the IRS ultimately publishes.

(3) This amount represents an estimated Market Wellhead Price. The table below shows the published Market Wellhead Prices through October 2006 (latest month available). November and December prices have been estimated by management. There can be no assurance that management's estimate will approximate what is ultimately published by the Department of Energy or the IRS. The 2006 monthly average prices are as follows:

January	$ 57.82	April	$ 62.51	July	$ 67.72	October	$ 53.26
February	55.69	May	64.31	August	67.21	November	53.52
March	55.22	June	64.36	September	59.36	December	56.27

Oil prices were considerably higher in 2005 than 2004, but still below the 2005 Phase- out Prices. Because oil prices were substantially below the 2005 Phase- out Price, there was no phase- out for 2005. Management estimates that the Market Wellhead Price in 2006 will need to average approximately $55.00 to start a phase- out and average approximately $69.00 for a complete phase- out. The commonly reported crude oil price of futures contracts traded on the New York Mercantile

Exchange (NYMEX Price) for 2006 averaged $66.12. The ending NYMEX Price at December 29, 2006 was $61.05. The NYMEX Price averaged $6.04 above the Market Wellhead Price for calendar year 2005 and is estimated to be approximately $6.18 above the Market Wellhead Price for calendar year 2006. There can be no assurance that future oil prices will average under future phase- out levels. To partially mitigate the financial risk of a phase- out, which reduces the tax credits earned and reduces the installment sale gains from Gallagher's IRC Section 29- Syn/Coal investments, Gallagher has entered into arrangements (described below) in both 2006 and 2007 with unaffiliated third parties, which constitute call spreads on oil futures that create financial hedges that were designed to generate gains to Gallagher in the event of certain levels of increased oil prices.
Using the information in the preceding paragraph, for calendar year 2006, Gallagher estimates that the NYMEX Price would need to average approximately $60.60 per barrel for calendar year 2006 for any phase- out to begin and average approximately $76.10 per barrel for calendar year 2006 for a complete phase- out.
Information regarding IRC Section 29- related Syn/Coal facilities is as follows:

(1) It is not possible for Gallagher to calculate exactly what oil prices will average (as determined by the IRS) for all of calendar year 2006. Accordingly, for purposes of recognizing revenues and expenses related to IRC Section 29- related Syn/Coal investments for 2006 discussed below, Gallagher assumed an average 2006 calendar year NYMEX Price of $66.12. This average produces an IRC Section 29 phase- out of approximately 36% and was determined by using actual daily closing prices from January 1 to December 29, 2006.

(2) Gallagher and its partners continued to operate its three IRC Section 29- related Syn/Coal facilities that historically have generated pretax income, but relatively few tax credits for Gallagher. For 2006, reported revenues and expenses assume a 36% phase- out, whereas there was no such phase- out in 2005.

(3) From January 1 through June 12, 2006, Gallagher did not operate its two IRC Section 29- related Syn/Coal facilities that historically have generated pretax losses yet produce substantially all of Gallagher's IRC Section 29- related Syn/Coal tax credits.

(4) At December 31, 2006, the remaining carrying value of the five facilities and other related assets totaled $8.5 million. Gallagher has historically (and expects to continue to) depreciated/amortized these assets at approximately $2.1 million per quarter. If Gallagher chooses to either permanently shut down the facilities or enter into a significantly prolonged idle period, all or part of this remaining carrying value could become impaired and require a non- cash charge against earnings in the period that such a determination is made.

(5) To partially mitigate the financial risk of a phase- out, which reduces the value of the tax credits earned and reduces the installment sale gains from Gallagher's IRC Section 29- Syn/Coal investments, Gallagher entered into arrangements in both 2006 and 2007 with unaffiliated third parties which constitute call spreads on oil futures to create financial hedges designed to generate gains to Gallagher in the event of certain levels of increased oil prices. These hedges are not intended to be "perfect hedges" for accounting purposes, but are intended to mitigate a substantial portion of the negative impact to Gallagher of increased oil prices. Any oil price derivative gains are designed to offset a portion of the expenses associated with operating Gallagher's IRC Section 29- Syn/Coal facilities in the event of a phase- out of IRC Section 29 tax credits, which phase- outs are based on oil prices averaging certain levels for calendar years 2006 and 2007. Gallagher made an up- front payment of $8.5 million on June 12, 2006 to enter into an oil price derivative, which expired on December 31, 2006. On January 17, 2007, Gallagher made an up- front payment of $2.7 million to enter into another similar oil price derivative, which will be marked to market value each quarter as part of the Financial Services Segment operating results, through the earlier of December 31, 2007, the date the contract expires, or the date the contract is sold.

(6) The information provided above is highly dependent on future events and actual results may differ materially. Significant uncertainty with respect to future events includes, among others, Gallagher's ability to negotiate cost savings with its business associates and partners, available coal stocks and prices, weather, plant operating capacities, oil prices, the actual levels of production by quarter and whether Gallagher elects in the future to pursue hedging strategies. Gallagher cannot at this time predict whether or to what extent it will ultimately be able to benefit from its IRC Section 29- related Syn/Coal facilities nor can Gallagher definitively estimate the revenues, income and/or tax credits that these facilities will provide.

During 2007, Gallagher will monitor the NYMEX Price and decide whether it should continue to produce Syn/Coal. Gallagher's evaluation, in part, will be based on whether Gallagher believes the 2007 price of oil will average a price that will yield Gallagher positive financial results.

Gallagher is an investor in a privately- owned, multi- pollutant reduction venture, Chem- Mod LLC (Chem- Mod) which possesses rights, information and technology for the reduction of unwanted emissions created during the combustion of coal. As reported by Chem- Mod in a press release dated February 8, 2006, Chem- Mod has developed and is the exclusive licensee of a new proprietary emissions technology it refers to as The Chem- Mod Solution, which uses a dual injection sorbent system to reduce mercury, sulfur dioxide and other toxic emissions at coal- fired power plants. Substantial testing of The Chem- Mod Solution has been completed both in a laboratory environment and at five full- scale commercial power plants, all yielding positive test results. Although Chem- Mod is in the early stages of commercializing the technology, the principal potential market for The Chem- Mod Solution is coal- fired power plants owned by utility companies. Chem- Mod has indicated publicly that it believes The Chem- Mod Solution is a more cost- effective technology for reducing emissions in a manner consistent with the Environmental Protection Agency's Clean Air Mercury Rules than other technologies currently in the marketplace. Gallagher, through two wholly- owned subsidiaries, currently owns a 10% equity interest in Chem- Mod, and an option to acquire an additional 32% indirect equity interest in Chem- Mod. In addition, Gallagher, through another wholly- owned subsidiary, currently owns a 20% direct equity interest in Chem- Mod International LLC, the exclusive licensee of The Chem- Mod Solution on a global basis, excluding the U.S. and Canada (Gallagher's interests in Chem- Mod and Chem- Mod International LLC are collectively referred to herein as Chem- Mod Interests). Gallagher first began providing funding to Chem- Mod in June 2004. Currently, Gallagher's carrying value with respect to its Chem- Mod Interests is approximately $0.6 million. Gallagher also has additional funding commitments of approximately $0.8 million. Gallagher's option to acquire the additional 32% indirect equity interest in Chem- Mod is exercisable at any time on or prior to December 31, 2007 at an exercise price of $11.0 million. Chem- Mod and its equityholders are currently evaluating a variety of strategies to maximize value for Chem- Mod's equityholders, including a potential sale. However, there are a number of variables surrounding such strategies, particularly in light of the early stage of Chem- Mod's commercialization efforts. While Gallagher currently believes that its Chem- Mod Interests may prove to have substantial value, there can be no assurance given as to timing or amount, if any, with respect to any realization on this investment.
On April 19, 2006, Gallagher funded $4.7 million related to another clean energy venture formed by the founders of Chem- Mod, C- Quest Technologies LLC (C- Quest). C- Quest possesses rights, information and technology for the reduction of carbon dioxide emissions created by burning fossil fuels. Gallagher, through a wholly- owned subsidiary, currently owns a 5% direct equity interest in C- Quest and has an option to acquire an additional 22% direct interest in C- Quest. In addition, Gallagher, through a wholly- owned subsidiary, currently owns a 5% direct equity interest in C- Quest Technologies International LLC (C- Quest International), and has an option to acquire an additional 22% direct interest in C- Quest International, which possesses rights to use information and technology of C- Quest on a global basis, excluding the U.S. and Canada. Gallagher's options to acquire the additional 22% direct interest in C- Quest and C- Quest International are exercisable at any time on or prior to April 18, 2010 at an exercise price of $5.5 million for each option ($11.0 million total).

Financial Condition and Liquidity

Cash Provided by Operations - Liquidity describes the ability of a company to generate sufficient cash flows to meet the cash requirements of its business operations. The insurance brokerage industry is not capital intensive. Historically, Gallagher's capital requirements have primarily included dividend payments on its common stock, repurchases of its common stock, funding of its investments, acquisitions of brokerage and risk management operations and capital expenditures. The capital used to fund Gallagher's investment portfolio was primarily generated from the excess cash provided by its operations and tax savings generated from tax advantaged investments.
Litigation and retail contingent commission related matters had a substantial negative impact on Gallagher's net cash provided by operating activities in 2005 and first quarter 2006. Such matters are likely to continue to have a substantial unfavorable impact in 2007. As previously discussed, AJGFS has been in the process of reducing its ownership interests in its non- tax advantaged investments, and in 2005, that process was accelerated in anticipation of payments that were needed to be made as a result of the Headwaters litigation matter. The liquidation of AJGFS' investments along with positive net cash flows from AJGFS' operating activities provided enough liquidity to fund the payments related to the Headwaters litigation matter. Gallagher anticipates that any contingent commission matters in 2007 will be funded by net cash flows from operating activities. If net cash flows from operating activities do not provide the necessary cash flow to cover the contingent commission matters, then Gallagher can use borrowings under its Credit Agreement to meet its short- term cash flow needs.
Historically, Gallagher's ability to meet its future cash requirements related to the payments of dividends on its common stock and the repurchases of its common stock substantially depends upon its ability to generate positive cash flows from its operating activities and will continue to do so in the future. However, with respect to Gallagher's future potential cash requirements related to the repurchase of its common stock, Gallagher has occasionally used borrowings under its Credit Agreement to fund such repurchases, and could do so in the future if necessary. Cash provided by operating activities was $104.7 million, $188.8 million and $277.2 million for 2006, 2005 and 2004, respectively. The decrease in cash provided by operating activities in 2006 compared to 2005 was primarily due to the $92.1 million of payments made to Headwaters in first quarter 2006 related to the first quarter 2005 settlement and to the $26.9 million Gallagher paid into a fund in January 2006 to be distributed to certain eligible policyholder clients under the AVC. Gallagher's cash flows from operating activities are primarily derived from its earnings from continuing operations, as adjusted for realized gains and losses and its noncash expenses, which include depreciation, amortization, deferred compensation, restricted stock and stock- based compensation

expenses. The decrease in cash provided by operating activities in 2005 compared to 2004 was primarily due to the $50.0 million payment to Headwaters made in May 2005 related to first quarter 2005 litigation charge of $131.0 million and to Gallagher's $24.5 million funding of the pension plan during 2005. The retail contingent commission related matters charge of $73.6 million and the claims handling obligations charge of $15.0 million did not have a significant impact on cash provided by operating activities in 2005, as the vast majority of these charges were non- cash in 2005. When assessing the overall liquidity of Gallagher, the focus should be on earnings from continuing operations, adjusted for noncash items, in the statement of earnings and cash provided by operating activities in the statement of cash flows as indicators of trends in liquidity. From a balance sheet perspective, the focus should not be on premiums and fees receivable, premiums payable or restricted cash for trends in liquidity. Because of the variability related to the timing of premiums and fees receivable and premiums payable, net cash flows provided by operations will vary substantially from quarter- to- quarter and year- to- year related to these items. In addition, funds restricted as to Gallagher's use, premiums and clients' claim funds held as fiduciary funds, are presented in Gallagher's consolidated balance sheet as "Restricted cash" and have not been included in determining Gallagher's overall liquidity. In order to consider these items in assessing trends in liquidity for Gallagher, they should be looked at in a combined manner, because changes in these balances are interrelated and are based on the timing of premium movement. In assessing the overall liquidity of Gallagher from a balance sheet perspective, it should be noted that at December 31, 2006, Gallagher had no Corporate related borrowings outstanding, a cash and cash equivalent balance of $208.0 million and tangible net worth of $334.4 million. Gallagher has a $450.0 million unsecured multicurrency credit agreement (Credit Agreement) it can use from time- to- time to borrow funds to supplement operating cash flows. Due to outstanding letters of credit, $432.4 million remained available for potential borrowings at December 31, 2006. The Credit Agreement contains various covenants that require Gallagher to maintain specified levels of net worth and financial leverage ratios. Gallagher was in compliance with these covenants at December 31, 2006.

Except for 2005, Gallagher's earnings from continuing operations before income taxes have increased every year since 1991. In 2005, earnings from continuing operations before income taxes were adversely impacted by charges incurred for the litigation and retail contingent commission related matters and the claims handling obligations. Gallagher expects the historically favorable trend in earnings from continuing operations before income taxes to continue in the foreseeable future because it intends to continue to expand its business through organic growth from existing operations and growth through acquisitions. Acquisitions allow Gallagher to expand into desirable businesses and geographic locations, further extend its presence in the retail and wholesale insurance brokerage services industry and increase the volume of general services currently provided. However, management has no plans to substantially change the nature of the services performed by Gallagher. Gallagher believes that it has the ability to adequately fund future acquisitions through the use of cash and/or its common stock.

Another source of liquidity to Gallagher is the issuance of its common stock related to its stock option and employee stock purchase plans. Gallagher has four stock option plans for directors, officers and key employees of Gallagher and its subsidiaries. The options are primarily granted at the fair value of the underlying shares at the date of grant and generally become exercisable at the rate of 10% per year beginning the calendar year after the date of grant. In addition, Gallagher has an employee stock purchase plan which allows Gallagher's employees to purchase its common stock at 85% of its fair market value. Proceeds from the issuance of its common stock related to these plans have contributed favorably to net cash provided by financing activities and Gallagher believes this favorable trend will continue in the foreseeable future.

Currently, Gallagher believes it has sufficient capital to meet its cash flow needs. However, in the event that Gallagher needs capital to fund its operations and its investing and common stock repurchase requirements, it would use borrowings under its Credit Agreement to meet its short- term needs and would consider other alternatives for its long- term needs. Such alternatives would include raising capital through public markets or restructuring its operations in the event that cash flows from operations are reduced dramatically due to lost business. However, Gallagher has historically been profitable and cash flows from operations and short- term borrowings under its Credit Agreement have been sufficient to fund Gallagher's operating, investment and capital expenditure needs.

Dividends - In 2006 Gallagher declared $117.2 million in cash dividends on its common stock, or $1.20 per common share. Gallagher's dividend policy is determined by the Board of Directors. Quarterly dividends are declared after considering Gallagher's available cash from earnings and its anticipated cash needs. On January 12, 2007, Gallagher paid a fourth quarter dividend of $.30 per common share to shareholders of record at December 31, 2006, a 7% increase over the fourth quarter dividend per share in 2005. On January 18, 2007, Gallagher announced an increase in its quarterly dividend for the first quarter of 2007 from $.30 to $.31 per common share, a 3.3% increase over 2006. If each quarterly dividend in 2007 is $.31 per common share, this increase in the dividend will result in an annualized increase in the net cash used by financing activities in 2007 of approximately $4.0 million.

Capital Expenditures - Net capital expenditures were $33.0 million, $22.8 million and $29.0 million for 2006, 2005 and 2004, respectively. In 2007, Gallagher expects total expenditures for capital improvements to be approximately $40.0 million, primarily related to office moves and expansions and updating computer systems and equipment. The increase in net capital expenditures in 2006 primarily relates to capitalized costs associated with the implementation of a new human resource management system and several other system initiatives.

Common Stock Repurchases - Gallagher has a common stock repurchase plan that has been approved by the Board of Directors. Under the plan, Gallagher repurchased 1.1 million shares at a cost of $31.3 million and 1.8 million shares at a cost of $51.8 million in 2006 and 2004, respectively. Gallagher did not repurchase any shares under the plan in 2005. The reduction in shares repurchased in 2005 as compared to 2004 was primarily due to anticipated cash needs to fund the Headwaters and AVC related payments in 2005 and 2006. Repurchased shares are held for reissuance in connection with its equity compensation and stock option plans. Under the provisions of the repurchase plan, as of December 31, 2006, Gallagher was authorized to repurchase approximately 3.9 million additional shares. On January 18, 2007, Gallagher announced the continuation of the repurchase plan, bringing the cumulative total repurchase authorization to 5.0 million shares. Gallagher is under no commitment or obligation to repurchase any particular amount of common stock and at its discretion may suspend the repurchase plan at any time. The common stock repurchases reported in the consolidated statement of cash flows for 2006 also include 23,000 shares (at a cost of $0.7 million) that were repurchased by Gallagher to settle escrow obligations in connection with two acquisitions made prior to 2006 and 47,000 shares (at a cost of $1.3 million) that were repurchased by Gallagher to cover employee income tax withholding obligations in connection with 2006 restricted stock distributions. The common stock repurchases reported in the consolidated statement of cash flows for 2005 represent 76,000 shares (at a cost of $2.2 million) that were repurchased by Gallagher to cover employee income tax withholding obligations in connection with 2005 restricted stock distributions. The common stock repurchases reported in the consolidated statement of cash flows for 2004 also include 25,000 shares (at a cost of $2.2 million) that were repurchased by Gallagher to settle escrow obligations in connection with acquisitions made prior to 2004 and 25,000 shares (at a cost of $2.2 million) that were repurchased by Gallagher to cover employee income tax withholding obligations in connection with 2004 restricted stock distributions.

Acquisitions - Cash paid for acquisitions, net of cash acquired, was $80.8 million, $32.9 million and $112.8 million in 2006, 2005 and 2004, respectively. While stock is Gallagher's preferred "currency" for acquisitions, cash in lieu of stock was used in order to complete a significant portion of the acquisitions in 2006, 2005 and 2004. The increased use of cash for acquisitions in 2004 and 2006 correlates with the reduction in common stock repurchases in the period 2004 to 2006. Gallagher completed eleven, ten and nineteen acquisitions in 2006, 2005 and 2004, respectively.

During 2006, Gallagher issued 0.2 million shares of its common stock, paid $8.9 million in cash and accrued $7.0 million in current liabilities related to earnout obligations of fifteen acquisitions made prior to 2006 and recorded additional goodwill of $17.0 million. During 2005, Gallagher issued 0.4 million shares of its common stock and paid $1.8 million in cash and accrued $2.7 million in current liabilities related to earnout obligations of eight acquisitions made prior to 2005 and recorded additional goodwill of $15.3 million. During 2004, Gallagher paid $2.3 million in cash related to earnout obligations of three acquisitions made prior to 2004 and recorded additional goodwill and expiration lists of $1.8 million and $0.5 million, respectively.

Dispositions - In first quarter 2005, Gallagher entered into an agreement to sell the net assets of Northshore International Insurance Services (NiiS), a medical claims management and auditing services provider, for cash of $4.8 million. Gallagher recognized a pretax loss of $12.7 million ($12.3 million after tax loss) in first quarter 2005 in connection with the sale. Also, in first quarter 2005, Gallagher entered into an agreement to sell all of the stock of Gallagher Benefit Administrators, Inc. (GBA), a third party employee benefit claim payment administrator, for cash of $9.2 million and a promissory note in the amount of $4.4 million. Gallagher recognized a pretax gain of $9.6 million ($6.8 million after tax gain) in first quarter 2005 in connection with the sale. The promissory note has a 10% fixed rate of interest, with interest only payments payable monthly through August 22, 2007, when the note matures. In second quarter 2005, Gallagher sold its ownership interests in the limited partnership that owns the Florida Community Development investment. Pursuant to the transaction, Gallagher received cash of $25.7 million and recorded a pretax gain of $12.6 million ($7.6 million after tax gain) in second quarter 2005 in connection with the sale. See Note 5 to the Consolidated Financial Statements for an additional discussion on the 2005 business dispositions.

On December 7, 2006, the real estate partnership that owned Gallagher's home office land and building, in which Gallagher has a 60% ownership interest, sold Gallagher's home office land and building. As a result of the sale, Gallagher received cash proceeds of $7.9 million, extinguished related debt of $75.2 million and recognized a $4.2 million pretax loss in the Financial Services Segment.

Contractual Obligations and Commitments

In connection with its investing and operating activities, Gallagher has entered into certain contractual obligations as well as funding commitments and financial guarantees. See Notes 3, 8 and 17 to the Consolidated Financial Statements for additional discussion of these obligations and commitments. Gallagher's future minimum cash payments, excluding interest, associated with its contractual obligations pursuant to its Credit Agreement, investment related borrowings, operating leases and purchase commitments at December 31, 2006 were as follows (in millions):

	Payments Due by Period						
Contractual Obligations	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**	**Total**
Credit Agreement	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Investment related borrowings:							
Airplane leasing company debt	2.1	2.2	2.3	2.5	18.9	-	28.0
Syn/Coal facility purchase note	6.8	-	-	-	-	-	6.8
Total debt obligations	8.9	2.2	2.3	2.5	18.9	-	34.8
Operating lease obligations	58.6	51.6	43.3	37.7	30.3	63.1	284.6
Net Syn/Coal purchase commitments	3.1	-	-	-	-	-	3.1
Outstanding purchase obligations	3.3	-	-	-	-	-	3.3
Total contractual obligations	$ 73.9	$ 53.8	$ 45.6	$ 40.2	$ 49.2	$ 63.1	$ 325.8

The amounts presented in the table above may not necessarily reflect the actual future cash funding requirements of Gallagher, because the actual timing of the future payments made may vary from the stated contractual obligation.

Credit Agreement - Gallagher has a $450.0 million Credit Agreement it uses to post standby or commercial letters of credit (LOCs) and that it can use from time- to- time to borrow funds to supplement operating cash flows. At December 31, 2006, $17.6 million of LOCs (of which Gallagher has $6.5 million of liabilities recorded as of December 31, 2006) were outstanding under the Credit Agreement, some of which related to Gallagher's investments as discussed in Note 3 to the Consolidated Financial Statements. There were no borrowings outstanding under the Credit Agreement at December 31, 2006. Accordingly, as of December 31, 2006, $432.4 million remained available for potential borrowings, of which $107.4 million may be in the form of additional LOCs. Gallagher is under no obligation to utilize the Credit Agreement in performing its normal business operations. See Note 8 to the Consolidated Financial Statements for a discussion of the terms of the Credit Agreement.

Investment Related Borrowings - As more fully described in Notes 3 and 8 to the Consolidated Financial Statements, at December 31, 2006, the accompanying balance sheet includes $34.8 million of borrowings related to Gallagher's investment related enterprises, none of which is recourse to Gallagher. These borrowings are partially secured by the underlying assets of the investment enterprises and support their operations.

Operating Lease Obligations - Gallagher generally operates in leased premises. Certain office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain annual escalation clauses, which are generally related to increases in an inflation index.

Net Syn/Coal Purchase Commitments - Gallagher has interests in two IRC Section 29- related Syn/Coal facilities that it consolidates. See Note 3 to the Consolidated Financial Statements for additional disclosures regarding these partnerships. The facilities have entered into raw coal purchase and IRC Section 29- related Syn/Coal sales agreements. These agreements terminate immediately in the event the IRC Section 29- related Syn/Coal produced ceases to qualify for credits under IRC Section 29 or upon termination of either the purchase or sales agreements. The net annual IRC Section 29- related Syn/Coal purchase commitments represent the minimum raw coal purchases at estimated costs less sales of IRC Section 29- related Syn/Coal at estimated prices.

Outstanding Purchase Obligations - Gallagher is a service company and thus typically does not have a material amount of outstanding purchase obligations at any point in time. The amount disclosed in the contractual obligations table above represents the aggregate amount of unrecorded purchase obligations that Gallagher has outstanding as of December 31, 2006. These obligations represent agreements to purchase goods or services that were executed in the normal course of business.

Off- Balance Sheet Arrangements

Off- Balance Sheet Commitments - Gallagher's total unrecorded commitments associated with outstanding LOCs, financial guarantees and funding commitments as of December 31, 2006 were as follows (in millions):

	Amount of Commitment Expiration by Period						
Off- Balance Sheet Commitments	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**	**Total Amounts Committed**
Investment related:							
Letters of credit	$ 1.0	$ -	$ -	$ -	$ -	$ 16.6	$ 17.6
Funding commitments	0.8	0.4	0.6	-	-	-	1.8
Total commitments	$ 1.8	$ 0.4	$ 0.6	$ -	$ -	$ 16.6	$ 19.4

At December 31, 2006, Gallagher had no off- balance sheet commitments related to its Risk Management operations. Since commitments may expire unused, the amounts presented in the table above do not necessarily reflect the actual future cash funding requirements of Gallagher. See Notes 3 and 17 to the Consolidated Financial Statements for a discussion of Gallagher's outstanding LOCs, financial guarantees and funding commitments. All of the LOCs represent multiple year commitments and have annual, automatic renewing provisions and are classified by the latest commitment date.

Since January 1, 2002, Gallagher acquired sixty- four companies, which were accounted for as business combinations. Substantially all of the purchase agreements related to these acquisitions contain earnout obligations. The earnout obligations related to the 2006 acquisitions are disclosed in Note 4 to the Consolidated Financial Statements. These earnout payables represent the maximum amount of additional consideration that could be paid pursuant to the purchase agreements related to these acquisitions. These potential earnout obligations are primarily based upon future earnings of the acquired entities and were not included in the purchase price that was recorded for these acquisitions at their respective acquisition dates. Future payments made under these arrangements will generally be recorded as additional goodwill when the earnouts are settled. The aggregate amount of unrecorded earnout payables outstanding as of December 31, 2006 was $73.9 million and related to acquisitions made by Gallagher in the period from 2003 to 2006.

Off- Balance Sheet Debt - Gallagher's unconsolidated investment portfolio includes investments in enterprises where Gallagher's ownership interest is between 1% and 50%, whereby management has determined that Gallagher's level of economic interest is not sufficient to require consolidation. As a result, these investments are accounted for using either the lower of amortized cost/cost or fair value, or the equity method, as appropriate, depending on the legal form of Gallagher's ownership interest and the applicable percentage of the entity owned. As such, the balance sheets of these investees are not consolidated in Gallagher's consolidated balance sheet at December 31, 2006 and 2005. The December 31, 2006 and 2005 balance sheets of several of these unconsolidated investments contain outstanding debt, which are also not required to be included in Gallagher's consolidated balance sheet.

Based on the ownership structure of these investments, management believes that Gallagher's exposure to losses related to these investments is limited to the combination of its net carrying value, funding commitments and LOCs. In the event that certain of these enterprises were to default on their debt obligations and Gallagher's net carrying value became impaired, the amount to be impaired could have a material effect on Gallagher's consolidated operating results and/or financial position. See Notes 3 and 17 to the Consolidated Financial Statements.

In addition to obligations and commitments related to Gallagher's investing activities discussed above, at December 31, 2006, Gallagher has posted an LOC of $6.5 million for the benefit of an insurance company related to Gallagher's self- insurance deductibles, for which it has a recorded liability of $6.5 million. Gallagher has an equity investment in a rent- a- captive facility, formed in 1997, which Gallagher uses as a placement facility for certain of its insurance brokerage operations. At December 31, 2006, Gallagher has posted $5.7 million of LOCs to allow the rent- a- captive to meet minimum statutory surplus requirements and for additional collateral related to premium and claim funds held in a fiduciary capacity. These LOCs have never been drawn upon.

Quantitative and Qualitative Disclosure about Market Risk

Gallagher is exposed to various market risks in its day- to- day operations. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest and foreign currency exchange rates and equity prices. The following analyses present the hypothetical loss in fair value of the financial instruments held by Gallagher at December 31, 2006 that are sensitive to changes in interest rates and equity prices. The range of changes in interest rates used in the analyses reflects Gallagher's view of changes that are reasonably possible over a one- year period. This discussion of market risks related to Gallagher's consolidated balance sheet includes estimates of future economic environments caused by changes in market risks. The effect of actual changes in these risk factors may differ materially from Gallagher's estimates. In the ordinary course of business, Gallagher also faces risks that are either nonfinancial or unquantifiable, including credit risk and legal risk. These risks are not included in the following analyses.

Gallagher's invested assets are primarily held as cash and cash equivalents, which are subject to various market risk exposures such as interest rate risk. The fair value of Gallagher's cash and cash equivalents investment portfolio at December 31, 2006 approximated its carrying value due to its short- term duration. Market risk was estimated as the potential decrease in fair value resulting from a hypothetical one percentage point increase in interest rates for the instruments contained in the cash and cash equivalents investment portfolio. The resulting fair values were not materially different from the carrying values at December 31, 2006.

Gallagher has other investments that have valuations that are indirectly influenced by equity market and general economic conditions that can change rapidly. In addition, some investments require direct and active financial and operational support from Gallagher. A future material adverse effect may result from changes in market conditions or if Gallagher elects to withdraw financial or operational support.

During 2006, Gallagher had an arrangement with an unaffiliated third party which constituted a call spread on oil futures that created a financial hedge that was designed to generate gains to Gallagher in the event of certain levels of increased oil prices. This hedge was not intended to be a "perfect hedge" for accounting purposes, but was intended to mitigate a substantial portion of the negative impact to Gallagher of increased oil prices. Any hedging gains were designed to offset a portion of the expenses associated with operating Gallagher's IRC Section 29- Syn/Coal facilities in the event of a phase- out of IRC Section 29 tax credits, which phase- outs were based on oil prices averaging certain levels for calendar year 2006. Gallagher made an up- front payment of $8.5 million to enter into this financial hedge, which was marked to market value each period with the resulting unrealized gain/loss included in Gallagher's operating results. The oil price derivative expired on December 31, 2006 and resulted in a loss of $8.5 million that was included in Gallagher's Financial Services Segment operating results for 2006. On January 17, 2007, Gallagher entered into a similar arrangement with an unaffiliated third party which constitutes a call spread on oil futures to create a financial hedge that is designed to generate gains to Gallagher in the event of certain levels of increased oil prices. Gallagher made an up- front payment of $2.7 million to enter into this financial hedge, which will be marked to market value each quarter as part of the Financial Services Segment operating results, through December 31, 2007, the date the contract expires or the date the contract is sold. If the average NYMEX price per barrel of oil is less than $68.00 for 2007 and Gallagher holds it for the duration of the contract, the financial hedge will result in a loss to Gallagher of $2.7 million in 2007. The NYMEX oil price on January 25, 2007 was $54.23 and the 2007 year- to- date average NYMEX oil price through January 25, 2007 was $54.23 (20.3% below $68.00).

At December 31, 2006, Gallagher had no borrowings outstanding under its Credit Agreement. However, in the event that Gallagher does have borrowings outstanding, the fair value of these borrowings would likely approximate their carrying value due to their short- term duration and variable interest rates. The market risk would be estimated as the potential increase in the fair value resulting from a hypothetical one- percentage point decrease in Gallagher's weighted average short- term borrowing rate at December 31, 2006 and the resulting fair values would not be materially different from its carrying value.

Gallagher is subject to foreign currency exchange rate risk primarily from its U.K. based subsidiaries that incur expenses denominated primarily in British pounds while receiving a substantial portion of their revenues in U.S. dollars. Foreign currency gains (losses) related to this market risk are recorded in earnings from continuing operations before income taxes as they are incurred. Assuming a hypothetical adverse change of 10% in the average foreign currency exchange rate for 2006 (a weakening of the U.S. dollar), earnings from continuing operations before income taxes would decrease by approximately $12.9 million. Gallagher is also subject to foreign currency exchange rate risk associated with the translation of its foreign subsidiaries into U.S. dollars. However, it is management's opinion that this foreign currency exchange risk is not material to Gallagher's consolidated operating results or financial position. Gallagher manages the balance sheet of its foreign subsidiaries, where possible, such that foreign liabilities are matched with equal foreign assets thereby maintaining a "balanced book" which minimizes the effects of currency fluctuations. With respect to managing foreign currency exchange rate risk, Gallagher had a foreign currency hedging strategy in place in 2006 and 2005 to minimize its exposure to this risk. The impact of this hedging strategy was not material to Gallagher's Consolidated Financial Statements for 2006 or 2005.

Arthur J. Gallagher & Co.
Consolidated Statement of Earnings
(In millions, except per share data)

	Year Ended December 31, 2006	2005	2004
Commissions	$ 849.5	$ 784.3	$ 726.8
Retail contingent commissions	2.5	28.8	33.8
Fees	585.8	537.5	490.0
Investment income - Brokerage and Risk Management	34.2	20.8	15.1
Investment income - Financial Services	87.1	108.9	163.2
Investment gains (losses)	(25.1)	3.6	8.1
Total revenues	1,534.0	1,483.9	1,437.0
Compensation	880.9	789.9	714.8
Operating	322.4	322.3	267.9
Investment expenses	103.7	104.9	157.1
Interest	8.5	11.6	9.5
Depreciation	31.8	32.7	32.7
Amortization	24.6	20.7	17.7
Litigation related matters	-	131.0	-
Retail contingent commission related matters	9.0	73.6	-
Total expenses	1,380.9	1,486.7	1,199.7
Earnings (loss) from continuing operations before income taxes	153.1	(2.8)	237.3
Provision (benefit) for income taxes	24.6	(31.4)	47.8
Earnings from continuing operations	128.5	28.6	189.5
Discontinued operations:			
Earnings (loss) from discontinued operations before income taxes	-	0.2	(1.8)
Gain on disposal of operations	-	9.5	-
Provision (benefit) for income taxes	-	7.5	(0.8)
Earnings (loss) from discontinued operations	-	2.2	(1.0)
Net earnings	$ 128.5	$ 30.8	$ 188.5
Basic net earnings (loss) per share:			
Earnings from continuing operations	$ 1.32	$ .30	$ 2.07
Earnings (loss) from discontinued operations	-	.03	(.01)
Net earnings	$ 1.32	$ .33	$ 2.06
Diluted net earnings (loss) per share:			
Earnings from continuing operations	$ 1.31	$ .30	$ 2.00
Earnings (loss) from discontinued operations	-	.02	(.01)
Net earnings	$ 1.31	$ .32	$ 1.99

Dividends declared per common share	$ 1.20	$ 1.12	$ 1.00

See notes to consolidated financial statements.

Arthur J. Gallagher & Co.
Consolidated Balance Sheet
(In millions)

	December 31,	
	2006	2005
Cash and cash equivalents	$ 208.0	$ 317.8
Restricted cash	588.9	518.3
Unconsolidated investments - current	49.2	43.2
Premiums and fees receivable	1,422.3	1,396.8
Other current assets	107.8	125.7
Total current assets	2,376.2	2,401.8
Unconsolidated investments - noncurrent	32.5	68.2
Fixed assets related to consolidated investments - net	32.5	126.0
Other fixed assets - net	70.6	59.1
Deferred income taxes	286.8	236.1
Other noncurrent assets	91.8	80.1
Goodwill - net	316.6	245.7
Amortizable intangible assets - net	213.1	172.5
Total assets	$ 3,420.1	$ 3,389.5
Premiums payable to insurance and reinsurance companies	$ 1,958.8	$ 1,917.4
Accrued compensation and other accrued liabilities	316.4	378.3
Unearned fees	39.7	35.7
Income taxes payable	51.0	24.6
Other current liabilities	26.5	25.0
Corporate related borrowings	-	-
Investment related borrowings - current	8.9	5.3
Total current liabilities	2,401.3	2,386.3
Investment related borrowings - noncurrent	25.9	107.6
Other noncurrent liabilities	128.8	126.5
Total liabilities	2,556.0	2,620.4
Stockholders' equity:		
Common stock - issued and outstanding 98.4 shares in 2006 and 95.7 shares in 2005	98.4	95.7
Capital in excess of par value	285.7	216.3
Retained earnings	475.0	463.7
Accumulated other comprehensive earnings (loss)	5.0	(6.6)
Total stockholders' equity	864.1	769.1
Total liabilities and stockholders' equity	$ 3,420.1	$ 3,389.5

See notes to consolidated financial statements.

Arthur J. Gallagher & Co.
Consolidated Statement of Cash Flows
(In millions)

	Year Ended December 31, 2006	2005	2004
Cash flows from operating activities:			
Earnings from continuing operations	$ 128.5	$ 28.6	$ 189.5
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities:			
Net loss (gain) on investments and other	25.1	(3.6)	(8.1)
Depreciation and amortization	56.4	53.4	53.3
Amortization of deferred compensation and restricted stock	8.6	7.2	10.0
Stock- based compensation expense	16.0	8.9	5.6
Increase in restricted cash	(55.7)	(29.4)	(51.3)
Increase in premiums receivable	(1.1)	(51.0)	(32.8)
Increase in premiums payable	16.1	67.2	61.8
Decrease in trading securities - net	-	-	5.9
(Increase) decrease in other current assets	(10.8)	6.9	22.6
Net change in accrued compensation and other accrued liabilities	(50.9)	105.6	45.4
Net change in fees receivable/unearned fees	(9.8)	14.9	(9.7)
Net change in income taxes payable	26.4	(0.2)	0.5
Tax benefit from issuance of common stock	-	10.6	17.6
Net change in deferred income taxes	(41.1)	(84.0)	(45.9)
Other	(3.0)	61.0	13.8
Net cash provided by operating activities of continuing operations	104.7	196.1	278.2
Earnings (loss) from discontinued operations	-	2.2	(1.0)
Net gain on sales of discontinued operations	-	(9.5)	-
Net cash provided by operating activities	104.7	188.8	277.2
Cash flows from investing activities:			
Net additions to fixed assets	(33.0)	(22.8)	(29.0)
Cash paid for acquisitions, net of cash acquired	(80.8)	(32.9)	(112.8)
Proceeds from sales of discontinued operations	-	37.6	-
Proceeds from sale of consolidated operation	7.9	-	-
Net proceeds from investment transactions	10.0	3.5	2.8
Net cash used by investing activities	(95.9)	(14.6)	(139.0)
Cash flows from financing activities:			
Proceeds from issuance of common stock	24.1	28.1	30.6
Tax benefit from issuance of common stock	7.9	-	-
Repurchases of common stock	(33.3)	(2.2)	(56.2)
Dividends paid	(114.4)	(102.3)	(84.9)
Borrowings on line of credit facilities	37.0	1.9	12.9
Repayments on line of credit facilities	(37.0)	(0.1)	-
Borrowings of long- term debt	-	0.1	-
Repayments of long- term debt	(2.9)	(6.5)	(9.6)
Net cash used by financing activities	(118.6)	(81.0)	(107.2)
Net (decrease) increase in cash and cash equivalents	(109.8)	93.2	31.0
	317.8	224.6	193.6

Cash and cash equivalents at beginning of year			
Cash and cash equivalents at end of year	$ 208.0	$ 317.8	$ 224.6
Supplemental disclosures of cash flow information:			
Interest paid	$ 9.3	$ 12.7	$ 11.5
Income taxes paid	30.6	47.0	71.3

See notes to consolidated financial statements.

Arthur J. Gallagher & Co.
Consolidated Statement of Stockholders' Equity
(In millions)

	Common Stock		Capital in Excess of	Retained	Accumulated Other Comprehensive Earnings	
	Shares	Amount	Par Value	Earnings	(Loss)	Total
Balance at December 31, 2003	90.0	$ 90.0	$ 86.8	$ 442.3	$ -	$ 619.1
Comprehensive and net earnings	-	-	-	188.5	-	188.5
Compensation expense related to stock option plan grants	-	-	5.6	-	-	5.6
Tax benefit from issuance of common stock	-	-	17.6	-	-	17.6
Common stock issued in:						
Twelve purchase transactions	1.2	1.2	36.4	-	-	37.6
Stock option plans	2.2	2.2	20.2	-	-	22.4
Employee stock purchase plan	0.3	0.3	7.9	-	-	8.2
Deferred compensation	0.1	0.1	1.6	-	-	1.7
Restricted stock	0.1	0.1	8.2	-	-	8.3
Common stock repurchases	(1.8)	(1.8)	(54.4)	-	-	(56.2)
Cash dividends declared on common stock	-	-	-	(91.8)	-	(91.8)
Balance at December 31, 2004	92.1	92.1	129.9	539.0	-	761.0
Net earnings	-	-	-	30.8	-	30.8
Net change in pension asset/liability, net of taxes of $4.0 million	-	-	-	-	(6.2)	(6.2)
hedge, net of taxes of $0.2 million	-	-	-	-	(0.4)	(0.4)
Comprehensive earnings						24.2
Compensation expense related to stock option plan grants	-	-	8.9	-	-	8.9
Tax benefit from issuance of common stock	-	-	10.6	-	-	10.6
Common stock issued in:						
Eleven purchase transactions	1.3	1.3	36.1	-	-	37.4
Stock option plans	1.6	1.6	17.8	-	-	19.4
Employee stock purchase plan	0.4	0.4	8.3	-	-	8.7
Deferred compensation	0.2	0.2	2.1	-	-	2.3

Restricted stock	0.2	0.2	4.7	-	-	4.9
Common stock repurchases	(0.1)	(0.1)	(2.1)	-	-	(2.2)
Cash dividends declared on common stock	-	-	-	(106.1)	-	(106.1)
Balance at December 31, 2005	95.7	95.7	216.3	463.7	(6.6)	769.1
Net earnings	-	-	-	128.5	-	128.5
Net change in pension asset/liability, net of taxes of $7.4 million	-	-	-	-	11.2	11.2
Net change in value of foreign hedge, net of taxes of $0.2 million	-	-	-	-	0.4	0.4
Comprehensive earnings						140.1
Compensation expense related to stock option plan grants	-	-	15.7	-	-	15.7
Tax benefit from issuance of common stock	-	-	7.9	-	-	7.9
Common stock issued in:						
Thirteen purchase transactions	1.8	1.8	47.3	-	-	49.1
Stock option plans	1.3	1.3	14.0	-	-	15.3
Employee stock purchase plan	0.4	0.4	8.4	-	-	8.8
Deferred compensation	0.2	0.2	2.4	-	-	2.6
Restricted stock	0.2	0.2	5.8	-	-	6.0
Common stock repurchases	(1.2)	(1.2)	(32.1)	-	-	(33.3)
Cash dividends declared on common stock	-	-	-	(117.2)	-	(117.2)
Balance at December 31, 2006	98.4	$ 98.4	$ 285.7	$ 475.0	$ 5.0	$ 864.1

See notes to consolidated financial statements.

Arthur J. Gallagher & Co.
Notes to Consolidated Financial Statements
December 31, 2006

1. Summary of Significant Accounting Policies

Nature of Operations - Arthur J. Gallagher & Co. (Gallagher) provides insurance brokerage and risk management services to a wide variety of commercial, industrial, institutional and governmental organizations. Commission revenue is principally generated through the negotiation and placement of insurance for its clients. Fee revenue is primarily generated by providing other risk management services including claims management, information management, risk control services and appraisals in either the property/casualty (P/C) market or the human resource/employee benefit market. Investment income and other revenue is generated from Gallagher's investment portfolio, which includes fiduciary funds, tax advantaged investments, real estate partnerships and other investments. Gallagher is headquartered in Itasca, Illinois, has operations in seven countries and does business in 120 countries globally through a network of correspondent brokers and consultants.

Basis of Presentation - The accompanying consolidated financial statements include the accounts of Gallagher and all of its majority owned subsidiaries (50% or greater ownership). Substantially all of Gallagher's investments in partially owned entities in which Gallagher's ownership is less than 50% are accounted for using either the lower of amortized cost/cost or fair value, or the equity method, as appropriate, depending on the legal form of Gallagher's ownership interest and the applicable ownership percentage of the entity. For partially owned entities accounted for using the equity method, Gallagher's share of the net earnings of these entities is included in consolidated net earnings. All material intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior years' financial statements in order to conform to the current year presentation.

Use of Estimates - The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein.

Revenue Recognition - Gallagher's revenues are derived from commissions, fees and investment income.

Commission revenues are recognized at the latter of the billing or the effective date of the related insurance policies, net of an allowance for estimated policy cancellations. Commission revenues related to installment premiums are recognized periodically as billed. Contingent commissions and commissions on premiums directly billed by insurance carriers are recognized as revenue when the data necessary to reasonably determine such amounts has been obtained by Gallagher. Typically, these types of commission revenues cannot be reasonably determined until the cash or the related policy detail is received by Gallagher from the insurance carriers. A contingent commission is a commission paid by an insurance carrier that is based on the overall profit and/or volume of the business placed with that insurance carrier. Commissions on premiums billed directly by insurance carriers to the insureds generally relate to a large number of small premium P/C transactions and a substantial portion of the revenues generated by Gallagher's employee benefit operations. Under these direct bill arrangements the billing and policy issuance process is controlled entirely by the insurance carrier. The income effects of subsequent premium adjustments are recorded when the adjustments become known.

Fee revenues generated from the Brokerage Segment primarily relate to fees negotiated in lieu of commissions, which are recognized in the same manner as commission revenues. Fee revenues generated from the Risk Management Segment relate to third party claims administration, loss control and other risk management consulting services, which are provided over a period of time, typically one year. These fee revenues are recognized ratably as the services are rendered. The income effects of subsequent fee adjustments are recorded when the adjustments become known.

Brokerage expense is deducted from gross revenues in the determination of Gallagher's total revenues. Brokerage expense represents commissions paid to sub- brokers related to the placement of certain business by Gallagher's Brokerage Services- Retail Division. This expense is recognized in the same manner as commission revenues.

Premiums and fees receivable in the accompanying consolidated balance sheet are net of allowances for estimated policy cancellations and doubtful accounts. The allowance for estimated policy cancellations was $4.9 million at December 31, 2006 and 2005, which represents a reserve for future reversals in commission and fee revenues related to the potential cancellation of client insurance policies that were in force as of year- end. The allowance for doubtful accounts was $7.5 million and $6.7 million at December 31, 2006 and 2005, respectively. The allowance for estimated policy cancellations is established through a charge to revenues, while the allowance for doubtful accounts is established through a charge to other operating expenses. Both of these allowances are based on estimates and assumptions using historical data to project future experience. Gallagher periodically reviews the adequacy of these allowances and makes adjustments as necessary. The use of different estimates or assumptions could produce different results.

Investment income primarily includes interest income, dividend income, net realized and unrealized gains (losses), income (loss) from equity investments, installment gains, income from consolidated investments and gains on sales of operations. Interest income is recorded as earned. Income (loss) from equity investments represents Gallagher's proportionate share of income or losses from investments accounted for using the equity method.

Claims Handling Obligations - Based on legal interpretations and accounting guidance issued by the Institute of Chartered Accountants in the U.K. in 2004, Gallagher reassessed its obligations in 2005 to provide future claims handling and certain administrative services for reinsurance brokerage clients. This guidance, which is referred to as FRS 5, was first applicable in 2004 and is specifically directed to insurance brokers engaged in the industry practice of providing clients future claims handling and administrative services. Based on a detailed review of its reinsurance brokerage operations in both the U.S. and U.K. that was completed in 2005, its current accounting practices for these operations and legal interpretations, Gallagher determined that under certain circumstances, it is obligated to provide future claims handling and certain administrative services based on its current business practices. Accordingly, a liability of $15.0 million has been accrued in the accompanying December 31, 2006 and 2005 consolidated balance sheet based on the estimated costs to provide these future services to former clients. This liability is based on estimates and assumptions using historical data to project future experience. Gallagher periodically reviews the adequacy of this liability and will make adjustments as necessary. The use of different estimates or assumptions could produce different results.

Earnings per Share - Basic net earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding during the reporting period. Diluted net earnings per share is computed by dividing net earnings by the weighted average number of common and common equivalent shares outstanding during the reporting period. Common equivalent shares include incremental shares from dilutive stock options, which are calculated from the date of grant under the treasury stock method using the average market price for the period.

Cash and Cash Equivalents - Short- term investments, consisting principally of commercial paper and certificates of deposit that have a maturity of 90 days or less at date of purchase, are considered cash equivalents.

Restricted Cash - In its capacity as an insurance broker, Gallagher collects premiums from insureds and, after deducting its commissions and/or fees, remits these premiums to insurance carriers. Unremitted insurance premiums are held in a fiduciary capacity until disbursed by Gallagher and are restricted as to use by laws in certain states and foreign jurisdictions in which Gallagher's subsidiaries operate. Various state and foreign agencies regulate insurance brokers and provide specific requirements that limit the type of investments that may be made with such funds. Accordingly, Gallagher invests these funds in cash, money market accounts, commercial paper and certificates of deposit. Gallagher earns interest income on these unremitted funds, which is included in investment income - Brokerage and Risk Management in the accompanying consolidated statement of earnings. These unremitted amounts are reported as restricted cash in the accompanying consolidated balance sheet, with the related liability reported as premiums payable to insurance carriers. Additionally, several of Gallagher's foreign subsidiaries are required by various foreign agencies to meet certain liquidity and solvency requirements. Gallagher was in compliance with these requirements at December 31, 2006.

Related to its third party administration business, Gallagher is responsible for client claim funds that it holds in a fiduciary capacity. Gallagher does not earn any interest income on these funds held. These client funds have been included in restricted cash, along with a corresponding liability, in the accompanying consolidated balance sheet.

Investments - For investments that do not have quoted market prices, Gallagher utilizes various valuation techniques to estimate fair value and proactively looks for indicators of impairment. Factors, among others, that may indicate that an impairment could exist include defaults on interest and/or principal payments, reductions or changes to dividend payments, sustained operating losses or a trend of poor operating performance, recent refinancings or recapitalizations, unfavorable press reports, untimely filing of financial information, significant customer or revenue loss, litigation, tax audits, losses by other companies in a similar industry, overall economic conditions, management and expert advisor changes and significant changes in strategy. In addition, in cases where the ultimate value of an investment is directly dependent on Gallagher for future financial support, Gallagher assesses its willingness and intent to provide future funding.

If an indicator of impairment exists, Gallagher compares the investment's carrying value to an estimate of its fair value. To estimate the fair value of loans, Gallagher discounts the expected future cash flows from principal and interest payments. This requires Gallagher to exercise significant judgment when estimating both the amount and the timing of the expected cash flows. To estimate the fair value of its equity investments, Gallagher compares values established in recent recapitalizations or appraisals conducted by third parties. In some cases, no such recapitalizations or appraisals exist and Gallagher must perform its own valuations. This also requires Gallagher to exercise significant judgment. Even if impairment indicators exist, no impairment may be required if the estimated fair value is not less than the current carrying value or the decline in value is determined to be temporary and Gallagher has the ability and intent to hold the investment for a period of time sufficient for the value to recover. When Gallagher determines an impairment is other- than- temporary, and therefore that an impairment is required, it is recorded as a realized loss against current period earnings.

Both the process to review for indicators of impairment and, if such indicators exist, the method to compute the amount of impairment incorporate quantitative data and qualitative criteria including the receipt of new information that can dramatically change the decision about the valuation of an investment in a short period of time. The determination of whether a decline in fair value is other- than- temporary is necessarily a matter of subjective judgment. The timing and amount of realized losses reported in earnings could vary if management's conclusions were different.

Due to the inherent risk of investments, Gallagher cannot give assurance that there will not be impairments in the future should economic and other conditions change.

Premium Financing - A Brokerage Segment subsidiary of Gallagher (acquired in September 2006) makes short- term loans (generally with terms of twelve months or less) to its clients to finance premiums. These premium financing contracts are structured to result in minimal potential bad debt expense to Gallagher. Such receivables are considered delinquent after seven days of the payment due date. Generally, insurance policies are cancelled within one month of the contractual payment due date if the payment remains delinquent. Interest income is recognized as it is earned over the life of the contract using the interest "level- yield" method. Unearned interest related to contracts receivable is included in the receivable balance in the accompanying consolidated balance sheet. The outstanding contracts receivable balance was $3.7 million at December 31, 2006.

Fixed Assets - Fixed assets are carried at cost, less accumulated depreciation, in the accompanying consolidated balance sheet. Gallagher periodically reviews long- lived assets for impairment whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. Under those circumstances, if the fair value were less than the carrying amount of the asset, a loss would be recognized for the difference. Depreciation for fixed assets is computed using the straight- line method over the following estimated useful lives:

	Useful Life
Furniture and equipment	Three to ten years
Buildings and improvements	Three to forty years
Airplanes of a consolidated leasing company	Fifteen years
Syn/Coal equipment	Monthly pro rata basis through December 2007
Leasehold improvements	Lesser of remaining life of the asset or life of lease

Intangible Assets - Intangible assets represent the excess of cost over the value of net tangible assets of acquired businesses. Gallagher classifies its intangible assets as either goodwill, expiration lists or non- compete agreements. Expiration lists and non- compete agreements are amortized using the straight- line method over their estimated useful lives (five to fifteen years for expiration lists and five to six years for non- compete agreements), while goodwill is not subject to amortization. Allocation of intangible assets between goodwill, expiration lists and non- compete agreements and the determination of estimated useful lives are based on valuations Gallagher receives from qualified independent appraisers. The calculations of these amounts are based on estimates and assumptions using historical and pro forma data and recognized valuation methods. The use of different estimates or assumptions could produce different results. Intangible assets are carried at cost, less accumulated amortization in the accompanying consolidated balance sheet.

While goodwill is not amortized, it is subject to periodic reviews for impairment. Gallagher reviews intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. Such impairment reviews are performed at the division level with respect to goodwill and at the business unit level for amortizable intangible assets. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings. Based on the results of impairment reviews in 2006 and 2004, Gallagher wrote- off $1.0 million and $1.8 million, respectively, of amortizable intangible assets. No such indicators were noted in 2005. The determinations of impairment indicators and fair value are based on estimates and assumptions related to the amount and timing of future cash flows and future interest rates. The use of different estimates or assumptions could produce different results.

Income Taxes - Deferred income tax has been provided for the effect of temporary differences between financial reporting and tax bases of assets and liabilities and has been measured using the enacted marginal tax rates and laws that are currently in effect. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

Fair Value of Financial Instruments - The carrying amounts of financial assets and liabilities reported in the accompanying consolidated balance sheet for cash and cash equivalents, restricted cash, premiums and fees receivable, premiums payable to insurance carriers, accrued salaries and bonuses, accounts payable and other accrued liabilities, unearned fees and income taxes payable, at December 31, 2006 and 2005, approximate fair value because of the short maturity of these instruments. Fair values for other investments including notes receivable are disclosed in Note 3. The carrying amounts of borrowings outstanding under debt agreements listed in Note 8 approximate their fair values at December 31, 2006 because the borrowings are at floating interest rates or the rates are not significantly different from the prevailing market rates.

Litigation- Gallagher is engaged in various legal actions related to claims, lawsuits and proceedings incident to the nature of its business. Gallagher records liabilities for material loss contingencies, including legal costs (such as fees and expenses of external lawyers and other service providers) to be incurred, when it is probable that a liability has been incurred on or before the balance sheet date and the amount can be reasonably estimated. Such contingent liabilities are not discounted. To the extent such losses and legal costs can be recovered under Gallagher's insurance programs, estimated recoveries are recorded concurrently with the losses recognized. Significant management judgment is required to estimate the amounts of such contingent liabilities and the related insurance recoveries. In order to assess its potential liability, Gallagher analyzes its litigation exposure based on available information, including consultation with outside counsel handling the defense of these matters. As these liabilities are uncertain by their nature, the recorded amounts may change due to a variety of different factors, including new developments in or changes in approach, such as changing the settlement strategy as applicable to each matter.

Stock- Based Compensation - Effective January 1, 2006, Gallagher adopted the fair value method of accounting for employee stock options pursuant to Statement of Financial Accounting Standards (SFAS) No.123 (revised 2004) (SFAS 123(R)), "Share- Based Payment." See Note 2 for a discussion on accounting for employee stock options and the impact of SFAS 123(R) on Gallagher's 2006 operating results.

2. Effect of New Accounting Pronouncements

Stock Options

In 2003, Gallagher adopted the fair value method of accounting for employee stock options pursuant to SFAS 123, "Accounting for Stock- Based Compensation," and SFAS 148, "Accounting for Stock- Based Compensation- Transition and Disclosure, An Amendment of SFAS 123." Prior to January 1, 2003, Gallagher applied the intrinsic value method as permitted under SFAS 123 and defined in Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees," which excluded employee options granted at fair market value from compensation expense. Substantially all of the stock options currently outstanding have an exercise price equal to the fair market price at the date of grant and, therefore, under APB 25, virtually no compensation expense was recorded prior to January 1, 2003. The change to the fair value method of accounting was applied prospectively to all stock option awards granted, modified, or settled after January 1, 2003 and to all employee stock purchases made subsequent to January 1, 2003 through participation in Gallagher's employee stock purchase plan.

In 2004, the FASB issued SFAS 123(R), which is a revision of SFAS 123. SFAS 123(R) superseded APB 25 and amended SFAS 95, "Statement of Cash Flows." Generally, the approach to accounting for share- based payments in SFAS 123(R) is similar to the approach described in SFAS 123, which Gallagher adopted on a prospective basis in 2003. However, SFAS 123(R) requires all share- based payments to employees, including grants of employee stock options (for all grant years), to be recognized in the financial statements over the shorter of the vesting period or the retirement eligible date of the participants based on their grant date fair values.

Gallagher adopted SFAS 123(R) effective January 1, 2006 using the modified- prospective method to account for share- based payments made to employees. The modified- prospective method is similar to the modified- prospective method described in SFAS 148. Under this method, compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123(R) for all share- based payments granted on or after January 1, 2006 and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to January 1, 2006 that remain unvested on the effective date. In addition, Gallagher has elected to use the alternative transition method of Financial Accounting Standards Board (FASB) Staff Position SFAS 123R- 3 to determine the accounting of the income tax effects of payments made related to stock based compensation.

Gallagher used the Black- Scholes formula to estimate the value of stock options granted to employees in 2005 and prior years and has continued to use this allowable option valuation model in 2006. Because SFAS 123(R) must be applied not only to new awards but to previously granted awards that are not fully vested on the effective date, and because Gallagher adopted SFAS 123 using the prospective method, which applied only to awards granted, modified or settled after the adoption date, compensation cost for some previously granted awards that was not recognized under SFAS 123 is now recognized under SFAS 123(R). Beginning in 2006, Gallagher is applying the provisions of SFAS 123(R) to all unvested awards granted prior to the adoption of SFAS 123 (prior to January 1, 2003) for recognition of share- based payments to employees.

SFAS 123(R) requires that compensation cost be recognized for unvested awards over the period through the date that the employee is no longer required to provide future services to earn the award, rather than over the explicit service period. Accordingly, for 2006 and future stock option grants, Gallagher has adjusted its existing accounting policy to recognize compensation cost to coincide with the date that the employee is eligible to retire, rather than the actual retirement date, for all options granted. However, stock options granted after June 30, 2006 no longer contain the accelerated vesting upon retirement provision.

SFAS 123(R) also requires the benefits of tax deductions in excess of compensation amounts recognized for book purposes to be reported as a financing cash flow rather than as an operating cash flow as required previously. This change in presentation in the accompanying consolidated statement of cash flows has reduced net operating cash flows and increased net financing cash flows by $7.9 million for the year ended December 31, 2006. SFAS 123(R) also requires any unearned deferred compensation and unearned restricted stock to be recorded as reductions in capital in excess of par rather than as contra equity accounts in stockholders' equity as required previously. This change in presentation in the accompanying consolidated balance sheet reduced capital in excess of par by $21.6 million and $19.8 million at December 31, 2006 and 2005, respectively, but had no impact on total stockholders' equity as of either date.

During the years ended December 31, 2006, 2005 and 2004, Gallagher recognized $16.0 million, $8.9 million and $5.6 million, respectively, of compensation expense related to its stock option plans and its employee stock purchase plan. For 2006, Gallagher incurred $5.6 million of additional stock based compensation expense ($3.4 million after tax) due to the adoption of SFAS 123(R) related to the vesting in 2006 of options granted prior to January 1, 2003. Both basic and diluted net earnings per share were reduced by $.03 in 2006 due to the adoption of SFAS 123(R).

At December 31, 2006, Gallagher had four stock option plans, which are described more fully in Note 11. Gallagher primarily grants stock options for a fixed number of shares to employees, with an exercise price equal to the fair value of the underlying shares at the date of grant. For all periods presented prior to 2006, and for all options granted prior to January 1, 2003, Gallagher accounted for stock option grants under the recognition and measurement principles of APB 25 and related Interpretations and, accordingly, recognized virtually no compensation expense for these stock options granted to employees. The following table illustrates the effect on earnings from continuing operations and earnings from continuing operations per share for the years ended December 31, 2005 and 2004, if Gallagher had applied the fair value recognition provisions of SFAS 123 to all of its stock-based employee compensation (in millions, except per share data):

	Year Ended December 31,	
	2005	**2004**
Earnings from continuing operations - as reported	$ 28.6	$ 189.5
Add: Stock- based employee compensation expense included in reported net earnings, net of related tax effects	6.9	4.5
Deduct: Total stock- based employee compensation expense determined under fair value based method for all awards (see Note 11), net of related tax effects	(10.0)	(8.0)
Pro forma net earnings	$ 25.5	$ 186.0
Basic earnings from continuing operations per share - as reported	$ .30	$ 2.07
Basic earnings from continuing operations per share - pro forma	.27	2.03
Diluted earnings from continuing operations per share - as reported	.30	2.00
Diluted earnings from continuing operations per share - pro forma	.27	1.97

Income Taxes

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes an Interpretation of SFAS No. 109." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise's tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest, penalties, accounting in interim periods and disclosure related to uncertain income tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. Accordingly, Gallagher will be required to adopt FIN 48 in first quarter 2007. Gallagher is currently evaluating the impact that the adoption of FIN 48 will have, if any, on its consolidated financial statements and notes thereto. However, Gallagher does not expect the adoption of FIN 48 to have a material effect on its financial position or operating results.

Defined Benefit Pension and Other Postretirement Plans

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)." SFAS 158, which represents the completion of the first phase in the FASB's postretirement benefits accounting project, applies to all plan sponsors who offer defined postretirement benefit plans and requires an entity to:

- Recognize in its balance sheet an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status.
- Measure a defined benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year.
- Recognize changes in the funded status of a defined benefit postretirement plan in comprehensive earnings in the year in which the changes occur.

SFAS 158 does not change the amount of net periodic benefit cost included in net earnings. The requirement to recognize the funded status of a defined benefit postretirement plan and the disclosure requirements are effective for fiscal years ending after December 15, 2006 for public entities. Accordingly, Gallagher adopted SFAS 158 in fourth quarter 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year end balance sheet is effective for fiscal years ending after December 15, 2008. Gallagher currently utilizes December 31 as the measurement date for its plan assets and benefit obligations and, therefore, complies with this requirement. Effective December 31, 2006, Gallagher adopted SFAS 158 and recognized a noncurrent prepaid pension asset of $8.3 million, a noncurrent deferred tax liability of $3.4 million and accumulated other comprehensive earnings of $5.0 million in the accompanying consolidated balance sheet. See Notes 15 and 16 for additional information required to be disclosed in accordance with SFAS 158.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement," which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS 157 also responds to investors' requests for expanded information about the extent to which entities measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require or permit assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. Under SFAS 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Fair value measurements are required to be separately disclosed by level within the fair value hierarchy.

SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and for all interim periods within those fiscal years. Accordingly, Gallagher will be required to adopt SFAS 157 in first quarter 2008.

Gallagher is currently evaluating the impact that the adoption of SFAS 157 will have, if any, on its consolidated financial statements and notes thereto.

3. Investments

The following is a summary of Gallagher's other investments and the related outstanding letters of credit (LOCs), financial guarantees and funding commitments (in millions):

Unconsolidated Investments:	December 31, 2006 Current	December 31, 2006 Noncurrent	December 31, 2005 Current	December 31, 2005 Noncurrent	December 31, 2006 LOCs & Financial Guarantees	December 31, 2006 Funding Commitments
Direct and indirect investments in Asset Alliance Corporation (AAC):						
Common stock	$ -	$ 13.7	$ -	$ 15.5	$ -	$ -
Preferred stock	13.4	-	0.1	13.3	-	-
Debentures	-	-	13.2	-	-	-
Indirectly held	-	1.1	-	1.4	-	-
Total AAC	13.4	14.8	13.3	30.2	-	-
Low income housing (LIH) investments:						
Bridge loans	1.8	-	5.4	-	-	-
Partnership interests	-	0.8	-	1.1	-	-
LIH Developer	-	-	-	8.9	-	-
Total LIH developments	1.8	0.8	5.4	10.0	-	-
Alternative energy investments:						
IRC Section 29 Syn/Coal production receivables	25.7	-	14.9	-	-	-
IRC Section 29 Syn/Coal unamortized assets	6.6	-	6.5	6.7	-	-
Equity interest in biomass projects and pipeline	0.1	9.5	0.1	13.9	-	-
Clean energy related ventures	-	0.6	-	0.7	-	0.8
Total alternative energy investments	32.4	10.1	21.5	21.3	-	0.8
Real estate, venture capital and other investments	1.6	6.8	3.0	6.7	5.4	1.0
Total unconsolidated investments	$ 49.2	$ 32.5	$ 43.2	$ 68.2	$ 5.4	$ 1.8

Asset Alliance Corporation - Through common stock and preferred stock investments, Gallagher effectively owns 25% of AAC, an investment management company that owns up to a two- thirds interest in ten private investment management firms (the Firms). AAC and the Firms collectively manage domestic and international investment hedge fund portfolios for various institutions and individuals, which totaled approximately $3.1 billion at December 31, 2006. AAC has a proportional interest in the Firms' revenues or net earnings that result principally from fees and participation in investment returns from the managed investment portfolios. Gallagher accounts for its holdings in AAC's common stock using equity method accounting.

In 2002, Beacon Hill Asset Management LLC (Beacon Hill) withdrew from managing hedge fund portfolios for AAC due to various legal, contractual and business issues. In 2003, investors in a Beacon Hill investment partnership filed a lawsuit to recover investment losses naming AAC as a co- defendant. In fourth quarter 2006, all parties to this lawsuit entered into a settlement agreement, which is subject to court approval, to resolve this pending litigation. The net impact of this settlement, together with another unrelated settlement entered into by AAC in the latter part of 2006, did not have a material impact on Gallagher's 2006 operating results or on the December 31, 2006 carrying value of its AAC investment.

Low Income Housing (LIH) Investments - Gallagher's investments in LIH consist of three components:

Bridge Loans represent early- stage loans on properties that are mainly being developed to qualify for LIH tax credits. The current loan is collateralized by the land and buildings financed and carries an interest rate of 4.00%. The loans are generally outstanding for twelve to thirty- six months and accrue interest until the projects are refinanced by a purchaser or syndicator. No loan has ever defaulted since Gallagher began making these types of loans in 1996.

Partnership Interests represent Gallagher's ownership in completed and certified LIH developments. At December 31, 2006, Gallagher owned limited partnership interests in 21 LIH developments. These are generating tax benefits to Gallagher on an ongoing basis in the form of both tax deductions for operating losses and tax credits. These investments are generally accounted for using the effective yield method and are carried at amortized cost. Under the effective yield method, Gallagher recognizes the tax credits as they are allocated by the partnerships, which are included, net of amortization of the investment, as a component of the provision for income taxes. Gallagher has never incurred a loss on a LIH project.

Eight of the LIH developments have been determined to be variable interest entities (VIE), as defined by FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities," but are not required to be consolidated. Gallagher invested in these developments between 1990 and 2000 as a limited partner. At December 31, 2006, total assets and total debt of these developments were approximately $53.0 million and $40.0 million, respectively. Gallagher's maximum exposure to a potential loss from these VIEs was $0.8 million at December 31, 2006, which equaled the net aggregate carrying value of its investments.

LIH Developer represented Gallagher's 27% ownership interest in the company that is the developer and/or syndicator of most of Gallagher's LIH development investments. On December 28, 2006, Gallagher sold its 27% ownership interest for cash of $4.0 million. A $3.0 million pretax loss was recognized in connection with this transaction.

Alternative Energy Investments - Gallagher has made investments in partnerships formed to develop energy that qualifies for tax credits under Internal Revenue Code (IRC) Section 29. These consist of (i) waste- to- energy (Biomass) partnerships which own the rights to gas emissions (Biogas) from landfills and the wells and infrastructure necessary to capture the Biogas and (ii) synthetic coal (Syn/Coal) partnerships which own and lease equipment that processes qualified fuel under IRC Section 29. Gallagher has an interest in seven IRC Section 29- related Biomass limited partnerships and five IRC Section 29- related Syn/Coal limited partnerships or limited liability companies that generate tax benefits to Gallagher on an ongoing basis in the form of both tax deductions for operating losses and tax credits. At December 31, 2006, two of the IRC Section 29- related Syn/Coal limited partnerships were consolidated into Gallagher's financial statements due to ownership percentage. The remainder of these investments were carried at amortized cost. Gallagher recognizes the tax credits as they are allocated by the partnerships, which are included as a component of the provision for income taxes.

During fourth quarter 2005, Gallagher sold a portion of its equity ownership interest in the "parent" company that operates two of the Biomass limited partnerships. As part of that same transaction, Gallagher converted $6.0 million of debt into an equity interest in that company. On December 31, 2006, Gallagher recognized a $2.4 million loss related to the write- down of these two Biomass limited partnerships.

IRC Section 29 Production Receivables represent the uncollected installment sale proceeds as of each balance sheet date related to Gallagher's sales of several IRC Section 29- related operations (Biomass and Syn/Coal) that have been either partially or completely sold to third parties. Due to uncertainties related to the phase- out level for 2006, Gallagher has agreed to delay collection of many of these receivables until second quarter 2007, when the actual amounts will become known due to the determination of the phase- out level for 2006.

Four of the Biomass projects have been determined to be VIEs but are not required to be consolidated. Gallagher is a limited partner in each investment. The investments were entered into by Gallagher between 1991 and 1998. At December 31, 2006, total assets and total debt of these investments were approximately $5.1 million and $2.8 million, respectively. Gallagher's maximum exposure to a potential loss from these VIEs was zero at December 31, 2006, which equaled the net aggregate carrying value of its investments.

As part of selling its interests in IRC Section 29- related Biomass partnerships, Gallagher provided indemnifications to the buyers for taxes that may arise as a result of incorrect representations. Gallagher obtained legal, tax, and other expert services and advice when making these representations. At December 31, 2006, the maximum potential amount of future payments that Gallagher could be required to make under these indemnifications totaled approximately $16.8 million, net of the applicable income tax benefit. Gallagher did not record any liability in its December 31, 2006 consolidated balance sheet for these potential indemnifications. As part of selling its interests in IRC Section 29- related Syn/Coal partnerships, Gallagher provided indemnifications to the buyers for taxes that may arise as a result of incorrect representations. Gallagher obtained legal, tax, and other expert services and advice when making these representations, and subsequently obtained private letter rulings (PLRs) from the Internal Revenue Service (IRS). Gallagher has not recorded any liability in its December 31, 2006 consolidated balance sheet for these potential indemnifications. See IRC Section 29- related Syn/Coal Matters below for the potential exposures related to Syn/Coal as of December 31, 2006.

IRC Section 29 Unamortized Assets primarily represent the remaining book value related to the IRC Section 29- related operations (Biomass and Syn/Coal) that have been either partially or completely sold to third parties. Gallagher accounts for these investments on the installment sale basis, which requires that the amortization of the bases of the assets sold be recognized ratably over time against the installment sale proceeds received as a component of investment income. The amortization period is based on the expected life of the IRC Section 29- related tax credits. IRC Section 29 unamortized assets also include the remaining book value of the portion of the IRC Section 29- related Syn/Coal limited partnerships that Gallagher owns. The remainder of these investments are carried at amortized cost.

IRC Section 29- related Syn/Coal Matters- The Permanent Subcommittee on Investigations of the Government Affairs Committee of the U.S. Senate (Subcommittee) is conducting an ongoing investigation of potential abuses of tax credits by producers of synthetic fuel under IRC Section 29. The Subcommittee Chairman, in a memorandum updated in September 2006, has stated that the investigation is examining the utilization of IRC Section 29- related Syn/Coal Credits, the nature of the technologies and the fuels created, the use of these fuels, and other aspects of IRC Section 29. The memorandum also states that the investigation will address the IRS's administration of IRC Section 29- related Syn/Coal Credits.

Gallagher continues to believe it is claiming IRC Section 29- related Syn/Coal Credits in accordance with IRC Section 29 and four PLRs previously obtained by IRC Section 29- related Syn/Coal partnerships in which it has an interest. Gallagher understands these PLRs are consistent with those issued to other taxpayers and has received no indication from the IRS that it will seek to revoke or modify them. In that regard, one of the IRC Section 29- related Syn/Coal partnerships in which Gallagher has an interest was under examination by the IRS for the tax year 2000 and in March 2004, Gallagher was notified that the examination was closed without any changes being proposed. In third quarter 2006, the IRS began an examination of this same partnership for the tax year 2004.

The IRS is continuing to audit taxpayers claiming IRC Section 29- related Syn/Coal Credits with respect to a variety of issues. The partnerships in which Gallagher has an interest may be audited in the future, and any such audit could adversely affect Gallagher's ability to claim IRC Section 29- related Syn/Coal Credits or cause it to be subject to liability under indemnification obligations related to the prior sale of interests in partnerships claiming IRC Section 29- related Syn/Coal Credits. Furthermore, IRC Section 29- related Syn/Coal Credits have been controversial both politically and administratively, and no assurance can be given that the IRS will not in the future discontinue issuing PLRs, issue administrative guidance adverse to Gallagher's interests, or support the enactment of legislation to curtail or repeal IRC Section 29. A bill to repeal IRC Section 29 was introduced in the U.S. House of Representatives in 2005 that was not enacted, but a similar bill could be reintroduced in a future session and any such action could potentially result in the curtailment or repeal of IRC Section 29- related Syn/Coal Credits prior to the end of 2007, when the IRC Section 29- related Syn/Coal Credits expire under current law. Similarly, future administrative or judicial decisions could adversely affect Gallagher's ability to claim IRC Section 29- related Syn/Coal Credits or cause it to be subject to liability under indemnification obligations related to prior sales of partnership interests.

Gallagher has insurance policies in place, the scope of which Gallagher believes would provide substantial coverage in the event the Syn/Coal Credits are disallowed. While there can be no assurance that such coverage would ultimately be available, if the full amount of the policies were collected, Gallagher's maximum after tax exposure at December 31, 2006 relating to the disallowance of the Syn/Coal Credits is as follows (in millions):

	Maximum	Net of Insurance
Gross tax credits recorded by Gallagher	$ 262.5	$ 168.0
Installment sale proceeds subject to indemnification	292.8	73.3
Net carrying value of assets held at December 31, 2006	3.3	3.3
Total exposure	$ 558.6	$ 244.6

IRC Section 29 tax credits will expire on December 31, 2007 if the law is not extended. In addition, through December 31, 2007, IRC Section 29 has a phase- out provision that is triggered when the "Market Wellhead Price" of domestic crude oil reaches certain "Phase- out Prices," as determined by the IRS. Management estimates that the Market Wellhead Price in 2006 would need to average approximately $55.00 to start a phase- out and average approximately $69.00 for a complete phase- out. The commonly reported crude oil price of futures contracts traded on the New York Mercantile Exchange (NYMEX Price) for 2006 averaged $66.12. The NYMEX Price averaged $6.04 above the Market Wellhead Price for calendar year 2005 and is estimated to be approximately $6.18 above the Market Wellhead Price for calendar year 2006. There can be no assurance that future oil prices will average under future phase- out levels.

During the period from January 1 to June 12, 2006, Gallagher idled the two IRC Section 29- related Syn/Coal facilities that generate substantially all of the IRC Section 29- related tax credits for Gallagher. Effective June 12, 2006, Gallagher restarted production at these two facilities. To partially mitigate the financial risk of a phase- out, which reduces the tax credits earned and reduces the installment sale gains from Gallagher's IRC Section 29- Syn/Coal investments, Gallagher entered into arrangements with unaffiliated third parties which constitute call spreads on oil futures to create financial hedges that were designed to generate gains to Gallagher in the event of certain levels of increased oil prices. These hedges are not intended to be "perfect hedges" for accounting purposes, but are intended to mitigate a substantial portion of the negative impact to Gallagher of increased oil prices. Any oil price derivative gains are designed to offset a portion of the expenses associated with operating Gallagher's IRC Section 29- Syn/Coal facilities in the event of a phase- out of IRC Section 29 tax credits, which phase- outs are based on oil prices averaging certain levels for calendar years 2006 and 2007. Gallagher made an up- front payment of $8.5 million on June 12, 2006 to enter into an oil price derivative, which expired on December 31, 2006. The oil price derivative resulted in a loss of $8.5 million in 2006 that was included in the Financial Services Segment operating results. On January 17, 2007, Gallagher made an up- front payment of $2.7 million to enter into another similar oil price derivative, which will be marked to market value each quarter as part of the Financial Services Segment operating results, through the earlier of December 31, 2007, the date the contract expires, or the date the contract is sold. At December 31, 2006, the remaining carrying value of the five facilities and other related assets was approximately $8.5 million in the aggregate. Gallagher has historically depreciated/amortized these assets at approximately $2.1 million per quarter and expects to continue to do so through the expiration date of IRC Section 29, which is December 31, 2007. If Gallagher chooses to either permanently shut down the facilities or enter into a significantly prolonged idle period, all or part of this remaining carrying value could become impaired and require a non- cash charge against earnings in the period that such a determination is made.

Litigation related matters in 2005 represented a pretax charge of $131.0 million ($84.2 million after tax) recorded by Gallagher in first quarter 2005. On February 11, 2005, a jury in the Fourth District Court for the State of Utah awarded damages against Gallagher's subsidiary, AJG Financial Services, Inc. (AJGFS), and in favor of Headwaters Incorporated (Headwaters) in the amount of $175.0 million. AJGFS and Headwaters entered into a definitive agreement effective as of May 1, 2005 to settle this and all other litigation between the companies for $50.0 million, which was paid to Headwaters in May 2005. Additionally, AJGFS and Headwaters have modified their existing licensing agreement, allowing AJGFS to utilize Headwaters' technology on two of AJGFS' synthetic fuel facilities in exchange for (i) $70.0 million, which was paid to Headwaters on January 4, 2006, and (ii) an annual royalty to Headwaters in 2005, 2006 and 2007. The first quarter 2005 litigation charge provides for amounts related to this settlement, including the $120.0 million of settlement costs, together with litigation, bonding and other costs of approximately $11.0 million. In connection with the Headwaters licensing agreement, Gallagher recorded $15.4 million and $14.6 million of royalty expense in 2006 and 2005, respectively, which was included in investment expenses, based on the IRC Section 29- related Syn/Coal production volume and an assumed 36% phase- out. At full production and no phase- out, the maximum annual royalty in 2007 would be equal to $20.0 million of AJGFS' estimated annual pre- royalty, pretax earnings of $40.0 million from these two facilities. However, the royalties paid to Headwaters in 2007 will again be less than the maximum annual royalty discussed above if oil prices remain at levels in excess of the phase- out levels.

Equity Interest in Biomass Projects and Pipeline consists of a Biomass "parent" company and related partnerships which own the rights to Biogas from landfills and the wells, infrastructure and a pipeline to capture, distribute and sell Biogas.

Clean energy related ventures - This investment represents Gallagher's ownership interest in a privately- owned, multi- pollutant reduction venture, Chem- Mod LLC (Chem- Mod), which possesses rights, information and technology for the reduction of unwanted emissions created during the combustion of coal. As reported by Chem- Mod in a press release dated February 8, 2006, Chem- Mod has developed and is the exclusive licensee of a new proprietary emissions technology it refers to as The Chem- Mod Solution, which uses a dual injection sorbent system to reduce mercury, sulfur dioxide and other toxic emissions at coal- fired power plants. Substantial testing of The Chem- Mod Solution has been completed both in a laboratory environment and at five full- scale commercial power plants, all yielding positive test results. Although Chem- Mod is in the early stages of commercializing the technology, the principal potential market for The Chem- Mod Solution is coal- fired power plants owned by utility companies. Chem- Mod has indicated publicly that it believes The Chem- Mod Solution is a more cost- effective technology for reducing emissions in a manner consistent with the EPA's Clean Air Mercury Rules than other technologies currently in the marketplace. Gallagher, through a wholly- owned subsidiary, currently owns a 10% direct equity interest in Chem- Mod and has an option to acquire an additional 32% indirect equity interest in Chem- Mod. In addition, Gallagher, through another wholly- owned subsidiary, currently owns a 20% direct equity interest in Chem- Mod International LLC, the exclusive licensee of The Chem- Mod Solution on a global basis, excluding the U.S. and Canada (Gallagher's interests in Chem- Mod and Chem- Mod International LLC are collectively referred to herein as Chem- Mod Interests). Gallagher first began providing funding to Chem- Mod in June 2004. Currently, Gallagher's carrying value with respect to its Chem- Mod Interests is approximately $0.6 million. Gallagher also has additional funding commitments of approximately $0.8 million. Gallagher's option to acquire the additional 32% indirect equity interest in Chem- Mod is exercisable at any time on or prior to December 31, 2007 at an exercise price of $11.0 million. Chem- Mod and its equityholders are currently evaluating a variety of strategies to maximize value for Chem- Mod's equityholders, including a potential sale. However, there are a number of variables surrounding such strategies, particularly in light of the early stage of Chem- Mod's commercialization efforts. While Gallagher currently believes that its Chem- Mod Interests may prove to have substantial value, there can be no assurance given as to timing or amount, if any, with respect to any realization on this investment.

On April 19, 2006, Gallagher funded $4.7 million related to another clean energy venture formed by the founders of Chem- Mod, C- Quest Technologies LLC (C- Quest). C- Quest possesses rights, information and technology for the reduction of carbon dioxide emissions created by burning fossil fuels. Gallagher, through a wholly- owned subsidiary, currently owns a 5% direct equity interest in C- Quest and has an option to acquire an additional 22% direct interest in C- Quest. In addition, Gallagher, through a wholly- owned subsidiary, currently owns a 5% direct equity interest in C- Quest Technologies International LLC (C- Quest International), and has an option to acquire an additional 22% direct interest in C- Quest International, which possesses rights to use information and technology of C- Quest on a global basis, excluding the U.S. and Canada (the equity interest and option rights in C- Quest and C- Quest International are collectively referred to herein as C- Quest Interests). Currently, Gallagher's carrying value with respect to its C- Quest Interests is $0.1 million. Gallagher's option to acquire the additional 22% direct interest in C- Quest and C- Quest International is exercisable at any time on or prior to April 18, 2010 at an exercise price of $5.5 million for each option ($11.0 million total). During 2006, Gallagher recognized a $2.2 million loss as a result of adjustments to the fair values of the option costs and a $2.4 million loss as a result of the write- offs of its ownership interests in C- Quest and C- Quest International. The options will be valued at fair value when a fair value can be established and the equity investment accounted for using equity method accounting.

Bermuda Insurance Investments - Prior to July 2005, Gallagher had an equity investment (less than 2% ownership) in Allied World Assurance Holdings, Ltd (AWAH), which is a Bermuda based insurance and reinsurance company founded in 2001. This investment was carried at cost. In second quarter 2005, Gallagher received a $5.8 million distribution from AWAH, of which $2.1 million was deemed a dividend and $3.7 million was deemed a return of capital. In third quarter 2005, Gallagher sold its remaining interest in this investment for cash. No gain or loss resulted from this sale.

Real Estate, Venture Capital and Other Investments - At December 31, 2006, Gallagher had investments in three real estate ventures with a net carrying value of $1.1 million in the aggregate, the largest of which was $0.5 million. Gallagher also had investments in five venture capital investments and funds that consisted of various debt and equity investments in development- stage companies and turn- arounds with an aggregate net carrying value of $7.3 million, the largest of which was $5.9 million. Three of the eight investments discussed above have been determined to be VIEs but are not required to be consolidated. These were originally invested in between 1997 and 2006. At December 31, 2006, total assets and total debt of these three investments were approximately $10.2 million and $26.0 million, respectively. Gallagher's maximum exposure to a potential loss related to these investments was $0.3 million at December 31, 2006, which equaled the net aggregate carrying value of these investments.

Consolidated Investments - Gallagher has an ownership interest in excess of 50% in three investment enterprises, which are consolidated into Gallagher's consolidated financial statements: an airplane leasing limited liability company and two Syn/Coal facilities.

Prior to January 25, 2007, Gallagher owned 90% of an airplane leasing company that leases two cargo airplanes to the French Postal Service. In fourth quarter 2005, the lease agreement for the two airplanes was extended for an additional five years to 2011. The extended agreement was cash flow neutral to Gallagher. In addition, during fourth quarter 2005, the loan agreement related to the two airplanes was extended for an additional five years to 2011. On December 22, 2006, Gallagher agreed to sell its 90% interest in the airplane leasing company and recognized a $2.7 million pretax loss in the Financial Services Segment. On January 25, 2007, the transaction closed and Gallagher received cash of $0.7 million and extinguished related debt of $27.9 million.

Gallagher purchased a 98% equity interest in a Syn/Coal production facility in 2004 that had previously been operated by Gallagher through a facility rental agreement. The purchase price was made with an $11.1 million seller financed note payable that is non- recourse to Gallagher. Principal and interest payments are currently being deferred in accordance with the acquisition agreement until the actual tax credits generated by the facility in 2006 can be computed in April 2007. The other IRC Section 29- related Syn/Coal investment represents Gallagher's 99% equity interest in an IRC Section 29- related Syn/Coal facility. Both of these investments are held by Gallagher to generate IRC Section 29- related Syn/Coal Credits.

Prior to second quarter 2005, Gallagher had an 80% investment in a limited partnership that is developing an 11,000- acre community near Orlando, Florida (Florida Community Development). In second quarter 2005, Gallagher sold its ownership interests in the limited partnership that owns the Florida Community Development investment. Pursuant to the transaction, Gallagher received cash of $25.7 million and recorded a pretax gain on the sale of $12.6 million in second quarter 2005. Terms of the transaction required Gallagher to continue to post a $12.6 million letter of credit to guarantee $12.4 million of bonds issued by the Florida Community Development. On December 1, 2006, Gallagher was released from its remaining $12.6 million letter of credit related to the Florida Community Development. In Gallagher's previously reported financial information, the Florida Community Development's operating results were included in the Financial Services Segment. The Florida Community Development's 2005 and 2004 operating results have been reclassified to discontinued operations in the accompanying consolidated statement of earnings. See Note 5 for a discussion on discontinued operations.

Gallagher has a 60% ownership interest in a real estate limited partnership that, prior to December 7, 2006, owned the land and building that Gallagher leases for its executive offices and several of its subsidiary operations, which was consolidated into Gallagher's consolidated financial statement. On December 7, 2006, the real estate partnership sold Gallagher's home office land and building. Pursuant to the sale transaction, the total purchase price paid by the buyer for the building was $83.8 million. In addition, the buyer also reimbursed the real estate partnership for a prepayment fee equal to $4.8 million incurred by the real estate partnership in connection with the prepayment of the mortgage on the building and other loan fees. The outstanding balance on the mortgage as of the sale date was $75.2 million. Based on its ownership in the real estate partnership, Gallagher received cash proceeds of $7.9 million related to the sale, which resulted in a pretax loss to Gallagher of $4.2 million that was recorded in fourth quarter 2006 in the Financial Services Segment. Terms of the transaction require Gallagher to post a one- year, $1.0 million letter of credit as collateral for Gallagher's representations and warranties. In connection with the sale of Gallagher's home office land and building, $84.1 million of net fixed assets and $75.2 million of investment related borrowings were removed from the consolidate balance sheet and such amounts were treated as non- cash items in the accompanying 2006 consolidated statement of cash flow.

The following is a summary of these consolidated investments and the related outstanding LOCs, financial guarantees and funding commitments (in millions):

	December 31, 2006	December 31, 2005	December 31, 2006 LOCs & Financial Guarantees	December 31, 2006 Funding Commitments
Home office land and building:				
Fixed assets	$ -	$ 101.9	$ -	$ -
Accumulated depreciation	-	(18.3)	-	-
Non- recourse borrowings - current	-	(0.9)	-	-
Non- recourse borrowings - noncurrent	-	(72.2)	-	-
Recourse borrowings - noncurrent	-	(3.0)	-	-
Net other consolidated assets and liabilities	-	4.0	-	-
Net investment	-	11.5	-	-
Airplane leasing company:				
Fixed assets	49.1	51.8	-	-
Accumulated depreciation	(21.3)	(17.7)	-	-
Non- recourse borrowings - current	(2.1)	(1.9)	-	-
Non- recourse borrowings - noncurrent	(25.9)	(28.0)	-	-
Net other consolidated assets and liabilities	0.2	(0.4)	-	-
Net investment	-	3.8	-	-
Syn/Coal partnerships:				
Fixed assets	15.7	15.6	-	-
Accumulated depreciation	(11.0)	(7.3)	-	-
Non- recourse borrowings - current	(6.8)	(2.5)	-	-
Non- recourse borrowings - noncurrent	-	(4.4)	-	-
Net other consolidated assets and liabilities	2.1	(1.3)	-	-
Net investment	-	0.1	-	-
Total consolidated investments:				
Fixed assets	64.8	169.3	-	-
Accumulated depreciation	(32.3)	(43.3)	-	-
Non- recourse borrowings - current	(8.9)	(5.3)	-	-
Non- recourse borrowings - noncurrent	(25.9)	(104.6)	-	-
	-	(3.0)	-	-

Recourse borrowings - noncurrent				
Net other consolidated assets and liabilities	2.3	2.3	-	-
Net investment	$ -	$ 15.4	$ -	$ -

As presented in the above table, two of the three consolidated investments had borrowings related to their assets as of December 31, 2006. See Note 17 for a summary of future cash payments, excluding interest, related to the borrowings of Gallagher's consolidated investments.

Impairment Reviews - Gallagher has a management investment committee that has met ten to twelve times per year (in the period from 2004 to 2006) to review its investments. For investments that do not have quoted market prices, Gallagher utilizes various valuation techniques to estimate fair value and proactively looks for indicators of impairment. Factors, among others, that may indicate that an impairment could exist include defaults on interest and/or principal payments, reductions or changes to dividend payments, sustained operating losses or a trend of poor operating performance, recent refinancings or recapitalizations, unfavorable press reports, untimely filing of financial information, significant customer or revenue loss, litigation, tax audits, losses by other companies in a similar industry, overall economic conditions, management and expert advisor changes, and significant changes in strategy. In addition, in cases where the ultimate value of an investment is directly dependent on Gallagher for future financial support, Gallagher assesses its willingness and intent to provide future funding.

If an indicator of impairment exists, Gallagher compares the investment's carrying value to an estimate of its fair value. To estimate the fair value of loans, Gallagher discounts the expected future cash flows from principal and interest payments. This requires Gallagher to exercise significant judgment when estimating both the amount and the timing of the expected cash flows. To estimate the fair value of its equity investments, Gallagher compares values established in recent recapitalizations or appraisals conducted by third parties. In some cases, no such recapitalizations or appraisals exist and Gallagher must perform its own valuations. This also requires Gallagher to exercise significant judgment. Even if impairment indicators exist, no impairment may be required if the estimated fair value is not less than the current carrying value or the decline in value is determined to be temporary and Gallagher has the ability and intent to hold the investment for a period of time sufficient for the value to recover. When Gallagher determines an impairment is other- than- temporary, and therefore that an impairment is required, it is recorded as a realized loss against current period earnings.

Both the process to review for indicators of impairment and, if such indicators exist, the method to compute the amount of impairment incorporate quantitative data and qualitative criteria including the receipt of new information that can dramatically change the decision about the valuation of an investment in a short period of time. The determination of whether a decline in fair value is other- than- temporary is necessarily a matter of subjective judgment. The timing and amount of realized losses reported in earnings could vary if management's conclusions were different.

Due to the inherent risk of investments, Gallagher cannot give assurance that there will not be investment impairments in the future should economic and other conditions change.

Significant components of investment income are as follows (in millions):

	Year Ended December 31,		
	2006	**2005**	**2004**
Investment income - Brokerage and Risk Management	$ 34.2	$ 20.8	$ 15.1
AAC related investments:			
Interest and dividends	1.2	1.4	1.5
Income (loss) from equity ownership	(2.1)	(4.1)	2.1
Gain on sale of portion of minority interest	-	-	0.3
Low income housing (LIH) investments:			
Interest	0.2	0.1	0.3
Income (loss) from equity ownership	(1.9)	0.1	2.0
Loss on sale of LIH Developer	(3.0)	-	-
IRC Section 29- related Syn/Coal facilities:			
Three unconsolidated facilities			
Installment gains	31.7	54.5	42.8
Other income	0.5	1.0	0.9
Oil hedge loss	(6.2)	-	-
Two consolidated facilities			
Operating revenue	49.3	42.8	31.9
Oil hedge loss	(2.3)	-	-
Other alternative energy investments:			
Interest and other income	0.3	1.0	1.3
Installment gains	1.1	1.3	1.9
Loss from equity ownership	(2.7)	(1.5)	(1.5)
Other realized losses	(7.0)	(2.5)	-
Home office land and building:			
Operating revenue	4.9	6.5	6.6
Loss on sale of home office land and building	(4.2)	-	-
Airplane leasing company:			
Operating revenue	3.5	4.1	3.4
Loss on sale of airplane leasing company	(2.7)	-	-
Real estate, venture capital and other investments:			
Interest, dividends and other income	1.1	1.7	0.1
Net realized gains on dispositions, recoveries and impairments	0.3	4.0	7.8
Dividend from Allied World Assurance Holdings, Ltd	-	2.1	-
Impact of FIN 46 from consolidated investments	-	-	69.9
Total investment income	$ 96.2	$ 133.3	$ 186.4

Investment income - Brokerage and Risk Management primarily represents interest income earned on Gallagher's cash and cash equivalents, and one-time gains related to small books of business of $4.5 million, $1.5 million and $1.4 million in 2006, 2005 and 2004, respectively.

Investment income from AAC related investments primarily represents income associated with Gallagher's debt, preferred and common stock investments in AAC. Gallagher accounts for the common stock portion of its investment using equity method accounting and accounts for the interest and dividend income on its debt and preferred stock investments as it is

earned. In 2006, Gallagher recognized a $2.2 million charge using equity method accounting for an AAC tax adjustment for the sales and impairments of three of its private investment management firms. In 2005, AAC recognized a charge related to the sales and impairment of its investments in three of its private investment management firms. Gallagher's portion of the charge using equity method accounting was $3.1 million.

Investment income from LIH investments primarily represents income associated with Gallagher's equity investment in a LIH Developer that was accounted for using equity method accounting and interest income from bridge loans made by Gallagher related to LIH developments. Gallagher sold its interests in the LIH Developer in fourth quarter 2006 and recognized a $3.0 million loss on the sale.

Investment income from IRC Section 29- related Syn/Coal facilities consists of two pieces: income from three unconsolidated facilities and income from two consolidated facilities. Income from the three unconsolidated facilities relates to the installment sale gains from the sales of Gallagher's interests in limited partnerships that operate IRC Section 29- related Syn/Coal facilities that occurred in 2001, 2002 and 2004. Income from the two consolidated facilities relates to Gallagher's 98% and 99% equity interests in two IRC Section 29- related Syn/Coal production facilities that are held by Gallagher to generate IRC Section 29- related Syn/Coal Credits. Gallagher acquired its interest in these two facilities in fourth quarter 2003 and second quarter 2004. In 2006, 2005 and 2004, income from the two consolidated Syn/Coal facilities was $49.3 million, $42.8 million and $31.9 million, respectively. Total expenses, including interest and depreciation expenses, relating to this income were $78.1 million, $78.7 million and $61.2 million in 2006, 2005 and 2004, respectively.

Investment income from other alternative energy investments primarily relates to Gallagher's equity interest in a company and related partnerships that own the rights to Biogas from landfills and the wells, infrastructure and a pipeline to capture, distribute and sell Biogas and investments in clean energy related entities. Interest and other income includes interest income earned on debt investments related to the Biogas partnerships. Other realized losses are a result of writing- off the equity option investments in the clean energy related investments in 2006 and 2005 and an impairment in 2006 on the company that has the rights to the Biogas capture, distribution and sale. During 2006, Gallagher recognized a $2.2 million loss as a result of fair market value adjustments for the option costs of C- Quest and C- Quest International, a $2.4 million loss as a result of the write- offs of its equity investments in C- Quest and C- Quest International and a $2.4 million loss related to the write- down of two Biomass partnerships. During 2005, Gallagher realized a $2.5 million loss as a result of a write- down of a substantial portion of its equity investment in Chem- Mod.

Investment income from the home office land and building relates to rental income recognized due to Gallagher's 60% ownership interest in a limited partnership that owns the building that Gallagher leases for its executive offices and several of its subsidiary operations. Rental income of the home office building was $4.9 million, $6.5 million and $6.6 million in 2006, 2005 and 2004, respectively. Total expenses associated with the home office building rental income, including interest and depreciation expenses, were $4.9 million, $6.3 million and $6.6 million in 2006, 2005 and 2004, respectively. On December 7, 2006, the real estate partnership sold Gallagher's home office land and building. Based on its ownership in the real estate partnership, Gallagher received cash proceeds of $7.9 million related to the sale, which resulted in a pretax loss to Gallagher of $4.2 million that was recorded in fourth quarter 2006 in the Financial Services Segment. Prior to December 7, 2006, this investment was consolidated into Gallagher's consolidated financial statements.

Investment income from the airplane leasing company relates to rental income recognized due to Gallagher's 90% ownership interest in an airplane leasing company that leases two cargo airplanes to the French Postal Service. In 2006, 2005 and 2004, rental income of the airplane leasing company was $3.5 million, $4.1 million and $3.4 million, respectively, and total expenses associated with this income, including interest and depreciation expenses, was $5.5 million, $5.5 million and $4.9 million, respectively. On December 22, 2006, Gallagher agreed to sell its 90% ownership interest in the cargo plane leasing enterprise and recognized a $2.7 million pretax loss. The sale transaction was completed on January 25, 2007.

Investment income from real estate, venture capital and other investments principally relates to interest and dividend income, Gallagher's portion of the earnings (losses) of these entities accounted for using equity method accounting and net realized gains (losses). Such gains (losses) primarily include realized gains and losses related to impairments, dispositions and recoveries of venture capital investments, which included loans and equity holdings in start- up companies.

During 2006, Gallagher realized a net gain of $0.2 million, none of the components of which was more than $0.1 million.

During 2005, Gallagher realized a net $4.0 million investment gain related to assets impaired in prior years, the main components of which were as follows: a $1.3 million gain on the sale of a Biogas project, a $1.2 million gain on a recovery from a Biogas project and a $0.6 million gain on the sale of a shopping center investment. The remaining $0.9 million net gain is from other transactions, none of which is greater than $0.5 million, related to the sales or recoveries of venture capital investments.

During 2004, Gallagher recognized a net $7.8 million investment gain related to assets impaired in first quarter 2003, the main components of which were as follows: a $2.0 million reversal of a loss contingency reserve, a $1.0 million recovery of previously accrued interest income, a $3.0 million recovery of unsecured notes receivable, a $0.5 million gain from a distribution on an investment previously impaired and a $0.7 million gain related to distributions received from a venture capital fund. The reversal of the loss contingency reserve was made as a result of the successfully completed funding transaction related to a Gallagher partially owned Biogas project. During 2005, Gallagher recognized a $2.1 million dividend from its investment in Allied World Assurance Holdings, Ltd.

Investment income from consolidated investments for 2004 was also impacted by the adoption of FIN 46. In 2003, Gallagher adopted FIN 46, which required Gallagher to consolidate a Syn/Coal partnership in which it had a 5% ownership interest at the time of consolidation. Prior to 2003, this partnership was not consolidated because it was not controlled by Gallagher through a majority voting interest. Gallagher recognized both investment income and expenses of $69.9 million in 2004 related to the consolidation of the Syn/Coal partnership. During 2004, Gallagher sold a 4% ownership interest in this investment, which eliminated the requirement to consolidate the investment under the FIN 46 rules. This investment is now accounted for using equity method accounting.

4. Business Combinations

During 2006, Gallagher acquired substantially all of the net assets of the following insurance brokerage firms and a premium finance company (ten asset purchases and one stock purchase) in exchange for its common stock and/or cash. These acquisitions have been accounted for as business combinations (in millions except share data):

Name and Effective Date of Acquisitions	Common Shares Issued	Common Share Value	Cash Paid	Accrued Liability	Escrow Deposited	Recorded Purchase Price	Earnout Payables
	(000s)						
Benefit Management Group, Inc. (BMG) - January 1, 2006	132	$ 3.6	$ 10.3	$ -	$ 0.5	$ 14.4	$ 4.2
Sobieski & Bradley, Inc. - April 1, 2006	113	2.9	-	-	0.3	3.2	-
Y. S. Liedman & Associates (YSL) - May 1, 2006	128	3.3	1.6	-	0.1	5.0	2.7
Robert Keith & Associates, Inc. - June 1, 2006	9	0.1	1.3	-	0.1	1.5	0.9
Lemac & Associates, Inc. (LAI) - June 1, 2006	18	0.5	21.2	-	1.3	23.0	7.0
S.P. Tarantino Insurance Brokerage, Inc. (TIB) - July 1, 2006	55	0.9	5.6	-	0.5	7.0	3.6
Commonwealth Premium Finance Corporation - September 1, 2006	-	-	3.8	0.2	-	4.0	-
The Rains Group, Inc. (TRG) - September 20, 2006	428	10.2	1.9	-	1.4	13.5	-
Adams & Associates International, Ltd. - November 1, 2006	20	0.2	2.8	-	0.4	3.4	1.3
William H. Connolly & Co. (WHC) - November 1, 2006	567	14.7	-	-	1.6	16.3	-
Mid America Group, Inc. (MAG) - December 15, 2006	137	1.4	21.5	-	2.6	25.5	10.0
	1,607	$ 37.8	$ 70.0	$ 0.2	$ 8.8	$ 116.8	$ 29.7

Common shares exchanged in connection with acquisitions are valued at closing market prices as of the effective date of the respective acquisition. Escrow deposits that are returned to Gallagher as a result of adjustments to net assets acquired are recorded as reductions to goodwill when the escrows are settled. The earnout payables that are disclosed in the foregoing table represent the maximum amount of additional consideration that could be paid pursuant to the purchase agreements related to these acquisitions. These potential earnout obligations are primarily based upon future earnings of the acquired ntities and were not included in the purchase price that was recorded for these acquisitions at their respective acquisition dates because they are not fixed and determinable. Future payments made under these arrangements, if any are earned, will be paid in either cash or stock, typically at Gallagher's election, and will generally be recorded as additional goodwill when the earnouts are settled. The aggregate amount of unrecorded earnout payables outstanding as of December 31, 2006 related to acquisitions made by Gallagher in the period from 2003 to 2006 was $73.9 million.

During 2006, Gallagher issued 0.2 million shares of its common stock and paid $8.9 million in cash and accrued $7.0 million in current liabilities related to earnout obligations of fifteen acquisitions made prior to 2006 and recorded additional goodwill of $17.0 million. During 2005, Gallagher issued 0.4 million shares of its common stock and paid $1.8 million in cash and accrued $2.7 million in current liabilities related to earnout obligations of eight acquisitions made prior to 2005 and recorded additional goodwill of $15.3 million. During 2004, Gallagher paid $2.3 million in cash related to earnout obligations of three acquisitions made prior to 2004 and recorded additional goodwill and expiration lists of $1.8 million and $0.5 million, respectively.

The following is a summary of the estimated fair values of the assets acquired at the date of each acquisition based on preliminary purchase price allocations (in millions):

	BMG	YSL	LAI	TIB	TRG	WHC	MAG	Four Other Acquisitions	Total
Current assets	$ 0.2	$ 0.1	$ 19.1	$ 0.9	$ 0.1	$ 3.4	$ 0.2	$ 9.1	$ 33.1
Fixed assets	-	-	-	-	-	0.3	-	0.3	0.6
Goodwill	6.6	1.6	10.6	3.4	6.6	8.7	7.6	3.1	48.2
Expiration lists	7.1	3.0	11.0	3.6	6.5	6.7	17.2	3.5	58.6
Non- compete agreements	0.5	0.3	0.3	-	0.3	0.3	0.5	0.1	2.3
Total assets acquired	14.4	5.0	41.0	7.9	13.5	19.4	25.5	16.1	142.8
Current liabilities	-	-	18.0	0.9	-	3.1	-	4.0	26.0
Total liabilities assumed	-	-	18.0	0.9	-	3.1	-	4.0	26.0
Total net assets acquired	$ 14.4	$ 5.0	$ 23.0	$ 7.0	$ 13.5	$ 16.3	$ 25.5	$ 12.1	$ 116.8

These acquisitions allow Gallagher to expand into desirable geographic locations, further extend its presence in the retail and wholesale insurance brokerage services industry and increase the volume of general services currently provided. The excess of the purchase price over the estimated fair value of the tangible net assets acquired at the acquisition date was allocated within the Brokerage Segment to goodwill, expiration lists and non- compete agreements in the amounts of $48.2 million, $58.6 million and $2.3 million, respectively. Purchase price allocations are preliminarily established at the time of the acquisition and are subsequently reviewed within the first year of operations to determine the necessity for allocation adjustments.

Expiration lists and non- compete agreements related to these acquisitions are currently being amortized on a straight- line basis over a weighted average useful life of ten to fifteen years and five years, respectively. Goodwill is not amortized, but is subject to periodic reviews for impairment. Gallagher reviews intangible assets for impairment periodically (at least annually) and whenever events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. In reviewing intangible assets, if the fair value were less than the carrying amount of the respective (or underlying) asset, an indicator of impairment would exist and further analysis would be required to determine whether or not a loss would need to be charged against current period earnings. In 2006, Gallagher determined that an indicator of impairment existed related to the amortizable intangible assets of one of its 2003 Brokerage Segment acquisitions. Based on the results of this impairment review, Gallagher wrote- off $1.0 million of amortizable intangible assets in 2006. No such indicators were noted in 2005. In 2004, Gallagher determined that an indicator of impairment existed related to the amortizable intangible assets of one of its 2001 Brokerage Segment acquisitions. Based on the results of this impairment review, Gallagher wrote- off $1.8 million of amortizable intangible assets in 2004. Of the $58.6 million of expiration lists and $2.3 million of non- compete agreements related to the 2006 acquisitions, $14.0 million and $0.6 million, respectively, are not expected to be deductible for income tax purposes. Accordingly, Gallagher recorded a deferred tax liability of $5.7 million, and a corresponding amount of goodwill, in 2006 related to the nondeductible amortizable intangible assets. This amount has not been included in the above table.

Gallagher's consolidated financial statements for the year ended December 31, 2006 include the operations of these companies from the date of their respective acquisition. The following is a summary of the unaudited pro forma historical results, as if these purchased entities had been acquired at January 1, 2005 (in millions, except per share data):

	Year Ended December 31,	
	2006	2005
Total revenues	$ 1,568.3	$ 1,537.8
Earnings from continuing operations	131.1	31.1
Basic Earnings from continuing operations per share	1.34	0.33
Diluted Earnings from continuing operations per share	1.32	0.32

The unaudited pro forma results above have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred at January 1, 2005, nor is it necessarily indicative of future operating results. Annualized revenues of entities acquired in 2006 totaled approximately $54.4 million.

5. Discontinued Operations

In first quarter 2005, Gallagher entered into an agreement to sell the net assets of Northshore International Insurance Services (NiiS), a medical claims management and auditing services provider, for cash of $4.8 million. Gallagher recognized a pretax loss of $12.7 million ($12.3 million after tax loss) in first quarter 2005 in connection with the sale. In Gallagher's previously reported financial information, NiiS's operating results were included in the Brokerage Segment, which have been reclassified to discontinued operations in the accompanying consolidated statement of earnings for all periods presented.

In first quarter 2005, Gallagher entered into an agreement to sell all of the stock of Gallagher Benefit Administrators, Inc. (GBA), a third party employee benefit claim payment administrator, for cash of $9.2 million and a promissory note in the amount of $4.4 million. Gallagher recognized a pretax gain of $9.6 million ($6.8 million after tax gain) in first quarter 2005 in connection with the sale. The promissory note has a 10% fixed rate of interest, with interest only payments payable monthly through August 22, 2007, when the note matures. In Gallagher's previously reported financial information, GBA's operating results were included in the Risk Management Segment, which have been reclassified to discontinued operations in the accompanying consolidated statement of earnings for all periods presented.

In second quarter 2005, Gallagher sold its ownership interests in the limited partnership that owns the Florida Community Development investment. Pursuant to the transaction, Gallagher received cash of $25.7 million and recorded a pretax gain of $12.6 million ($7.6 million after tax gain) in second quarter 2005 in connection with the sale. In Gallagher's previously reported financial information, the Florida Community Development's operating results were included in the Financial Services Segment, which have been reclassified to discontinued operations in the accompanying consolidated statement of earnings for all periods presented.

Total revenues reclassified to discontinued operations for 2005 and 2004 were $11.0 million and $43.3 million, respectively.

6. Fixed Assets

Major classes of fixed assets consist of the following (in millions):

	December 31,	
	2006	2005
Furniture and equipment	$ 183.0	$ 162.7
Buildings and improvements	-	98.1
Land and improvements	-	3.8
Airplanes of consolidated leasing company	49.1	51.8
Leasehold improvements	37.1	31.8
Syn/Coal equipment	15.7	15.6
	284.9	363.8
Accumulated depreciation	(181.8)	(178.7)
Net fixed assets	$ 103.1	$ 185.1

7. Intangible Assets

Major classes of amortizable intangible assets consist of the following (in millions):

	December 31, 2006	December 31, 2005
Expiration lists	$ 266.1	$ 203.8
Accumulated amortization - expiration lists	(60.0)	(41.2)
	206.1	162.6
Non- compete agreements	20.5	20.0
Accumulated amortization - non-compete agreements	(13.5)	(10.1)
	7.0	9.9
Net amortizable assets	$ 213.1	$ 172.5

Estimated aggregate amortization expense for each of the next five years is as follows:

2007	$ 26.8
2008	24.7
2009	22.8
2010	19.8
2011	18.9
Total	$ 113.0

The changes in the carrying amount of goodwill for 2006 are as follows (in millions):

	Brokerage	Risk Management	Financial Services	Total
Balance as of January 1, 2006	$ 236.2	$ 9.5	$ -	$ 245.7
Goodwill acquired during the year	70.9	-	-	70.9
Adjustments related to independent appraisals and other purchase accounting adjustments	-	-	-	-
Goodwill written- off related to sales of business units and impairment reviews during the year	-	-	-	-
Balance as of December 31, 2006	$ 307.1	$ 9.5	$ -	$ 316.6

The carrying amount of goodwill as of December 31, 2006 allocated by domestic and foreign operations is as follows (in millions):

	Brokerage	Risk Management	Financial Services	Total
United States	$ 276.0	$ 1.2	$ -	$ 277.2
Foreign, principally United Kingdom, Australia and Bermuda	31.1	8.3	-	39.4
Total Goodwill - net	$ 307.1	$ 9.5	$ -	$ 316.6

8. Credit and Other Debt Agreements

On October 5, 2005, Gallagher entered into an unsecured multicurrency credit agreement (Credit Agreement), which expires on October 4, 2010, with a group of ten financial institutions. The Credit Agreement provides for a revolving credit commitment of up to $450.0 million, of which up to $125.0 million may be used for issuances of standby or commercial letters of credit (LOCs) and up to $30.0 million may be used for the making of swing loans, as defined in the Credit Agreement. Gallagher may from time- to- time request, subject to certain conditions, an increase in the revolving credit commitment up to a maximum aggregate revolving credit commitment of $550.0 million.

The Credit Agreement provides that Gallagher may elect that each borrowing in U.S. dollars be either base rate loans or Eurocurrency loans, as defined in the Credit Agreement. All loans denominated in currencies other than U.S. dollars shall be Eurocurrency loans. Interest rates on base rate loans and outstanding drawings on LOCs in U.S. dollars under the Credit Agreement are based on the base rate, as defined in the Credit Agreement. Interest rates on Eurocurrency loans or outstanding drawings on LOCs in currencies other than U.S. dollars under the Credit Agreement are based on adjusted LIBOR, as defined in the Credit Agreement, plus a margin of .400%, .500%, .600% or .800%, depending on the financial leverage ratio maintained by Gallagher. Interest rates on swing loans are based, at the election of Gallagher, on either the base rate, as defined in the Credit Agreement, or such alternate rate as may be quoted by the lead lender. The annual facility fee related to the Credit Agreement is either .100%, .125%, .150% or .200% of the used and unused portions of the revolving credit commitment, depending on the financial leverage ratio maintained by Gallagher. In connection with entering into the Credit Agreement, Gallagher incurred approximately $1.4 million of debt acquisition costs that were capitalized and will be amortized on a pro rata basis over the term of the Credit Agreement.

The terms of the Credit Agreement include various covenants, including covenants that require Gallagher to maintain specified levels of net worth and financial leverage ratios. Gallagher was in compliance with these covenants at December 31, 2006. The Credit Agreement also includes customary events of default, with corresponding grace periods, including, without limitation, payment defaults, cross- defaults to other agreements evidencing indebtedness and bankruptcy- related defaults. Gallagher's obligations under the Credit Agreement are unconditionally guaranteed by several of its wholly- owned subsidiaries.

At December 31, 2006, $17.6 million of LOCs (for which Gallagher had $6.5 million of liabilities recorded as of December 31, 2006) were outstanding under the Credit Agreement. See Notes 3 and 17 to the consolidated financial statements for a discussion on the LOCs. There were no borrowings outstanding under the revolving credit commitment at December 31, 2006. Accordingly, as of December 31, 2006, $432.4 million remained available for potential borrowings, of which $107.4 million may be in the form of additional LOCs.

The following is a summary of Gallagher's Credit Agreement and investment related debt (in millions):

	December 31, 2006	December 31, 2005
Corporate related borrowings:		
Gallagher's Credit Agreement:		
Periodic payments of interest and principal, prime or LIBOR plus up to 0.80%, expires October 2010	$ -	$ -
Investment related borrowings:		
Mortgage loan on Gallagher's home office:		
Monthly installments of principal and interest, fixed rate of 8.35%, 30 year amortization - loan was extinguished on December 7, 2006	-	76.1
Loan on airplanes leased to French Postal Service:		
Monthly principal and interest payments, fixed rate of 5.38%, balloon payment 2011	28.0	29.9
Syn/Coal facility purchase note:		
Quarterly variable principal and interest payments, fixed rate of 7.00%	6.8	6.9
	$ 34.8	$ 112.9

See Note 17 for additional discussion on commitments and contingencies.

9. Capital Stock and Stockholders' Rights Plan

Capital Stock- The table below summarizes certain information about Gallagher's capital stock at December 31, 2006 and 2005 (in millions, except par value data):

Class	Par Value		Authorized Shares
Preferred stock		No par	1
Common stock	$	1.00	400

Stockholders' Rights Plan- Non- voting Rights, authorized by the Board of Directors and approved by stockholders in 1987, are outstanding on each share of Gallagher's outstanding common stock. The Rights Plan was amended in 1996 to extend the expiration of the Rights to May 12, 2007, and was amended again on March 19, 2004 to increase the exercise price from $25.00 to $55.00. Under certain conditions, each Right may be exercised to purchase one share of common stock at the exercise price. The Rights become exercisable and transferable upon the earlier of (a) the tenth business day after a person or group (as defined) has acquired 20% or more of the common stock or (b) the tenth business day (or such later date as may be determined by the Board) after a person or group has commenced or publicly announced an intention to commence a tender offer or exchange offer which would result in such person or group acquiring 20% or more of the common stock. If Gallagher is acquired in a merger or business combination, each Right exercised gives the holder the right to purchase $110.00 of market value of common stock of the surviving company for the $55.00 exercise price. The Rights may be redeemed by Gallagher at $.0125 per Right at any time prior to the earlier of (a) or (b) above.

10. Earnings per Share

The following table sets forth the computation of basic and diluted net earnings per share (in millions, except per share data):

	Year Ended December 31,					
	2006		2005		2004	
Earnings from continuing operations	$	128.5	$	28.6	$	189.5
Earnings (loss) from discontinued operations		-		2.2		(1.0)
Net earnings	$	128.5	$	30.8	$	188.5
Weighted average number of common shares outstanding		97.1		94.1		91.5
Dilutive effect of stock options using the treasury stock method		1.3		2.0		3.0
Weighted average number of common and common equivalent shares outstanding		98.4		96.1		94.5
Basic net earnings (loss) per share:						
Earnings from continuing operations	$	1.32	$	.30	$	2.07
Earnings (loss) from discontinued operations		-		.03		(.01)
Net earnings	$	1.32	$	.33	$	2.06
Diluted net earnings (loss) per share						
Earnings from continuing operations	$	1.31	$	.30	$	2.00
Earnings (loss) from discontinued operations		-		.02		(.01)
Net earnings	$	1.31	$	.32	$	1.99

Options to purchase 8.9 million, 7.3 million and 1.9 million shares of common stock were outstanding at December 31, 2006, 2005 and 2004, respectively, but were not included in the computation of the dilutive effect of stock options for the year then ended. These options were excluded from the computation because the options' exercise prices were greater than the average market price of the common shares during the respective period and, therefore, would be antidilutive to earnings per share under the treasury stock method.

11. Stock Option Plans

Gallagher has four stock option- based employee compensation plans. Gallagher primarily grants stock options for a fixed number of shares to employees, with an exercise price equal to the fair value of the underlying shares of Gallagher common stock at the date of grant. All options granted under the plans must be approved by either the Compensation Committee of the Board of Directors (the Compensation Committee), which consists entirely of independent directors, within the meaning of the listing rules of the New York Stock Exchange or the Chief Executive Officer of Gallagher under a limited delegation of authority from the Compensation Committee.

Gallagher has incentive and nonqualified stock option plans for officers and key employees of Gallagher and its subsidiaries. Options granted under the incentive plan primarily become exercisable at the rate of 10% per year beginning the calendar year after the date of grant. Options granted under the nonqualified plan primarily become exercisable at the rate of 10% per year beginning the calendar year after the date of grant or earlier in the event of death, disability or, in the case of options granted on or before June 30, 2006, retirement (if the retirement eligible age requirement is met). Options expire ten years from the date of grant, or earlier in the event of termination of the employee (if the retirement eligible age requirement is not met). Prior to June 30, 2006, nonqualified options granted by Gallagher typically contained provisions where the vesting of the stock options accelerates to 100% on the employee's retirement date if the employee met the retirement eligible age requirement.

In addition, Gallagher has a non- employee directors' stock option plan, which currently authorizes 1.9 million shares for grant, with Discretionary Options granted at the direction of the Compensation Committee and Retainer Options granted in lieu of the directors' annual retainer. Discretionary Options are exercisable at such rates as shall be determined by the Compensation Committee on the date of grant. Retainer Options are cumulatively exercisable at the rate of 25% of the total Retainer Option at the end of each full fiscal quarter succeeding the date of grant. Options granted under the non- employee directors' plan contain provisions where the vesting of the stock options accelerates to 100% on the termination of the director.

Gallagher also has an incentive stock option plan for its officers and key employees resident in the U.K. The U.K. plan is essentially the same as Gallagher's domestic employee stock option plans, with certain modifications to comply with U.K. law and to provide potentially favorable tax treatment for grantees resident in the U.K.

All of the aforementioned stock option plans provide for the immediate vesting of all outstanding stock option grants in the event of a change in control of Gallagher as defined in the plan documents.

For purposes of the pro forma disclosures in Note 2 and for the expense recognition in 2006, 2005 and 2004, the estimated fair values of the stock option grants are amortized to expense over the options' expected lives. The fair value of stock options at the date of grant was estimated using the Black- Scholes option pricing model with the following weighted average assumptions:

	Year Ended December 31,		
	2006	2005	2004
Expected dividend yield	3.0%	3.0%	3.0%
Expected risk- free interest rate	4.9%	4.2%	4.2%
Volatility	25.8%	26.2%	26.7%
Expected life (in years)	6.5	6.9	6.8

The Black- Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because Gallagher's employee and director stock options have characteristics significantly different from those of traded options, and because changes in the selective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee and director stock options. The weighted average fair value per option for all options granted during 2006, 2005 and 2004, as determined on the grant date using the Black- Scholes option valuation model, was $6.87, $6.69 and $7.35, respectively.

The following is a summary of Gallagher's stock option activity and related information for 2006, 2005 and 2004 (in millions, except exercise price data):

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Year Ended December 31, 2006				
Beginning balance	16.6	$ 23.82		
Granted	0.4	27.52		
Exercised	(1.3)	11.82		
Forfeited or canceled	(0.5)	27.28		
Ending balance	15.2	$ 24.81	6.07	$ 75.3
Exercisable at end of year	6.4	$ 23.30	5.00	$ 41.9
Ending vested and expected to vest	14.9	$ 24.77	6.05	$ 74.4
Year Ended December 31, 2005				
Beginning balance	15.7	$ 22.00		
Granted	3.1	27.37		
Exercised	(1.6)	11.96		
Forfeited or canceled	(0.6)	26.81		
Ending balance	16.6	$ 23.82	6.63	$ 119.4
Exercisable at end of year	5.6	$ 20.67	4.90	$ 58.1
Ending vested and expected to vest	16.6	$ 23.82	6.63	$ 119.4
Year Ended December 31, 2004				
Beginning balance	15.0	$ 18.59		
Granted	3.2	29.89		
Exercised	(2.2)	10.36		
Forfeited or canceled	(0.3)	21.22		
Ending balance	15.7	$ 22.00	6.59	$ 166.1
Exercisable at end of year	5.1	$ 17.47	4.69	$ 77.7
Ending vested and expected to vest	15.7	$ 22.00	6.59	$ 166.1

Options with respect to 4.5 million shares were available for grant at December 31, 2006.
The total intrinsic value of options exercised during 2006, 2005 and 2004 amounted to $19.3 million, $25.9 million and $42.7 million, respectively.
As of December 31, 2006, there was approximately $51.1 million of total unrecognized compensation cost related to nonvested options. That cost is expected to be recognized over a weighted average period of approximately six years.

Other information regarding stock options outstanding and exercisable at December 31, 2006 is summarized as follows (in millions, except exercise price data):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 1.11 - $ 18.97	2.5	2.65	$ 14.19	1.8	$ 13.93
22.70 - 24.90	3.9	5.94	23.95	1.6	23.88
24.99 - 27.11	2.5	5.59	26.44	1.3	26.36
27.12 - 27.35	2.6	8.40	27.25	0.4	27.23
27.36 - 29.42	2.5	7.58	29.28	0.6	29.23
29.45 - 36.94	1.2	6.59	32.19	0.7	32.43
$ 1.11 - $ 36.94	15.2	6.07	$ 24.81	6.4	$ 23.30

12. Deferred Compensation

Gallagher has a Deferred Equity Participation Plan, which is a non- qualified plan that provides for distributions to certain key executives of Gallagher upon their normal retirement. Under the provisions of the plan, Gallagher contributes shares of its common stock, in an amount approved by the Compensation Committee, to a rabbi trust on behalf of the executives participating in the plan. Distributions under the plan normally may not be made until the participant reaches age 62 and are subject to forfeiture in the event of voluntary termination of employment prior to age 62. All distributions from the plan, except for accumulated non- invested dividends, are made in the form of Gallagher's common stock.

In first quarter 2006, 2005 and 2004, Gallagher contributed $4.3 million, $4.7 million and $4.6 million, respectively, to the plan through the issuance of 148,000, 157,000 and 142,000 restricted shares, respectively, of Gallagher's common stock. The Gallagher common stock that is issued under the plan to the rabbi trust is valued at historical cost (fair market value at the date of grant) and the unearned deferred compensation obligation is recorded as a reduction of capital in excess of par value in the accompanying consolidated balance sheet and is being amortized to compensation expense ratably over the vesting period of the participants. Future changes in the fair value of the Gallagher common stock that is owed to the participants do not have any impact on Gallagher's consolidated financial statements. During 2006, 2005 and 2004, $2.6 million, $2.3 million and $1.7 million, respectively, was charged to compensation expense related to this plan. During 2006 and 2005, 30,000 and 68,000 shares of Gallagher's common stock, respectively, were vested and distributed to employees related to this plan, with an aggregate fair value of $0.8 million and $1.9 million, respectively. No shares were vested or distributed to employees in 2004. Gallagher had $16.2 million (related to 780,000 shares) and $14.5 million (related to 660,000 shares) of unearned deferred compensation outstanding at December 31, 2006 and 2005, respectively.

13. Restricted Stock Awards

Gallagher has adopted a restricted stock plan for its directors, officers and other employees. Under the provisions of the plan, Gallagher is authorized to issue 4.0 million restricted shares of Gallagher common stock. The Compensation Committee is responsible for the administration of the plan. Each award granted under the plan represents a right of the holder of the award to receive restricted shares of Gallagher common stock, cash or a combination of restricted shares and cash, subject to the holder's continued employment with Gallagher for a period of time after the date the award is granted. The Compensation Committee shall determine each recipient of an award under the plan, the number of restricted shares of common stock subject to such award and the period of continued employment required for the vesting of such award. These terms will be included in an award agreement between Gallagher and the recipient of the award. As of December 31, 2006, 3.4 million restricted shares were available for grant under this plan.

In first quarter 2006, 2005 and 2004, Gallagher granted 104,000, 124,000 and 65,000 restricted shares, respectively, of its common stock to employees related to incentive compensation plans, with an aggregate fair value of $3.0 million, $3.7 million and $2.1 million, respectively, at the date of grant. In second quarter 2006, 2005 and 2004 Gallagher granted 68,000, 40,000 and 6,000 restricted shares, respectively, of its common stock to employees related to incentive compensation plans, with an aggregate fair value of $1.8 million, $1.1 million and $0.2 million, respectively, at the date of grant. In third quarter 2006, Gallagher granted 52,000 restricted shares of its common stock to employees related to incentive compensation plans with an aggregate fair value of $1.4 million at the date of grant. In fourth quarter 2006, 2005 and 2004, Gallagher granted 5,000, 36,000 and 49,000 restricted shares, respectively, of its common stock to employees related to incentive compensation plans, with an aggregate fair value of $0.1 million, $1.1 million and $1.3 million, respectively, at the date of grant.
The 2006, 2005 and 2004 restricted stock awards generally vest annually on a pro rata basis as follows (in actual shares):

	Shares Granted		
Vesting Period	**2006**	**2005**	**2004**
One year	-	21,000	19,000
Two years	58,000	53,000	46,000
Three years	51,000	90,000	55,000
Four years	19,000	-	-
Five years	51,000	36,000	-
Ten years	50,000	-	-
Total shares granted	229,000	200,000	120,000

Gallagher accounts for restricted stock at historical cost which equals its fair market value at the date of grant. When restricted shares are issued, an unearned restricted stock obligation is recorded as a reduction of capital in excess of par value in the accompanying consolidated balance sheet and is being amortized to compensation expense ratably over the shorter of the vesting period or the retirement eligible date of the participants. Prior to June 30, 2006, the restricted stock awards granted by Gallagher typically contained provisions where participants will continue to vest in the awards through the vest dates if they leave Gallagher and have met the retirement eligible age requirement. Thus, the recognition of stock compensation expense related to restricted stock awards will not follow the vesting schedules presented above. Future changes in the fair value of the Gallagher common stock that is owed to the participants do not have any impact on Gallagher's consolidated financial statements. During 2006, 2005 and 2004, $6.0 million, $4.9 million and $8.3 million, respectively, was charged to compensation expense related to restricted stock awards granted between 2002 to 2006. During 2006, 2005 and 2004, 138,000, 308,000, and 251,000 shares of Gallagher's common stock, respectively, were vested and distributed to employees related to this plan, with an aggregate fair value of $3.8 million, $8.9 million and $8.2 million, respectively. Gallagher had $5.5 million (related to 345,000 shares) and $5.3 million (related to 260,000 shares) of unearned restricted stock outstanding at December 31, 2006 and 2005, respectively.

14. Employee Stock Purchase Plan

Gallagher has an employee stock purchase plan (ESPP) under which the sale of 4.0 million shares of Gallagher's common stock has been authorized. Eligible employees may contribute up to 15% of their compensation toward the quarterly purchase of Gallagher's common stock, the purchases of which are effective as of the end of each quarter. The employees' purchase price is 85% of the lesser of the fair market value of the stock on the first business day or the last business day of the quarterly offering period. Employees may annually purchase shares having a fair market value of up to $25,000 (measured as of the first day of the quarterly offering period of each calendar year). Gallagher recognizes compensation expense related to the common stock issued under the ESPP. Currently, there are 2.8 million shares reserved for future issuance.

The 2006, 2005 and 2004 ESPP information is as follows (in millions, except per share and share data):

	1st	2nd	3rd	4th	Total
2006					
Fair market value per share at date of purchase	$ 27.81	$ 25.34	$ 26.67	$ 29.55	
Purchase price per share	$ 23.64	$ 21.54	$ 21.54	$ 22.64	
Shares issued	130,000	105,000	83,000	73,000	391,000
Aggregate purchase price	$ 3.1	$ 2.3	$ 1.8	$ 1.6	$ 8.8
Stock compensation expense recognized	$ 0.5	$ 0.4	$ 0.5	$ 0.5	$ 1.9
2005					
Fair market value per share at date of purchase	$ 28.80	$ 27.13	$ 28.81	$ 30.88	
Purchase price per share	$ 24.48	$ 23.06	$ 23.13	$ 24.62	
Shares issued	121,000	94,000	81,000	70,000	366,000
Aggregate purchase price	$ 2.9	$ 2.2	$ 1.9	$ 1.7	$ 8.7
Stock compensation expense recognized	$ 0.5	$ 0.4	$ 0.5	$ 0.4	$ 1.8
2004					
Fair market value per share at date of purchase	$ 32.57	$ 30.45	$ 33.13	$ 32.50	
Purchase price per share	$ 27.16	$ 25.88	$ 25.85	$ 27.63	
Shares issued	100,000	81,000	69,000	59,000	309,000
Aggregate purchase price	$ 2.7	$ 2.1	$ 1.8	$ 1.6	$ 8.2
Stock compensation expense recognized	$ 0.5	$ 0.3	$ 0.3	$ 0.3	$ 1.4

15. Retirement Plans

Gallagher has a noncontributory defined benefit pension plan that prior to July 1, 2005 covered substantially all domestic employees who had attained a specified age and one year of employment. Benefits under the plan were based on years of service and salary history. Gallagher accounts for the defined benefit pension plan in accordance with Statement of Financial Accounting Standards No. 87 (SFAS 87), "Employers' Accounting for Pensions." In 2005, Gallagher amended its defined benefit pension plan to freeze the accrual of future benefits for all domestic employees, effective on July 1, 2005, which resulted in Gallagher recognizing a curtailment gain of $10.0 million. In the table below, the service cost component in 2006 represents plan administration costs that are incurred directly by the plan.

A reconciliation of the beginning and ending balances of the pension benefit obligation and fair value of plan assets and the funded status of the plan is as follows (in millions):

	Year Ended December 31,	
	2006	2005
Change in pension benefit obligation:		
Benefit obligation at beginning of year	$ 181.7	$ 195.7
Service cost	0.2	10.7
Interest cost	9.8	10.8
Net actuarial (gain) loss	(10.1)	15.9
Benefits paid	(4.0)	(3.2)
Curtailment	-	(48.2)
Benefit obligation at end of year	$ 177.6	$ 181.7
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 169.3	$ 137.0
Actual return on plan assets	22.2	11.0
Contributions by Gallagher	-	24.5
Benefits paid	(4.0)	(3.2)
Fair value of plan assets at end of year	$ 187.5	$ 169.3
Funded status of the plan (underfunded)	$ 9.9	$ (12.4)
Unrecognized net actuarial (gain) loss	(8.3)	10.2
Net amount recognized	$ 1.6	$ (2.2)
Amounts recognized in the consolidated balance sheet consist of:		
Prepaid (accrued) benefit cost (earnings)	$ 9.9	$ (12.4)
Accumulated other comprehensive (earnings) loss	(8.3)	10.2
Net amount recognized	$ 1.6	$ (2.2)

The components of the net periodic pension benefit cost for the plan consists of the following (in millions):

	Year Ended December 31,		
	2006	2005	2004
Service cost- benefits earned during the year	$ 0.2	$ 10.7	$ 17.2
Interest cost on benefit obligation	9.8	10.8	10.0
Expected return on plan assets	(13.8)	(12.1)	(10.2)
Amortization of prior service cost	-	0.2	0.3
Amortization of net actuarial loss	-	0.6	-
Amortization of transition obligation	-	-	0.1

Net periodic benefit (earnings) cost	(3.8)	10.2	17.4
Curtailment gain	-	(10.0)	-
Total benefit (earnings) cost	$ (3.8)	$ 0.2	$ 17.4

The following is information required to be separately disclosed for pension plans with an accumulated benefit obligation in excess of plan assets (in millions):

	December 31,	
	2006	2005
Projected benefit obligation	$ 177.6	$ 181.7
Accumulated benefit obligation	177.6	181.7
Fair value of plan assets	187.5	169.3

The following weighted average assumptions were used at December 31 in determining the plan's pension benefit obligation:

	December 31,	
	2006	2005
Discount rate	5.75%	5.75%
Weighted average expected long- term rate of return on plan assets	8.25%	8.25%

The following weighted average assumptions were used at January 1 in determining the plan's net periodic pension benefit cost:

	Year Ended December 31,	
	2006	2005
Discount rate	5.75%	6.00%
Weighted average rate of increase in future compensation levels	-	6.10%
Weighted average expected long- term rate of return on plan assets	8.25%	8.25%

The following is a summary of the plan's weighted average asset allocations at December 31 by asset category:

	December 31,	
Asset Category	**2006**	**2005**
Equity securities	62.0%	56.0%
Debt securities	29.0%	35.0%
Real estate	9.0%	9.0%
Total	100.0%	100.0%

The following benefit payments are expected to be paid by the plan (in millions):

2007	$ 4.1
2008	4.8
2009	5.4
2010	6.0
2011	6.8
Years 2012 to 2016	46.0

Plan assets are invested in various pooled separate accounts under a group annuity contract managed by a life insurance carrier. The plan's investment policy provides that investments shall be allocated in a manner designed to provide a long- term investment return greater than the actuarial assumptions, maximize investment return commensurate with risk and to comply with the Employee Retirement Security Act of 1974 (ERISA) by investing the funds in a manner consistent with ERISA's fiduciary standards. The weighted average expected long- term rate of return on plan assets assumption of 8.25% was determined based on a review of the asset allocation strategy of the plan using expected ten- year return assumptions for all of the asset classes in which the plan was invested at December 31, 2006. The ten- year return assumptions used in the valuation were based on data provided by the plan's external investment advisors.

In 2007, Gallagher does not anticipate making any contributions to the pension plan. This expected level of funding is based on the plan being frozen and over funded at December 31, 2006. In addition, Gallagher expects there will be no minimum contribution required under the IRC.

Gallagher also has a qualified contributory savings and thrift (401(k)) plan covering the majority of its domestic employees. Gallagher's matching contributions (up to a maximum of 5.0% of eligible compensation in 2006; up to a maximum of 2.5% of eligible compensation in 2005 and 2004) are at the discretion of Gallagher's Board of Directors and may not exceed the maximum amount deductible for federal income tax purposes. Gallagher contributed $20.8 million, $9.5 million and $8.7 million in 2006, 2005 and 2004, respectively. Gallagher also has a nonqualified deferred compensation plan for certain employees who, due to IRS rules, cannot take full advantage of the Gallagher matching contributions under the savings and thrift plan. The plan permits these employees to annually elect to defer a portion of their compensation until their retirement or a future date. Gallagher's matching contributions to this plan are also at the discretion of Gallagher's Board of Directors. Gallagher contributed $1.4 million, $0.9 million and $0.6 million to the plan in 2006, 2005 and 2004, respectively. The fair value of the plan's assets at December 31, 2006 and 2005 including employee contributions and investment earnings thereon, was $59.3 million and $50.7 million, respectively, and has been included in other noncurrent assets and the corresponding liability has been included in other noncurrent liabilities in the accompanying consolidated balance sheet. Gallagher also has several foreign benefit plans, the largest of which is a defined contribution plan that provides for contributions by Gallagher of 5% of eligible compensation. In addition, the plan allows for voluntary contributions by UK employees, which are matched 100% by Gallagher, up to a maximum of an additional 5% of eligible compensation. Net expense for foreign retirement plans amounted to $6.8 million, $6.3 million and $5.3 million in 2006, 2005 and 2004, respectively.

16. Postretirement Benefits Other than Pensions

In 1992, Gallagher amended its health benefits plan to eliminate retiree coverage, except for retirees and those employees who had already attained a specified age and length of service at the time of the amendment. The retiree health plan is contributory, with contributions adjusted annually, and is funded on a pay- as- you- go basis.

A reconciliation of the beginning and ending balances of the postretirement benefit obligation and the funded status of the plan is as follows (in millions):

	Year Ended December 31, 2006	2005
Change in postretirement benefit obligation:		
Benefit obligation at beginning of year	$ 8.0	$ 7.6
Service cost	-	-
Interest cost	0.4	0.4
Net actuarial loss	(0.1)	0.4
Benefits paid	(0.2)	(0.4)
Benefit obligation at end of year	$ 8.1	$ 8.0
Change in plan assets:		
Fair value of plan assets at beginning of year	$ -	$ -
Actual return on plan assets	-	-
Contributions by Gallagher	0.2	0.4
Benefits paid	(0.2)	(0.4)
Fair value of plan assets at end of year	$ -	$ -
Funded status of the plan (underfunded)	$ (8.1)	$ (8.0)
Unrecognized net actuarial gain	(3.2)	(3.3)
Unrecognized transition obligation	3.1	3.6
Net amount recognized	$ (8.2)	$ (7.7)
Amounts recognized in the consolidated balance sheet consist of:		
Accrued benefit liability	$ (8.1)	$ (7.7)
Accumulated other comprehensive earnings	(0.1)	-
Net amount recognized	$ (8.2)	$ (7.7)

The components of the net periodic postretirement benefit cost include the following (in millions):

	Year Ended December 31,		
	2006	2005	2004
Service cost - benefits earned during the year	$ -	$ -	$ -
Interest cost on benefit obligation	0.4	0.4	0.5
Amortization of transition obligation	0.5	0.5	0.5
Amortization of net actuarial gain	(0.2)	(0.3)	(0.3)
Net periodic benefit cost	$ 0.7	$ 0.6	$ 0.7

The discount rate used to measure the postretirement benefit obligation was 5.25% at December 31, 2006 and 2005. The discount rate used to measure the net periodic postretirement benefit cost at January 1 was 5.25% for 2006 and 6.00% for 2005. The transition obligation is being amortized at a rate of $0.5 million per year over a twenty- year period ending on December 31, 2012.
The following assumed healthcare cost trend rates were used at December 31 in determining the plan's postretirement benefit obligation:

	December 31,	
	2006	2005
Healthcare cost trend rate assumed for next year	9.00%	10.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year the rate reaches the ultimate trend rate	2011	2011

The assumed healthcare cost trend rate has a significant effect on the amounts reported and disclosed herein. A one percentage point change in the assumed healthcare cost trend rate would have the following effects (in millions):

	One Percentage Point	
	Increase	Decrease
Effect on the net periodic postretirement benefit cost in 2006	$ 0.1	$ (0.1)
Effect on the postretirement benefit obligation at December 31, 2006	0.8	(0.7)

The following represents expected future benefit payments to be paid by the plan and contributions to be made by Gallagher, (in millions):

	Prior to Reflecting Medicare Part D	After Reflecting Medicare Part D
2007	$ 0.6	$ 0.5
2008	0.6	0.5
2009	0.6	0.6
2010	0.7	0.6
2011	0.7	0.6
Years 2012 to 2016	3.4	3.1

17. Commitments, Contingencies, Financial Guarantees and Off- Balance Sheet Arrangements

In connection with its investing and operating activities, Gallagher has entered into certain contractual obligations as well as commitments. See Notes 3 and 8 for additional discussion of these obligations and commitments. Gallagher's future minimum cash payments, excluding interest, associated with its contractual obligations pursuant to the Credit Agreement, investment related borrowings, operating leases and purchase commitments at December 31, 2006 were as follows (in millions):

	Payments Due by Period						
Contractual Obligations	2007	2008	2009	2010	2011	Thereafter	Total
Credit Agreement	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Investment related borrowings:							
Airplane leasing company debt	2.1	2.2	2.3	2.5	18.9	-	28.0
Syn/Coal facility purchase note	6.8	-	-	-	-	-	6.8
Total debt obligations	8.9	2.2	2.3	2.5	18.9	-	34.8
Operating lease obligations	58.6	51.6	43.3	37.7	30.3	63.1	284.6
Net Syn/Coal purchase commitments	3.1	-	-	-	-	-	3.1
Outstanding purchase obligations	3.3	-	-	-	-	-	3.3
Total contractual obligations	$ 73.9	$ 53.8	$ 45.6	$ 40.2	$ 49.2	$ 63.1	$ 325.8

The amounts presented in the table above may not necessarily reflect the actual future cash funding requirements of Gallagher, because the actual timing of the future payments made may vary from the stated contractual obligation.

Credit Agreement - Gallagher has a $450.0 million Credit Agreement it uses to post LOCs and that it can use from time- to- time to borrow funds to supplement operating cash flows. At December 31, 2006, $17.6 million of LOCs (of which Gallagher has $6.5 million of liabilities recorded as of December 31, 2006) were outstanding under the Credit Agreement, some of which related to Gallagher's investments as discussed in Note 3. There were no borrowings outstanding under the Credit Agreement at December 31, 2006. Accordingly, as of December 31, 2006, $432.4 million remained available for potential borrowings, of which $107.4 million may be in the form of additional LOCs. Gallagher is under no obligation to utilize the Credit Agreement in performing its normal business operations. See Note 8 for a discussion of the terms of the Credit Agreement.

Investment Related Borrowings - As more fully described in Note 3, at December 31, 2006, the accompanying balance sheet includes $34.8 million of borrowings related to Gallagher's investment related enterprises, none of which is recourse to Gallagher. These borrowings are partially secured by the underlying assets of the investment enterprises and support their operations.

Operating Lease Obligations - Gallagher's executive offices and certain subsidiary and branch facilities are located at Two Pierce Place, Itasca, Illinois, where Gallagher leases approximately 308,000 square feet of space, or approximately 60% of the building. The lease commitment on this property expires February 28, 2018. Gallagher has a 60% ownership interest in a real estate limited partnership that, prior to December 7, 2006, owned the Two Pierce Place property. On December 7, 2006, the real estate partnership sold Gallagher's home office land and building. Based on its ownership in the real estate partnership, Gallagher received cash proceeds of $7.9 million related to the sale, which resulted in a pretax loss to Gallagher of $4.2 million that was recorded in fourth quarter 2006 in the Financial Services Segment. Terms of the transaction require Gallagher to post a one- year, $1.0 million letter of credit as collateral for Gallagher's representations and warranties. Prior to December 7, 2006, this investment was consolidated into Gallagher's consolidated financial statements.

Gallagher generally operates in leased premises at its other locations. Certain office space leases have options permitting renewals for additional periods. In addition to minimum fixed rentals, a number of leases contain annual escalation clauses which are generally related to increases in an inflation index.

Total rent expense, including rent relating to cancelable leases and leases with initial terms of less than one year, amounted to $66.3 million in 2006, $62.4 million in 2005 and $57.9 million in 2004.

Gallagher has leased certain office space to several non- Gallagher tenants under operating sublease arrangements. In the normal course of business, Gallagher expects that the leases will not be renewed or replaced. The following is a summary of the minimum future rentals to be received from non-Gallagher tenants on noncancelable operating leases related to these sublease arrangements of this office space as of December 31, 2006 (in millions):

Year	**Amount**
2007	$ 1.8
2008	1.6
2009	1.4
2010	1.6
2011	1.6
Thereafter	1.7
Total	$ 9.7

Charges for real estate taxes and common area maintenance are adjusted annually based on actual expenses, and the related revenues are recognized in the year in which the expenses are incurred. These amounts are not included in the minimum future rentals to be received in the contractual obligations table above.

Net IRC Section 29- related Syn/Coal Purchase Commitments - Gallagher has interests in two Syn/Coal facilities that it consolidates. See Note 3 for additional disclosures regarding these partnerships. The facilities have entered into raw coal purchase and IRC Section 29- related Syn/Coal sales agreements. These agreements terminate immediately in the event the IRC Section 29- related Syn/Coal produced ceases to qualify for credits under IRC Section 29 or upon termination of either the purchase or sales agreements. The net annual IRC Section 29- related Syn/Coal purchase commitments represent the minimum raw coal purchases at estimated costs less sales of IRC Section 29- related Syn/Coal at estimated prices.

Outstanding Purchase Obligations - Gallagher is a service company and thus typically does not have a material amount of outstanding purchase obligations at any point in time. The amount disclosed in the contractual obligations table above represents the aggregate amount of unrecorded purchase obligations that Gallagher had outstanding as of December 31, 2006. These obligations represent agreements to purchase goods or services that were executed in the normal course of business.

Off- Balance Sheet Commitments - Gallagher's total unrecorded commitments associated with outstanding letters of credit, financial guarantees and funding commitments as of December 31, 2006 were as follows (in millions):

	Amount of Commitment Expiration by Period						
Off- Balance Sheet Commitments	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**	**Total Amounts Committed**
Investment related:							
Letters of credit	$ 1.0	$ -	$ -	$ -	$ -	$ 16.6	$ 17.6
Funding commitments	0.8	0.4	0.6	-	-	-	1.8
Total commitments	$ 1.8	$ 0.4	$ 0.6	$ -	$ -	$ 16.6	$ 19.4

At December 31, 2006, Gallagher had no off- balance sheet commitments related to its Risk Management operations. Since commitments may expire unused, the amounts presented in the table above do not necessarily reflect the actual future cash funding requirements of Gallagher. See Note 3 for a discussion of Gallagher's outstanding LOCs, financial guarantees and funding commitments related to its Financial Services Segment and the Off-Balance Sheet Debt section below for a discussion of other LOCs. All but one of the LOCs represent multiple year commitments and have annual, automatic renewing provisions and are classified by the latest commitment date.

Since January 1, 2002, Gallagher has acquired sixty- four companies, which were accounted for as business combinations. Substantially all of the purchase agreements related to these acquisitions contain earnout obligations. The earnout obligations related to the 2006 acquisitions are disclosed in Note 4. These earnout payables represent the maximum amount of additional consideration that could be paid pursuant to the purchase agreements related to these acquisitions. These potential earnout obligations are primarily based upon future earnings of the acquired entities and were not included in the purchase price that was recorded for these acquisitions at their respective acquisition dates. Future payments made under these arrangements will generally be recorded as additional goodwill when the earnouts are settled. The aggregate amount of unrecorded earnout payables outstanding as of December 31, 2006 was $73.9 million related to acquisitions made by Gallagher in the period from 2003 to 2006.

Off- Balance Sheet Debt- Gallagher's unconsolidated investment portfolio includes investments in enterprises where Gallagher's ownership interest is between 1% and 50%, whereby management has determined that Gallagher's level of economic interest is not sufficient to require consolidation. As a result, these investments are accounted for using either the lower of amortized cost/cost or fair value, or the equity method, as appropriate, depending on the legal form of Gallagher's ownership interest and the applicable percentage of the entity owned. As such, the balance sheets of these investees were not consolidated in Gallagher's consolidated balance sheet at December 31, 2006 and 2005. The December 31, 2006 and 2005 balance sheets of several of these unconsolidated investments contain outstanding debt, which are also not required to be included in Gallagher's consolidated balance sheet.

In certain cases, Gallagher guarantees a portion of the enterprises' debt. Based on the ownership structure of these investments, management believes that Gallagher's exposure to losses related to these investments is limited to the combination of its net carrying value, funding commitments, LOCs and financial guarantees. In the event that certain of these enterprises were to default on their debt obligations and Gallagher's net carrying value became impaired, the amount to be written- off could have a material effect on Gallagher's consolidated operating results and/or financial position. See Note 3 for additional disclosures regarding these investments.

In addition to obligations and commitments related to Gallagher's investing activities discussed above, at December 31, 2006, Gallagher had posted an LOC of $6.5 million related to Gallagher's self- insurance deductibles, for which it had a recorded liability of $6.5 million. Gallagher has an equity investment in a rent- a- captive facility, formed in 1997, which Gallagher uses as a placement facility for certain of its insurance brokerage operations. At December 31, 2006, Gallagher had posted $5.7 million of LOCs to allow the rent- a- captive to meet minimum statutory surplus requirements and for additional collateral related to premium and claim funds held in a fiduciary capacity. These LOCs have never been drawn upon.

Gallagher's commitments associated with outstanding letters of credit (LOCs), financial guarantees and funding commitments at December 31, 2006 were as follows (all dollar amounts in table are in millions):

Description, Purpose and Trigger	Collateral	Compensation to Gallagher	Maximum Exposure	Liability Recorded
Tax advantaged investments				
"Reclamation" collateral (LOC) for land owned by Gallagher - expires after 2011	(1)	None	$ 4.4	$ -
Trigger - Activities cease and Gallagher does not proceed with the reclamation process				
Funding commitment to a multi- pollutant reduction venture - expires 2007	None	None	0.8	-
Trigger - Agreed conditions met				
Real estate, venture capital and other				
Funding commitments to three funds - expires 2009	None	None	1.0	-
Trigger - Agreed conditions met				
Investments accounted for on a consolidated basis				
Credit support (LOC) for Gallagher's corporate headquarters building sale - expires 2007	None	None	1.0	-
Trigger - Representation and warranty breach prompts a claim				
Other				
Credit support (LOC) for deductibles due by Gallagher on its own insurance coverages - expires after 2011	None	None	6.5	6.5
Trigger - Gallagher does not reimburse the insurance company for deductibles the insurance company advances on behalf of Gallagher				
Credit enhancement (LOC) for Gallagher's Bermuda captive insurance operation to meet minimum statutory capital requirements - expires after 2011	(2)	Reimbursement of LOC fees	3.7	-
Trigger - Dissolution or catastrophic financial results of the operation				
Credit support (LOC) for clients' claim funds held by Gallagher's Bermuda	None	Reimbursement of LOC fees	2.0	-

captive insurance operation in a fiduciary capacity - expires after 2011 Trigger - Investments fall below prescribed levels		
	$ 19.4	$ 6.5

(1) Specific parcels of land.
(2) The majority owners of the operation pledge their percentage ownership portion of any draw.

See Management's Discussion and Analysis of Financial Condition and Results of Operations section of Gallagher's 2006 Annual Report for an analysis of the Off- Balance Sheet Commitments. Since commitments may expire unused, the amounts presented in the table above do not necessarily reflect the actual future cash funding requirements of Gallagher.

As more fully described in Notes 3 and 8, at December 31, 2006, Gallagher had LOCs, financial guarantees and funding commitments related to its investments.

Litigation - Gallagher is engaged in various legal actions related to claims, lawsuits and proceedings incident to the nature of its business. Private parties have filed civil litigations against Gallagher under a variety of legal theories relating to, among other things, broker compensation practices. Gallagher believes it has meritorious defenses in all of its open cases and intends to defend itself vigorously. However, neither the outcomes of these cases nor their effect upon Gallagher's business, financial condition or results of operations can be predicted at this time.

On October 19, 2004, Gallagher was joined as a defendant in a purported class action, originally filed in August 2004, in the U.S. District Court for the Southern District of New York by OptiCare Health Systems Inc. against various large insurance brokerage firms and commercial insurers (OptiCare Health Systems Inc. v. Marsh & McLennan Companies, Inc., et al., Case No. 04 CV 06954 (DC)). The amended complaint alleges that the defendants used the contingent commission structure of placement service agreements in a conspiracy to deprive policyholders of "independent and unbiased brokerage services, as well as free and open competition in the market for insurance." Since fourth quarter 2004, nine other similar purported class actions have been filed alleging claims similar to those alleged by the plaintiff in the OptiCare litigation and such cases have been included in a Multi- District Litigation (MDL) proceeding before the U.S. District Court for the District of New Jersey. On October 3, 2006, the Court administering the MDL issued an opinion denying a defense motion to dismiss the Sherman Act claim on McCarran Ferguson antitrust immunity grounds. The Court reserved ruling on the motion to dismiss the RICO allegations and ordered class plaintiffs to file by October 25, 2006, supplemental statements with the Court specifying with particularity the terms of the conspiracy and fraudulent activity alleged by the plaintiffs as well as the basis for the Sherman Act claim. Plaintiffs have filed a motion for class certification and defendants have filed motions to dismiss.

On December 29, 2006 Gallagher reached an agreement to resolve all claims in the MDL and the previously reported Orland Hills case. Gallagher admitted no wrongdoing, but chose to conclude its involvement, rather than prolong what could have been a costly and burdensome lawsuit. Gallagher established a provision for this matter in 2005, and as a result, substantially all of the costs associated with the MDL settlement have been reserved for in its previously reported consolidated balance sheet.

The MDL settlement, which is subject to court approval, provides for Gallagher to distribute $28.0 million to current and former clients and others that used a broker to purchase retail insurance from 1994 to 2005. Gallagher will also pay $8.9 million in plaintiff's attorney fees. In the event the MDL settlement is not approved by the court, Gallagher may incur significant additional legal costs and face potential liability in connection with the MDL.

Gallagher's former Chief Financial Officer (Former CFO) filed a lawsuit against Gallagher in the Chancery Division of the Circuit Court of Cook County, Illinois on May 23, 2006, alleging Gallagher's breach and/or anticipatory breach of the Former CFO's employment agreement and bonus deferral agreement due to Gallagher's purported refusal to pay the Former CFO certain salary, bonus and other amounts. Gallagher denies the Former CFO's claims. Gallagher's answer or other responsive pleading to the Complaint is due on February 15, 2007.

See Note 3 for a discussion on a litigation related pretax charge of $131.0 million recorded by Gallagher in first quarter 2005.

Contingent Commissions and Other Industry Developments - The insurance industry in general, and Gallagher individually, continue to be the subjects of a significant level of scrutiny by various regulatory bodies, including State Attorneys General and the departments of insurance for various states, with respect to certain contingent commission arrangements (generally known as contingent commission or placement service agreements) between insurance brokers and insurance carriers.

On May 18, 2005, Gallagher's brokerage related subsidiaries and affiliates entered into an Assurance of Voluntary Compliance (the AVC) with the Attorney General of the State of Illinois and the Director of Insurance of the State of Illinois (collectively, the IL State Agencies) to resolve all of the issues related to investigations conducted by the IL State Agencies. A copy of the AVC was previously disclosed as an exhibit to Gallagher's Current Report on Form 8- K dated May 18, 2005.

As has been described in detail in Gallagher's previous financial filings, the AVC required Gallagher to pay $26.9 million into a fund (the Fund) to be distributed to certain eligible policyholder clients. These payments are in full satisfaction of Gallagher's obligations under the AVC and the IL State Agencies have agreed not to impose any other financial obligation or liability on Gallagher in connection with their investigations. No portion of the payments by Gallagher is considered a fine or penalty. As of December 31, 2006, $8.6 million remained in the Fund, which is available to satisfy existing and future AVC related claims and other potential settlement obligations as allowed by the AVC.

The AVC sets forth the procedures under which Gallagher mailed notices to its eligible policyholder clients and distributes the Fund to eligible policyholders electing to participate in payments from the Fund (Participating Policyholders). In order to obtain a payment from the Fund, Participating Policyholders must tender a release of claims against Gallagher arising from acts, omissions, transactions or conduct that are the subject of the investigations by the IL State Agencies.

On or before December 31, 2005, Gallagher undertook certain changes to business practices, including agreeing not to accept any contingent compensation from an insurer in connection with any retail insurance policy covering U.S. clients or risks other than as provided in the AVC. In addition, the AVC provides that Gallagher shall not take or receive any material ($500 or more) compensation or consideration from an insurer other than as provided in the AVC. As allowed under the AVC, Gallagher may accept contingent compensation from non- retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, the AVC allows Gallagher to collect retail contingent compensation related to contracts in place at entities acquired by Gallagher for up to three years from the date of each such acquisition.

In 2005, Gallagher recorded a pretax charge of $73.6 million ($44.2 million after tax) in connection with the regulatory and legal actions by the State Attorneys General and private litigants related to contingent commissions and various other historical business practices discussed above. In first quarter 2005, Gallagher incurred $35.0 million of the charge, which was primarily related to costs associated with the AVC and other investigations and inquiries from other governmental authorities related to contingent commissions and various other historical business practices. In fourth quarter 2005, Gallagher incurred the remainder of the charge, or $38.6 million, which was primarily related to costs associated with investigations and inquiries from governmental authorities related to contingent commissions and various other historical business practices, and pending civil litigation.

Gallagher continues to be the subject of a number of state investigations concerning various historical business practices in the insurance industry. In fourth quarter 2006, Gallagher recorded a pretax charge of $9.0 million to increase its reserve for the costs to be incurred to administratively conclude the MDL settlement and to resolve other regulatory matters and investigations. The amount accrued as of December 31, 2006 represents Gallagher's best estimate of the amount required to resolve the state investigations, which includes all of the costs related to the funding and administration of the MDL, plus an accrual for legal costs incurred or to be incurred to resolve these matters.

Gallagher Bassett Services, Inc. (GB), a third party administrator and a wholly- owned subsidiary of Gallagher, has received subpoenas from the Offices of the Attorney General of the State of New York, Connecticut and Illinois. The subpoenas request information in connection with separate investigations being conducted by each state and none of the subpoenas relate to Gallagher's brokerage operations. Gallagher is fully cooperating with these investigations.

Contingent Liabilities - Gallagher purchases insurance to provide protection from errors and omissions (E&O) claims that may arise during the ordinary course of business. However, insuring 100% of potential claims is not cost effective. Effective June 1, 2005, Gallagher began to retain the first $5.0 million of each and every E&O claim. Prior to June 1, 2005, Gallagher retained the first $2.5 million of each and every E&O claim. Gallagher's E&O insurance provides aggregate coverage for E&O losses up to $165.0 million in excess of Gallagher's retained amounts. Gallagher has historically maintained self- insurance reserves for the portion of its E&O exposure that is not insured. Gallagher periodically determines a range of possible reserve levels using actuarial techniques that rely heavily on projecting historical claim data into the future. Gallagher's E&O reserve in the December 31, 2006 consolidated balance sheet is above the lower end of the most recently determined actuarial range by $3.0 million and below the upper end of the actuarial range by $6.0 million. There can be no assurances that the historical claim data used to project the current reserve levels will be indicative of future claim activity. Thus, the actuarial ranges and E&O reserve level could change in the future as more information becomes known, which could materially impact the amounts reported and disclosed herein.

18. Income Taxes

Gallagher and its principal domestic subsidiaries are included in a consolidated Federal income tax return. Gallagher's international subsidiaries file various income tax returns in their jurisdictions. Significant components of earnings from continuing operations before income taxes and the provision (benefit) for income taxes are as follows (in millions):

	Year Ended December 31, 2006	2005	2004
Earnings (loss) from continuing operations before income taxes:			
Domestic	$ 134.4	$ 5.0	$ 221.3
Foreign, principally United Kingdom, Australia and Bermuda	18.7	(7.8)	16.0
	$ 153.1	$ (2.8)	$ 237.3
Provision (benefit) for income taxes - continuing operations:			
Federal:			
Current	$ 37.6	$ 41.9	$ 64.8
Deferred	(31.4)	(74.7)	(40.5)
	6.2	(32.8)	24.3
State and local:			
Current	9.3	11.3	23.7
Deferred	1.4	(9.9)	(5.4)
	10.7	1.4	18.3
Foreign:			
Current	2.9	4.7	4.5
Deferred	4.8	(4.7)	0.7
	7.7	-	5.2
Total provision (benefit) for income taxes - continuing operations	$ 24.6	$ (31.4)	$ 47.8

A reconciliation of the provision (benefit) for income taxes from continuing operations with the U.S. Federal income tax rate is as follows (in millions):

	Year Ended December 31, 2006		2005		2004	
	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings
Federal statutory rate	$ 53.6	35.0	$ (1.0)	35.0	$ 83.0	35.0
State income taxes - net of Federal benefit	6.9	4.5	0.9	NMF	12.1	5.1
Foreign taxes	1.1	0.8	2.9	NMF	(0.4)	(0.2)
Low income housing and alternative energy tax credits	(45.4)	(29.7)	(40.0)	NMF	(54.8)	(23.1)
Amortization expense of low income housing, net of tax benefit	0.3	0.2	0.3	NMF	1.1	0.5
Foreign dividends and other	0.9	0.6	3.8	NMF	6.3	2.7

permanent differences						
Stock compensation	0.7	0.5	0.6	NMF	0.5	0.2
Impact of pending sale of the airplane leasing company	4.3	2.8	-	NMF	-	-
Net change in uncertain tax positions	2.2	1.4	1.9	NMF	-	-
Foreign tax credit	-	-	(1.9)	NMF	-	-
IRC Section 965 dividend	-	-	1.1	NMF	-	-
Provision (benefit) for income taxes - continuing operations	$ 24.6	16.1	$ (31.4)	35.0	$ 47.8	20.2

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of Gallagher's deferred tax assets and liabilities are as follows (in millions):

	December 31, 2006		December 31, 2005	
Deferred tax assets:				
Alternative minimum tax (AMT) and other credit carryforwards	$	156.6	$	119.1
Accrued and unfunded compensation and employee benefits		39.1		62.9
Compensation expense related to stock options		10.5		-
Litigation and contingent commission related matters		59.5		60.9
Investment- related partnerships		37.1		46.7
Accrued liabilities		32.4		23.6
Minimum liability of pension plan		-		4.0
Other		10.8		4.1
Total deferred tax assets		346.0		321.3
Valuation allowance for deferred tax assets		-		-
Deferred tax assets		346.0		321.3
Deferred tax liabilities:				
Nondeductible amortizable intangible assets		23.1		23.5
Prepaid pension cost		3.4		-
Accrued liabilities		3.1		0.3
Investment- related partnerships		4.1		13.3
Total deferred tax liabilities		33.7		37.1
Net deferred tax assets	$	312.3	$	284.2

At December 31, 2006 and 2005, $59.2 million and $85.2 million, respectively, of deferred tax assets have been included in other current assets in the accompanying consolidated balance sheet. At December 31, 2006 and 2005, $33.7 million and $37.1 million, respectively, of deferred tax liabilities have been included in other current and noncurrent liabilities in the accompanying consolidated balance sheet. AMT credits and other credits have an indefinite and twenty year life, respectively. Gallagher expects to fully utilize the amounts carried forward.

Gallagher does not provide for U.S. Federal income taxes on the undistributed earnings ($39.5 million at December 31, 2006) of foreign subsidiaries which are considered permanently invested outside of the U.S. The amount of unrecognized deferred tax liability on these undistributed earnings was $9.0 million at December 31, 2006.

On October 22, 2004, the American Jobs Creation Act of 2004 (the Act) was signed into law. The Act provided for a special one- time opportunity for Gallagher to repatriate foreign earnings at a maximum rate of 5.25%. In 2005, Gallagher repatriated $29.5 million from its foreign subsidiaries. Accordingly, in 2005, Gallagher recorded income tax expense of $1.1 million related to the repatriation under the Act.

19. Quarterly Operating Results (unaudited)

Quarterly operating results for 2006 and 2005 were as follows (in millions, except per share data):

	1st	2nd	3rd	4th
2006				
Total revenues	$ 327.5	$ 370.6	$ 421.2	$ 414.7
Retail contingent commission related matters	-	-	-	9.0
Other expenses	298.5	322.9	360.4	390.1
Total expenses	298.5	322.9	360.4	399.1
Earnings from continuing operations before income taxes	29.0	47.7	60.8	15.6
Earnings from continuing operations	17.1	36.6	50.2	24.6
Net earnings	17.1	36.6	50.2	24.6
Basic net earnings per share:				
Earnings from continuing operations	$ .18	$ .38	$ .52	$ .25
Net earnings	$ .18	$ .38	$ .52	$ .25
Diluted net earnings per share:				
Earnings from continuing operations	$ .17	$ .37	$ .51	$ .25
Net earnings	$ .17	$ .37	$ .51	$ .25
2005				
Total revenues	$ 346.8	$ 371.1	$ 389.9	$ 376.1
Litigation related matters	131.0	-	-	-
Retail contingent commission related matters	35.0	-	-	38.6
Other expenses	305.5	313.7	324.3	338.6
Total expenses	471.5	313.7	324.3	377.2
Earnings (loss) from continuing operations before income taxes	(124.7)	57.4	65.6	(1.1)
Earnings (loss) from continuing operations	(73.6)	44.2	50.5	7.5
Earnings (loss) from discontinued operations	(5.4)	7.6	-	-
Net earnings (loss)	(79.0)	51.8	50.5	7.5
Basic net earnings (loss) per share:				
Earnings (loss) from continuing operations	$ (.80)	$ .47	$ .53	$ .08
Earnings (loss) from discontinued operations	(.05)	.08	-	-
Net earnings (loss)	$ (.85)	$ .55	$ .53	$ .08
Diluted net earnings (loss) per share:				
Earnings (loss) from continuing operations	$ (.80)	$ .46	$ .52	$ .08
Earnings (loss) from discontinued operations	(.05)	.08	-	-
Net earnings (loss)	$ (.85)	$ .54	$ .52	$ .08

20. Segment Information

Gallagher has identified three operating segments: Brokerage, Risk Management and Financial Services. The Brokerage Segment comprises three operating divisions: the Brokerage Services- Retail Division, Specialty Marketing and International and Gallagher Benefit Services. The Brokerage Segment, for commission or fee compensation, places commercial property/casualty (P/C) and employee benefit- related insurance on behalf of its customers. The Risk Management Segment provides P/C third- party administration, loss control and risk management consulting and insurance property appraisals. Third party administration is principally the management and processing of claims for self- insurance programs of Gallagher's clients or clients of other brokers. The Financial Services Segment is responsible for managing Gallagher's investment portfolio. Allocations of investment income and certain expenses are based on reasonable assumptions and estimates. Reported operating results by segment would change if different methods were applied.

Gallagher has changed its segment allocation method for income taxes. Previously, Gallagher had applied its overall effective tax rate for the consolidated group to each reporting segment. In 2006, Gallagher began allocating the provision for income taxes to the Brokerage and Risk Management Segments as if those segments were preparing income tax provisions on a separate company basis. As a result, the provision for income taxes for the Financial Services Segment now reflects the entire benefit to Gallagher of the IRC Section 29- related credits because that is the segment which produces the credits. Historical results have been reclassified to conform to the current presentation.

Financial information relating to Gallagher's segments for 2006, 2005 and 2004 is as follows (in millions):

	Brokerage	Risk Management	Financial Services	Total
Year Ended December 31, 2006				
Revenues:				
Commissions	$ 849.5	$ -	$ -	$ 849.5
Retail contingent commissions	2.5	-	-	2.5
Fees	188.5	397.3	-	585.8
Investment income - Brokerage and Risk Management	30.2	4.0	-	34.2
Investment income - Financial Services	-	-	87.1	87.1
Investment income gains	-	-	(25.1)	(25.1)
Total revenues	1,070.7	401.3	62.0	1,534.0
Compensation	645.0	235.9	-	880.9
Operating	220.3	102.1	-	322.4
Investment expenses	-	-	103.7	103.7
Interest	-	-	8.5	8.5
Depreciation	15.0	9.5	7.3	31.8
Amortization	24.1	0.5	-	24.6
Retail contingent commissions related matters	9.0	-	-	9.0
Total expenses	913.4	348.0	119.5	1,380.9
Earnings (loss) from continuing operations before income taxes	157.3	53.3	(57.5)	153.1
Provision (benefit) for income taxes	64.5	21.3	(61.2)	24.6
Earnings from continuing operations	$ 92.8	$ 32.0	$ 3.7	$ 128.5
Net foreign exchange gain (loss)	$ 2.1	$ 0.2	$ -	$ 2.3
Revenues:				
United States	$ 925.6	$ 346.7	$ 63.6	$ 1,335.9
Foreign, principally United Kingdom, Australia and Bermuda	145.1	54.6	(1.6)	198.1
Total revenues	$ 1,070.7	$ 401.3	$ 62.0	$ 1,534.0
At December 31, 2006				
Identifiable assets:				
United States	$ 2,012.9	$ 247.9	$ 502.0	$ 2,762.8
Foreign, principally United Kingdom, Australia and Bermuda	567.7	60.3	29.3	657.3
Total identifiable assets	$ 2,580.6	$ 308.2	$ 531.3	$ 3,420.1
Goodwill - net	$ 307.1	$ 9.5	$ -	$ 316.6
Amortizable intangible assets - net	209.5	3.6	-	213.1

	Brokerage	Risk Management	Financial Services	Total
Year Ended December 31, 2005				
Revenues:				
Commissions	$ 784.3	$ -	$ -	$ 784.3
Retail contingent commissions	28.8	-	-	28.8
Fees	169.8	367.7	-	537.5
Investment income - Brokerage and Risk Management	17.9	2.9	-	20.8
Investment income - Financial Services	-	-	108.9	108.9
Investment income gains	-	-	3.6	3.6
Total revenues	1,000.8	370.6	112.5	1,483.9
Compensation	584.0	205.9	-	789.9
Operating	234.1	88.2	-	322.3
Investment expenses	-	-	104.9	104.9
Interest	-	-	11.6	11.6
Depreciation	13.6	7.7	11.4	32.7
Amortization	20.3	0.4	-	20.7
Litigation related matters	-	-	131.0	131.0
Retail contingent commissions related matters	73.6	-	-	73.6
Total expenses	925.6	302.2	258.9	1,486.7
Earnings (loss) from continuing operations before income taxes	75.2	68.4	(146.4)	(2.8)
Provision (benefit) for income taxes	3.1	15.8	(50.3)	(31.4)
Earnings (loss) from continuing operations	$ 72.1	$ 52.6	$ (96.1)	$ 28.6
Net foreign exchange gain (loss)	$ (2.6)	$ (0.1)	$ -	$ (2.7)
Revenues:				
United States	$ 878.9	$ 335.1	$ 109.8	$ 1,323.8
Foreign, principally United Kingdom, Australia and Bermuda	121.9	35.5	2.7	160.1
Total revenues	$ 1,000.8	$ 370.6	$ 112.5	$ 1,483.9
At December 31, 2005				
Identifiable assets:				
United States	$ 1,927.7	$ 239.8	$ 569.7	$ 2,737.2
Foreign, principally United Kingdom, Australia and Bermuda	570.8	44.6	36.9	652.3
Total identifiable assets	$ 2,498.5	$ 284.4	$ 606.6	$ 3,389.5
Goodwill - net	$ 236.2	$ 9.5	$ -	$ 245.7
Amortizable intangible assets - net	168.3	4.2	-	172.5

	Brokerage	Risk Management	Financial Services	Total
Year Ended December 31, 2004				
Revenues:				
Commissions	$ 726.8	$ -	$ -	$ 726.8
Retail contingent commissions	33.8	-	-	33.8
Fees	146.2	343.8	-	490.0
Investment income - Brokerage and Risk Management	13.4	1.7	-	15.1
Investment income - Financial Services	-	-	93.3	93.3
Impact of FIN 46 on investment income all other	-	-	69.9	69.9
Investment income gains	-	-	8.1	8.1
Total revenues	920.2	345.5	171.3	1,437.0
Compensation	527.5	187.3	-	714.8
Operating	176.1	91.8	-	267.9
Investment expenses	-	-	89.9	89.9
Impact of FIN 46 on investment expenses	-	-	67.2	67.2
Interest	-	-	9.5	9.5
Depreciation	12.9	7.8	9.3	30.0
Impact of FIN 46 on depreciation	-	-	2.7	2.7
Amortization	17.3	0.4	-	17.7
Total expenses	733.8	287.3	178.6	1,199.7
Earnings (loss) from continuing operations before income taxes	186.4	58.2	(7.3)	237.3
Provision (benefit) for income taxes	37.4	11.3	(0.9)	47.8
Earnings (loss) from continuing operations	$ 149.0	$ 46.9	$ (6.4)	$ 189.5
Net foreign exchange gain (loss)	$ 2.3	$ -	$ -	$ 2.3
Revenues:				
United States	$ 814.9	$ 306.9	$ 167.9	$ 1,289.7
Foreign, principally United Kingdom, Australia and Bermuda	105.3	38.6	3.4	147.3
Total revenues	$ 920.2	$ 345.5	$ 171.3	$ 1,437.0
At December 31, 2004				
Identifiable assets:				
United States	$ 1,752.6	$ 189.0	$ 609.8	$ 2,551.4
Foreign, principally United Kingdom, Australia and Bermuda	601.9	42.2	37.8	681.9
Total identifiable assets	$ 2,354.5	$ 231.2	$ 647.6	$ 3,233.3
Goodwill - net	$ 209.5	$ 9.5	$ -	$ 219.0
Amortizable intangible assets - net	150.6	4.6	-	155.2

Report of Independent Registered Public Accounting Firm on Financial Statements

Board of Directors and Stockholders
Arthur J. Gallagher & Co.

We have audited the accompanying consolidated balance sheet of Arthur J. Gallagher & Co. (Gallagher) as of December 31, 2006 and 2005, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of Gallagher's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Arthur J. Gallagher & Co. at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

During 2006, Gallagher changed its method of accounting for the recognition of stock- based compensation expense and the recognition of the funded status of its defined benefit pension and postretirement plans, which has been discussed in Note 2 to the consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Gallagher's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 2, 2007, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Ernst & Young LLP

Chicago, Illinois
February 2, 2007

Management's Report on Internal Control Over Financial Reporting

Gallagher's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a- 15(f). Under the supervision and with the participation of management, including Gallagher's principal executive officer and principal financial officer, Gallagher conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In conducting Gallagher's evaluation of the effectiveness of its internal control over financial reporting, Gallagher has excluded the following acquisitions completed by Gallagher in 2006 of Sobieski & Bradley, Inc., Lemac & Associates, Inc., S.P. Tarantino Insurance Brokerage, Inc., Commonwealth Premium Finance Corporation, The Rains Group, Inc., Adams & Associates International, Ltd., William H. Connolly & Co. and Mid America Group, Inc. Collectively, these acquisitions constituted approximately 0.8% of total assets as of December 31, 2006 and approximately 0.9% of total revenues and 1.4% of net earnings for the year then ended. Refer to Note 4 to the consolidated financial statements for further discussion of these acquisitions and their impact on Gallagher's consolidated financial statements.

Based on Gallagher's evaluation under the framework in Internal Control Integrated Framework, management concluded that internal control over financial reporting was effective as of December 31, 2006. Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Arthur J. Gallagher & Co.
Itasca, Illinois
February 2, 2007

/s/ J. Patrick Gallagher, Jr.
J. Patrick Gallagher, Jr.
Chairman, President and Chief Executive Officer

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Directors and Stockholders
Arthur J. Gallagher & Co.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Arthur J. Gallagher & Co. (Gallagher) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Gallagher's management is responsible for maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Gallagher's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Sobieski & Bradley, Inc., Lemac & Associates, Inc., S.P. Tarantino Insurance Brokerage, Inc., Commonwealth Premium Finance Corporation, The Rains Group, Inc., Adams & Associates International, Ltd., William H. Connolly & Co. and Mid America Group, Inc. Collectively, these acquisitions constituted approximately 0.8% of total assets as of December 31, 2006 and approximately 0.9% of total revenues and 1.4% of net earnings for the year then ended. Management did not assess the effectiveness of internal control over financial reporting at these entities because Gallagher acquired these entities during 2006. Refer to Note 4 to the consolidated financial statements for further discussion of these acquisitions and their impact on Gallagher's consolidated financial statements. Our audit of internal control over financial reporting of Gallagher also did not include an evaluation of the internal control over financial reporting of the entities referred to above.

In our opinion, management's assessment that Gallagher maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Gallagher maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Arthur J. Gallagher & Co. as of December 31, 2006 and 2005 and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006 and our report dated February 2, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP
Ernst & Young LLP

Chicago, Illinois
February 2, 2007

Exhibit 21.0

Subsidiaries of Gallagher

In the following list of subsidiaries of Gallagher, those companies that are indented represent subsidiaries of the corporation under which they are indented. Except for directors' qualifying shares, 100% of the voting stock of each of the subsidiaries listed below, other than those indicated by footnote, is owned of record or beneficially by its indicated parent.

Name	State or Other Jurisdiction of Incorporation
Arthur J. Gallagher & Co. (Registrant)	Delaware
Arthur J. Gallagher & Co. (Illinois)	Illinois
Gallagher Offshore Support Services Private Limited	India
Arthur J. Gallagher Service Company	Delaware
Arthur J. Gallagher Brokerage & Risk Management Services, LLC	Delaware
Arthur J. Gallagher Risk Management Services, Inc.	Illinois
Gallagher Healthcare Insurance Services of Kansas City, LLC [1]	Missouri
Arthur J. Gallagher & Co. (Florida)	Florida
Arthur J. Gallagher & Co. of New York, Inc.	New York
Arthur J. Gallagher & Co. Insurance Brokers of California, Inc.	California
Charity First Insurance Services, Inc.	California
C. W. Excess Incorporated	New York
Lamberson Koster & Company	California
Manning & Smith Insurance, Inc.	Kansas
Commonwealth Premium Finance Corporation	Kentucky
Artex Risk Solutions, Inc.	Delaware
Western Litigation, Inc.	Texas
Risk Placement Services, Inc.	Illinois
Edwin M. Rollins Company	North Carolina
Risk Placement Services of Nevada, Inc.	Nevada
Arthur J. Gallagher & Co. (Bermuda) Limited	Bermuda
Arthur J. Gallagher Intermediaries (Bermuda) Limited	Bermuda
Arthur J. Gallagher Management (Bermuda) Limited	Bermuda
Gallagher Captive Services (Cayman) Limited	Cayman Islands
Scholastic Risk Services Limited	Bermuda
Artex Insurance Company Ltd[2]	Bermuda
Artex Underwriting Managers Ltd	Bermuda
Protected Insurance Company	Bermuda
Gallagher Holdings (UK) Limited	England
Arthur J. Gallagher (UK) Limited	England
Risk Management Partners Ltd.	England
Arthur J. Gallagher Asia Pte Ltd[3]	Singapore
Arthur J. Gallagher Asia Limited	Hong Kong
Arthur J. Gallagher Asia (L) BHD	Malaysia
Connor Hale Kerslake Limited	England
Arthur J. Gallagher Australasia Holdings Pty Ltd.	Australia
Australis Group (Underwriting) Pty Ltd.	Australia
Interpacific Underwriting Agencies Pty Ltd.	Australia
Arthur J. Gallagher Reinsurance Australasia Pty Ltd	Australia
Arthur J. Gallagher (Aus) Pty Ltd.	Australia
Gallagher Re, Inc.	Delaware
Gallagher Bassett Services, Inc.	Delaware
Gallagher Bassett of New York, Inc.	New York
Gallagher Bassett International Ltd. (UK)	England
Gallagher Bassett Canada Inc.	Canada
Gallagher Bassett Services Pty Ltd	Australia
Gallagher Bassett Workers Compensation Victoria Pty Ltd	Australia
Gallagher Bassett International S.A.	France

Name	State or Other Jurisdiction of Incorporation
AJG Financial Services, Inc.	Delaware
AJG Capital, Inc.[4]	Illinois
AJG Investments, Inc.	Delaware
AJG Coal, Inc.	Delaware

AJG Chem Mod Holdings LLC.	Delaware
Gallagher Holdings Bermuda Company Limited.	Bermuda
AJG Coal Indiana LLC	Delaware
AJG Two Pierce, Inc.	Delaware
Gallagher Benefit Services, Inc.	Delaware
GBS Retirement Services, Inc.	New York
GBS Insurance and Financial Services, Inc.	Delaware
GBS Administrators, Inc.	Washington

(1) 49% of the Common Stock of this subsidiary is owned by a third party.

(2) 76% of the Common Stock of this subsidiary is owned by two third parties.

(3) 49% of the Common Stock of this subsidiary is owned by two third parties.

(4) 10% of the Common Stock of this subsidiary is owned by an unrelated party.

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in this Annual Report (Form 10- K) of Arthur J. Gallagher & Co. (Gallagher) of our reports dated February 2, 2007, on the consolidated financial statements and on internal control over financial reporting, included in Gallagher's 2006 Annual Report to Stockholders.

Our audits also included the consolidated financial statement schedule of Gallagher listed in Item 15(2)(a). This schedule is the responsibility of Gallagher's management. Our responsibility is to express an opinion based on our audits. In our opinion, the consolidated financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We consent to the incorporation by reference in the Registration Statements (Form S- 8, No. 33- 604 and Form S- 8, No. 33- 14625) pertaining to the Arthur J. Gallagher & Co. Incentive and United Kingdom Incentive Plans, in the Registration Statements (Form S- 8, No. 33- 24251, Form S- 8, No. 33- 38031 and Form S- 8, No. 333- 57155) pertaining to the Arthur J. Gallagher & Co. 1988 Incentive and 1988 Nonqualified Stock Option Plans, in the Registration Statement (Form S- 8, No. 33- 30816) pertaining to the Arthur J. Gallagher & Co. Non- Employee Directors' Stock Option Plan, in the Registration Statements (Form S- 8, No. 33- 64614 and Form S- 8, No. 33- 80648) pertaining to the Arthur J. Gallagher & Co. 1988 Incentive, 1988 Nonqualified, and Non- Employee Directors' Stock Option Plans, in the Registration Statements (Form S- 8, No. 333- 06359, Form S- 8, No. 333- 40000, Form S- 8, No. 333- 87320 and Form S- 8, No. 333- 106535) pertaining to the Arthur J. Gallagher & Co. 1988 Nonqualified and Non- Employee Directors' Stock Option Plans, in the Registration Statement (Form S- 8, No. 333- 62930) pertaining to the Arthur J. Gallagher & Co. 1988 Nonqualified and Non- Employee Directors' Stock Option Plans and the Gallagher Healthcare Insurance Services, Inc. 2001 Nonqualified Stock Option Plan, in the Registration Statement (Form S- 8, No. 333- 106534) pertaining to the Arthur J. Gallagher & Co. Employee Stock Purchase Plan, in the Registration Statement (Form S- 8, No. 333- 106539) pertaining to the Arthur J. Gallagher & Co. Restricted Stock Plan, in the Registration Statements (Form S- 3, No. 333- 84139, Form S- 4, No. 333- 55254, Form S- 4, No. 333- 75197 and Form S- 4, No. 333- 84896), and in the related Prospectuses, of our reports dated February 2, 2007 with respect to internal control over financial reporting and the consolidated financial statements of Gallagher incorporated by reference herein, and our report included in the preceding paragraph with respect to the consolidated financial statement schedule included in this Annual Report (Form 10- K) for the year ended December 31, 2006.

/s/ Ernst & Young LLP
Ernst & Young LLP

Chicago, Illinois
February 2, 2007

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell his true and lawful attorneys- in- fact and agents, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ WILLIAM L. BAX

William L. Bax

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell his true and lawful attorneys- in- fact and agents, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ T. KIMBALL BROOKER

T. Kimball Brooker

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell his true and lawful attorneys- in- fact and agents, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ GARY P. COUGHLAN

Gary P. Coughlan

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell her true and lawful attorneys- in- fact and agents, for her, and in her name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ ILENE S. GORDON

Ilene S. Gordon

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell his true and lawful attorneys- in- fact and agents, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ ELBERT O. HAND

Elbert O. Hand

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell his true and lawful attorneys- in- fact and agents, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ David S. Johnson

David S. Johnson

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell her true and lawful attorneys- in- fact and agents, for her, and in her name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ KAY W. MCCURDY

Kay W. McCurdy

Exhibit 24.0

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned hereby constitutes and appoints John C. Rosengren and Douglas K. Howell his true and lawful attorneys- in- fact and agents, for him, and in his name, place and stead, in any and all capacities (i) to sign the Arthur J. Gallagher & Co. Annual Report on Form 10- K for the fiscal year ending December 31, 2006 and any and all amendments thereto and (ii) to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys- in- fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in such connection, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorneys- in- fact and agents, may lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed this instrument as of this 31st day of January, 2007.

/s/ James R. Wimmer

James R. Wimmer

Exhibit 31.1

Rule 13a- 14(a) Certification of Chief Executive Officer

Certification

I, J. Patrick Gallagher, Jr., certify that:

1. I have reviewed this annual report on Form 10- K of Arthur J. Gallagher & Co.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d- 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a- 15(f) and 15d- 15(f)) for the registrant and have:

   (a.) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b.) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles;

   (c.) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d.) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a.) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b.) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 2, 2007

/s/ J. Patrick Gallagher, Jr.
J. Patrick Gallagher, Jr.
Chairman, President and Chief Executive Officer
(principal executive officer)

Exhibit 31.2

Rule 13a- 14(a) Certification of Chief Financial Officer

Certification

I, Douglas K. Howell, certify that:

1. I have reviewed this annual report on Form 10- K of Arthur J. Gallagher & Co.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a- 15(e) and 15d- 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a- 15(f) and 15d- 15(f)) for the registrant and have:

   (a.) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b.) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles;

   (c.) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d.) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a.) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b.) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 2, 2007

/s/ Douglas K. Howell
Douglas K. Howell
Vice President
Chief Financial Officer
(principal financial officer)

Exhibit 32.1

Section 1350 Certification of Chief Executive Officer

I, J. Patrick Gallagher, Jr., the chief executive officer of Arthur J. Gallagher & Co., certify that (i) the Annual Report on Form 10- K of Arthur J. Gallagher & Co. for the twelve month period ended December 31, 2006 (the "Form 10- K") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10- K fairly presents, in all material respects, the financial condition and results of operations of Arthur J. Gallagher & Co. and its subsidiaries.

Date: February 2, 2007

/s/ J. Patrick Gallagher, Jr.

J. Patrick Gallagher, Jr.
Chairman, President and Chief Executive Officer
(principal executive officer)

Exhibit 32.2

Section 1350 Certification of Chief Financial Officer

I, Douglas K. Howell, the chief financial officer of Arthur J. Gallagher & Co., certify that (i) the Annual Report on Form 10- K of Arthur J. Gallagher & Co. for the twelve month period ended December 31, 2006 (the "Form 10- K") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10- K fairly presents, in all material respects, the financial condition and results of operations of Arthur J. Gallagher & Co. and its subsidiaries.

Date: February 2, 2007

/s/ Douglas K. Howell

Douglas K. Howell
Vice President
Chief Financial Officer
(principal financial officer)