

E ON AG  
Form 20-F  
March 07, 2007

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As filed with the Securities and Exchange Commission on March 7, 2007.

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 20-F**

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g)  
OF THE SECURITIES EXCHANGE ACT OF 1934**  
**OR**  
 **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended: **December 31, 2006**

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

Date of event requiring this shell company report \_\_\_\_\_.

For the transition period from \_\_\_\_ to \_\_\_\_

Commission file number: **1-14688**

**E.ON AG**  
(Exact name of Registrant as specified in its charter)  
**E.ON AG**  
(Translation of Registrant's name into English)

**Federal Republic of Germany**

**E.ON-Platz 1, D-40479 Düsseldorf, GERMANY**

(Jurisdiction of Incorporation or Organization)

(Address of Principal Executive Offices)

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

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
American Depositary Shares representing Ordinary Shares with no par value	New York Stock Exchange
Ordinary Shares with no par value	New York Stock Exchange*

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

**None**  
(Title of Class)

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

**None**  
(Title of Class)

**Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.**

As of December 31, 2006, 659,597,269 outstanding Ordinary Shares with no par value.

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. 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 Securities Exchange Act of 1934 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 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 which financial statement item the registrant has elected to follow. Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

\* Not for trading, but only in connection with the registration of American Depositary Shares.

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As used in this annual report,

E.ON, the Company, the E.ON Group or the Group refers to E.ON AG and its consolidated subsidiaries.

VEBA refers to VEBA AG and its consolidated subsidiaries prior to its merger with VIAG AG and the name change from VEBA AG to E.ON AG. VIAG or the VIAG Group refers to VIAG AG and its consolidated subsidiaries prior to its merger with VEBA.

PreussenElektra refers to PreussenElektra AG and its consolidated subsidiaries, which merged with Bayernwerk AG and its consolidated subsidiaries to form E.ON's German and continental European energy business in the Central Europe market unit consisting of E.ON Energie AG and its consolidated subsidiaries ( E.ON Energie ).

E.ON Ruhrgas refers to E.ON Ruhrgas AG (formerly Ruhrgas AG or Ruhrgas ) and its consolidated subsidiaries, which collectively comprise E.ON's gas business in the Pan-European Gas market unit.

E.ON UK refers to E.ON UK plc (formerly Powergen UK plc or Powergen ) and its consolidated subsidiaries, which collectively comprise E.ON's U.K. energy business in the U.K. market unit. Until December 31, 2003, Powergen and its consolidated subsidiaries, including LG&E Energy LLC ( LG&E Energy ), which was held by Powergen until its transfer to a direct subsidiary of E.ON AG in March 2003, formed E.ON's former Powergen division ( Powergen Group ).

E.ON Sverige refers to E.ON Sverige AB (formerly Sydkraft AB or Sydkraft ) and its consolidated subsidiaries, and E.ON Finland refers to E.ON Finland Oyj ( E.ON Finland ) and its consolidated subsidiaries, which collectively comprised E.ON's Nordic energy business in the Nordic market unit until the disposal of E.ON Finland.

E.ON U.S. refers to E.ON U.S. LLC (formerly LG&E Energy) and its consolidated subsidiaries, which collectively comprise E.ON's U.S. energy business in the U.S. Midwest market unit. Until December 31, 2003, E.ON U.S. formed the U.S. business of the Powergen Group.

Viterra refers to Viterra AG and its consolidated subsidiaries, which collectively comprised E.ON's real estate business in the other activities segment.

Degussa refers to Degussa AG and its consolidated subsidiaries, which collectively comprised E.ON's chemicals business in the other activities segment.

VEBA Oel refers to VEBA Oel AG and its consolidated subsidiaries, which collectively comprised E.ON's former oil division.

VAW refers to VAW aluminium AG and its consolidated subsidiaries, which collectively comprised E.ON's former aluminum division.

Unless otherwise indicated, all amounts in this annual report are expressed in European Union euros ( euros or EUR or ), United States dollars ( U.S. dollars or dollars or \$ ), British pounds ( GBP ), Swedish krona ( SEK ) or Swedish kronor ( öre ). Amounts stated in dollars, unless otherwise indicated, have been translated from euros at an assumed rate solely for convenience and should not be construed as representations that the euro amounts actually represent such dollar amounts or could be converted into dollars at the rate indicated. Unless otherwise stated, such dollar amounts have

been translated from euros at the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate ) on December 29, 2006, which was \$1.3197 per 1.00. Such rate may differ from the actual rates used in the preparation of the consolidated financial statements of E.ON as of December 31, 2006, 2005 and 2004, and for each of the years in the three-year period ended December 31, 2006, included in Item 18 of this annual report (the Consolidated Financial Statements ), which are expressed in euros, and, accordingly, dollar amounts appearing in this annual report may differ from the actual dollar amounts that were translated into euros in the preparation of such financial statements. For information regarding recent rates of exchange, see Item 3. Key Information Exchange Rates.

Beginning in 2000, E.ON has prepared its financial statements in accordance with generally accepted accounting principles in the United States ( U.S. GAAP ). Formerly, the Company prepared its financial statements

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in accordance with generally accepted accounting principles in Germany as prescribed by the German Commercial Code (*Handelsgesetzbuch*, the Commercial Code ) and the German Stock Corporation Act (*Aktiengesetz*, the Stock Corporation Act ). Sales and adjusted EBIT presented in this annual report for each of E.ON's segments are based on the consolidated accounts of the E.ON Group as shown in Note 31 (Segment Information) of the Notes to Consolidated Financial Statements under the captions External sales and Adjusted EBIT and are presented prior to the elimination of intersegment transactions. Adjusted EBIT is the measure pursuant to which the Group has evaluated the performance of its segments and allocated resources to them since 2004. Adjusted EBIT is an adjusted figure derived from income/(loss) from continuing operations (before intra-Group eliminations when presented on a segment basis) before income taxes and minority interests, excluding interest income. Adjustments include net book gains resulting from disposals, as well as cost-management and restructuring expenses and other non-operating earnings of an exceptional nature. In addition, interest income is adjusted using economic criteria. In particular, the interest portion of additions to provisions for pensions and nuclear waste management is allocated to adjusted interest income. E.ON uses adjusted EBIT as its segment reporting measure in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 131, Disclosures about Segments of an Enterprise and Related Information ( SFAS 131 ). However, on a consolidated Group basis adjusted EBIT is considered a non-GAAP measure that must be reconciled to the most directly comparable GAAP measure. For a reconciliation of Group adjusted EBIT to net income for each of 2006, 2005 and 2004, see Item 5. Operating and Financial Review and Prospects Results of Operations Business Segment Information. Adjusted EBIT should not be considered in isolation as a measure of E.ON's profitability and should be considered in addition to, rather than as a substitute for, the most directly comparable U.S. GAAP measures. In particular, there are material limitations associated with the use of adjusted EBIT as compared with such U.S. GAAP measures, including the limitations inherent in E.ON's determination of each of the adjustments noted above. E.ON seeks to compensate for those limitations by providing a detailed reconciliation of adjusted EBIT to income from continuing operations before income taxes and minority interests and net income, the most directly comparable U.S. GAAP measures, in the section of Item 5 noted above, as well as the more detailed textual analysis of year-on-year changes in the key components of each of the reconciling items appearing under the caption Reconciliation of Adjusted EBIT in Item 5. Operating and Financial Review and Prospects Results of Operations Business Segment Information, Year Ended December 31, 2006 Compared with Year Ended December 31, 2005 and Year Ended December 31, 2005 Compared with Year Ended December 31, 2004. As a result of these limitations and other factors, adjusted EBIT as used by E.ON may differ from, and not be comparable to, similarly titled measures used by other companies.

E.ON has calculated operating data for Group companies appearing in this annual report using actual amounts derived from Group books and records. The Company has obtained market-related data such as the market position of Group companies from publicly available sources such as industry publications. The Company has relied on the accuracy of information from publicly available sources without independent verification, and does not accept any responsibility for the accuracy or completeness of such information.

This annual report contains certain forward-looking statements and information relating to the E.ON Group that are based on beliefs of its management, as well as assumptions made by and information currently available to E.ON. When used in this document, the words anticipate, believe, estimate, expect, intend, plan and project and similar expressions, as they relate to the E.ON Group or its management, are intended to identify forward-looking statements. Such statements reflect the current views of E.ON with respect to future events and are subject to certain risks, uncertainties and assumptions. Many factors could cause the actual results, performance or achievements of the E.ON Group to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including, among others, changes in general economic and business conditions, changes in currency exchange rates and interest rates, introduction of competing products by other companies, lack of acceptance of new products or services by the Group's targeted customers, changes in business strategy, lack of successful completion of planned acquisitions and dispositions and/or the realization of expected benefits and various other factors, both referenced and not referenced in this annual report. Should one or more of

these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this annual report as anticipated, believed, estimated, expected, intended, planned or projected. E.ON does not intend, and does not assume any obligation, to update these forward-looking statements.

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Not applicable.

**Item 2. Offer Statistics and Expected Timetable.**

Not applicable.

**Item 3. Key Information.****SELECTED FINANCIAL DATA**

The selected financial data presented below in accordance with U.S. GAAP as of and for each of the years in the five-year period ended December 31, 2006 have been excerpted from or are derived from the Consolidated Financial Statements of E.ON as of and for the period ended December 31, 2006, 2005, 2004, 2003 and 2002, respectively.

The selected financial data set forth below should be read in conjunction with, and are qualified in their entirety by reference to, the Consolidated Financial Statements and the Notes to Consolidated Financial Statements.

	2006(1)	2006	Year Ended December 31, 2005      2004		2003	2002
			(in millions, except share amounts)			
<b>Statement of Income Data:</b>						
Sales	\$ 89,422	67,759	56,141	46,489	44,839	35,133
Sales excluding electricity and natural gas taxes(2)	84,721	64,197	51,616	42,150	39,953	34,200
Income/(Loss) from continuing operations before income taxes	6,774	5,133	7,152	6,332	5,204	(1,013)
Income/(Loss) from continuing operations after income taxes(3)	7,200	5,456	4,891	4,480	4,051	(324)
Income/(Loss) from continuing operations	6,506	4,930	4,355	4,011	3,602	(949)
Income/(Loss) from discontinued operations(4)	168	127	3,059	328	1,485	3,535
Net income	6,674	5,057	7,407	4,339	4,647	2,777
Basic earnings/(Loss) per share from continuing operations	9.87	7.48	6.61	6.11	5.51	(1.45)

Basic earnings (Loss) per share from discontinued operations, net(4)	0.25	0.19	4.64	0.50	2.27	5.42
Basic earnings per share from net income(5)	10.12	7.67	11.24	6.61	7.11	4.26
<b>Balance Sheet Data:</b>						
Total assets	\$ 167,908	127,232	126,562	114,062	111,850	113,503
Long-term financial liabilities	13,143	9,959	10,555	13,540	14,884	17,576
Stockholders' equity(6)	63,141	47,845	44,484	33,560	29,774	25,653
Number of authorized shares		692,000,000	692,000,000	692,000,000	692,000,000	692,000,000

(1) Amounts in this column are unaudited and have been translated solely for the convenience of the reader at an exchange rate of \$1.3197 = 1.00, the Noon Buying Rate on December 29, 2006.

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- (2) Laws in Germany and other European countries in which E.ON operates require the seller of electricity to collect electricity taxes and remit such amounts to tax authorities. Similar laws also require the seller of natural gas to collect and remit natural gas taxes to tax authorities.
- (3) Before minority interest of 526 million for 2006, as compared with 536 million, 469 million, 449 million and 625 million for 2005, 2004, 2003 and 2002, respectively.
- (4) For more details, see Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.
- (5) Includes earnings per share from the first-time application of new U.S. GAAP standards of 0.00, (0.01), 0.00, (0.67) and 0.29 for 2006, 2005, 2004, 2003 and 2002, respectively.
- (6) After minority interests.

**DIVIDENDS**

The following table sets forth the annual dividends paid per ordinary unit bearer share of E.ON AG (each, an Ordinary Share ) in euros, and the dollar equivalent, for each of the years indicated. The table does not reflect the related tax credits available to German taxpayers who receive dividend payments. Owners of Ordinary Shares who are United States residents should be aware that they will be subject to German withholding tax on dividends received. See Item 10. Additional Information Taxation.

<b>Year Ended December 31,</b>	<b>Dividends Paid per Ordinary Share with no par value \$(1)</b>	
2002	1.75	1.96
2003	2.00	2.39
2004	2.35	3.04
2005(2)	2.75	3.50
2006(3)	3.35	4.42

- (1) Translated into dollars at the Noon Buying Rate on the dividend payment date, which typically occurred during the second quarter of the following year, except for the 2006 amount, which has been translated at the Noon Buying Rate on December 29, 2006.
- (2) An extra dividend for 2005 of 4.25 per Ordinary Share, resulting from the proceeds from the sale of E.ON's remaining 42.9 percent stake in Degussa, was paid together with the regular 2005 dividend amount. For details on this transaction, see Item 5. Operating and Financial Review and Prospects Overview.
- (3) The dividend amount for the year ended December 31, 2006 is the amount proposed by E.ON's Supervisory Board and Board of Management and has not yet been approved by its stockholders. Prior to the payment of the dividends, a resolution approving such amount must be passed by E.ON's stockholders at the annual general

meeting to be held on May 3, 2007.

See also Item 8. Financial Information Dividend Policy.



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Fluctuations in the exchange rate between the euro and the dollar will affect the dollar equivalent of the euro price of the Ordinary Shares traded on the German stock exchanges and, as a result, will affect the price of the Company's American Depositary Receipts ( ADRs ) traded in the United States. Such fluctuations will also affect the dollar amounts received by holders of ADRs on the conversion into dollars of cash dividends paid in euros on the Ordinary Shares represented by the ADRs.

The following table sets forth, for the periods indicated, the average, high, low and/or period-end Noon Buying Rates for euros expressed in \$ per 1.00.

<b>Period</b>	<b>Average(1)</b>	<b>High</b>	<b>Low</b>	<b>Period-End</b>
2002	0.9495			1.0485
2003	1.1411			1.2597
2004	1.2478			1.3538
2005	1.2400			1.1842
2006	1.2661			1.3197
September		1.2833	1.2648	
October		1.2773	1.2502	
November		1.3261	1.2705	
December		1.3327	1.3073	
2007				
January		1.3286	1.2904	
February		1.3246	1.2933	

(1) The average of the Noon Buying Rates for the relevant period, calculated using the average of the Noon Buying Rates on the last business day of each month during the period.

On March 2, 2007, the Noon Buying Rate was \$1.3182 per 1.00.

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On May 1, 1998, the German Control and Transparency in Business Act (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*, or *KonTraG* ), came into effect. The provisions of *KonTraG* include the requirement that the board of management of a German stock corporation establish a risk management system to identify material risks to the corporation at an early stage. As part of their audit, the auditors of a stock corporation assess whether the system meets the requirements of *KonTraG*. The audit requirement has been applicable to all fiscal years beginning after December 31, 1998, although the former VEBA underwent this audit voluntarily already in fiscal year 1998.

Even prior to the requirements introduced by *KonTraG*, the Company believes it had an effective risk management system which integrates risk management in its Group-wide business procedures. The system includes controlling processes, Group-wide guidelines, data processing systems and regular reports to the Board of Management and Supervisory Board. The reliability of the risk management system is reviewed regularly by the internal audit units of the Company as well as by the Company's external independent auditors, based on requirements set forth in the Stock Corporation Act. The documentation and evaluation of the Company's risks are updated quarterly throughout the Group in the following steps:

Standardized documentation of risks and countermeasures;

Evaluation of risks according to the degree of severity and the probability of occurrence, and an annual assessment of the effectiveness of existing countermeasures; and

Analysis of the results and structured disclosure in a risk report.

The following discussion groups risks according to the categories of external, operational and financial risks, as used by the Company in its risk management system.

**External**

The Company faces the general risks of economic downturns experienced by all businesses. The following are specific external risks the Company faces:

***The Company's core energy operations face strong competition, which could depress margins.***

Since 1998, liberalization of the electricity markets in the EU has greatly altered competition in the German electricity market, which was formerly characterized by numerous strong competitors. Following liberalization, significant consolidation has taken place in the German market, resulting in four major interregional utilities: E.ON, RWE AG ( RWE ), Vattenfall Europe AG ( Vattenfall Europe ) and EnBW Energie Baden-Württemberg AG ( EnBW ). In addition, the market for electricity trading has become more liquid and competitive, with a total trading volume of approximately 1,133 terawatt hours ( TWh ) at the European Energy Exchange (EEX) spot and futures market in 2006, and additional volumes being traded on the over-the-counter market. Liberalization of the German electricity market also caused prices to decrease beginning in 1998, although prices have increased since 2001. Retail prices now exceed 1998 levels, and prices for sales to distributors and industrial customers have also increased. These price increases have generally been driven by increases in the price of fuel, as well as regulatory and other costs, with the result that competitive pressure on margins continues to exist. Higher wholesale prices are also expected to lead to the construction of new generation facilities, thereby increasing competition and the pressure on margins when the first such facilities come into operation. Although the Company intends to compete vigorously in the changed German

electricity market, it cannot be certain that it will be able to develop its business as successfully as its competitors. For information about regulatory changes that are affecting the German electricity market, see the discussion on changes in laws and regulations below.

Outside Germany, the electricity markets in which the Company operates are also subject to strong competition. The Company has significant U.K. and Swedish operations in electricity generation, distribution and supply, on both the wholesale and retail levels. Increased competition from new market entrants and existing market participants could adversely affect the Company's U.K. or Swedish market share in both the retail and wholesale sectors. The Company cannot guarantee it will be able to compete successfully in the United Kingdom,

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the Nordic countries, Eastern Europe, Italy or other electricity markets where it is already present or in new electricity markets the Company may enter. E.ON Ruhrgas also faces risks associated with increased competition in the gas sector; see Item 4. Information on the Company Business Overview Pan-European Gas Competitive Environment and Regulatory Environment Germany: Gas.

***Changes in applicable laws and regulations as well as the introduction of new laws and regulations could materially and adversely affect the Company's financial condition and results of operations.***

In each of its operations, the Company must comply with a number of laws and government regulations. For more information on laws and regulations affecting the Company's core energy business, including additional details on each of the regulatory regimes discussed below, see Item 4. Information on the Company Regulatory Environment. From time to time, changes or new laws, including applicable tax laws, and regulations may be introduced which may negatively affect the Company's businesses, financial condition and results of operations.

For example, the EU adopted new electricity and gas directives in 2003 which required changes to the electricity and gas industries of some EU member states, including Germany. One of the requirements is that an independent regulatory authority be established in each member state to oversee access to the electricity and gas networks. According to the directives, this regulatory body should have the authority to set or approve network charges or, alternatively, the methodologies used for calculating them, as well as the power to control compliance with the charges or methodologies once they are set. In Germany, the relevant legislation came into force in July 2005 and the German legislature authorized the Federal Network Agency (*Bundesnetzagentur* or the BNetzA, previously called the Regulatory Authority of Telecommunications and Post) to act as the required independent regulatory body. The new German energy legislation and the appointment of the BNetzA to oversee access to German electricity and gas networks has changed the previous system of negotiated third party network access in the electricity and gas industries in Germany. Although the new legislation has already come into force, the Company cannot yet predict all of the consequences of the new system, as the exact interpretation of some of the new regulatory rules is still pending and not all ordinances are in force; in particular, the new incentive regulation system has not been established. However, the BNetzA has interpreted some of the new regulatory rules and ordinances to reach a conclusion that is different than that reached by, and in some cases less favorable to, the Company as well as other German utilities. For example, the new German energy law contains two phases of regulation, and in the starting phase, the BNetzA and the state level regulators have to approve the network charges that are calculated by the network operators using a cost-based rate-of-return model. Thus the BNetzA and the state level regulators effectively set the network charges for network operators ex-ante. In 2006, the BNetzA reduced the allowed network charges submitted for its approval by the Company's electricity and gas distribution network operators, as described below. In doing so, the BNetzA used a different interpretation of the new ordinance than that used by E.ON's network operators (and the majority of German network operators) to calculate their network charges. The BNetzA has also announced that the reduced charges will be applicable from earlier dates than those which the Company believes should apply, so that the Company (and other German network operators) would need to refund amounts to customers equal to the difference between the calculated network charges as submitted to the BNetzA and the allowed network charges approved by the BNetzA for the time period in dispute. Several German utility companies have challenged the BNetzA's decisions in third party legal proceedings; however, final decisions have not yet been made and E.ON intends to wait for the outcome of the pending legal proceedings before making any refunds to customers. For more information, see Item 4. Information on the Company Regulatory Environment.

In the gas market, the gas industry developed an industry-wide gas network access model in order to comply with the new legislation, and the agreed model, with two variants for gas transportation, was finalized in mid-2006. Shortly thereafter, one of the variants for gas transportation was challenged in legal proceedings and the BNetzA decided that the challenged variant for gas transportation, which was widely used in the gas industry, does not comply with the new energy law, thus necessitating changes to the existing gas network operators' cooperation agreement.

In addition, in November 2006 a new network connection ordinance came into force in Germany which increases potential liability for network operators for damages caused by energy supply disturbances.

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In Sweden, new legislation was also adopted in order to comply with the requirements of the EU's electricity and gas directives, and the Company cannot be certain that the new requirements will not have a negative effect on its Swedish operations. In addition, Sweden has also enacted new legislation concerning electricity distribution which requires customer compensation for power blackouts lasting more than 12 hours. As discussed below, in early 2007 a severe storm resulted in a power outage in Sweden that affected approximately 170,000 E.ON Sverige customers, and many of these customers are entitled to compensation under the new law.

The EU has also adopted a directive requiring member states to establish a greenhouse gas emissions allowance trading scheme, under which permits to emit a specified amount of carbon dioxide (CO<sub>2</sub> emission certificates) are to be allocated to affected power stations and other industrial installations. All member states have already passed the required legislation and allocated the necessary CO<sub>2</sub> emission certificates for the first phase of the scheme, mostly free of charge. Although the Company does not generally expect the introduction of the emissions trading scheme to have a negative impact on its operations, the fact that the directive has only recently been implemented makes it impossible for the Company to predict how the trading of CO<sub>2</sub> emission certificates will develop or what long-term impact, if any, the new regime will have on its financial condition and results of operations. However, in each of 2005 and 2006, companies of both the U.K. and Central Europe market units had to purchase additional CO<sub>2</sub> emission certificates on the market, with a resultant increase in operating costs. Further, member states are currently developing national allocation plans for the next phase of the greenhouse gas emissions allowance trading scheme, which will run from 2008-2012, and a reduced number of CO<sub>2</sub> emission certificates is expected to be issued for this phase, which could further impact the Company's operations. In Germany, the EU and the German government have already agreed on a reduced allocation of CO<sub>2</sub> emissions certificates. In a reflection of current international heightened awareness of climate change, the European Commission recently published a package of measures to establish a new EU energy policy with the aim of, *inter alia*, combating climate change. In the package, the European Commission proposed further ambitious targets for cutting greenhouse gas emissions. The Company is unable to predict if and when such targets might be passed into law. For more information, see Item 4. Information on the Company Regulatory Environment and Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31, 2006 Compared with Year Ended December 31, 2005 and Year Ended December 31, 2005 Compared with Year Ended December 31, 2004.

In addition, in the summer of 2005 the Competition Directorate-General of the European Commission launched a sector inquiry concerning the electricity and gas markets in the EU. This investigation is based on Article 17 of Regulation 1/2003 and assesses the competition conditions in European gas and electricity markets. It cannot be excluded that this inquiry could result in individual antitrust proceedings against E.ON Group companies and/or legislative initiatives (at the EU or national level) that would seek to increase the current level of competition in the EU energy market. In its final report issued on January 10, 2007, the European Commission has identified the following barriers to a fully functioning internal energy market, which are market concentration, vertical foreclosure, lack of market integration and transparency and price formation.

The findings of the sector inquiry enable the European Commission to focus its enforcement action on the concerns identified in the report, such as: achieving adequate unbundling of network and supply activities, removing the regulatory gaps, in particular for cross border issues, addressing market concentration and barriers to entry, as well as increasing transparency in market operations.

One of the main suggestions arising from the sector inquiry report is ownership unbundling, *i.e.*, the separation of ownership between the electricity and gas networks and commercial activities elsewhere in the value chain. It is not clear yet whether the European Commission will decide to mandate ownership unbundling or choose to attempt to resolve the identified problems using other options, such as a fully independent system operator. On February 15, 2007, the EU Energy Council discussed the presented energy package in detail, including the results of the sector inquiry final report. The European Council will discuss the measures for an action plan at its meeting on March 8,

2007. The German Presidency has announced its intention not to support ownership unbundling but to analyze all possible options, including an independent system operator, and it is at this time impossible to predict the results of this inquiry, if any.

The European Commission also carried out investigations at the premises of several energy companies in Europe, including E.ON AG and some of its affiliates, in May and December 2006, followed by requests for

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information regarding different regulatory and energy market-related issues of E.ON Energie and E.ON Ruhrgas. The European Commission is currently analyzing the respective data and has recently issued additional requests for information. The European Commission is currently investigating the circumstances under which a seal installed by investigators at one of the Company's facilities failed.

In Germany, a draft bill has been introduced in the German parliament to tighten the provisions of Germany's law against restraints on competition. The draft bill stipulates that undertakings holding a dominant position in an energy market shall not charge or impose prices, price components or other commercial conditions that are less favorable than those of other undertakings in comparable markets (even if the deviation is slight) or charge prices that disproportionately exceed their costs. E.ON believes that, if implemented as currently drafted, these provisions would impede competition in Germany's energy markets, but is currently unable to quantify the effects that the implementation of the tightened provisions would have on E.ON.

Regulatory actions can also affect the prices the Company may charge customers. For example:

As noted above, in Germany the BNetzA has reduced the allowed network charges which were submitted for approval by the Company's electricity and gas distribution network operators. For electricity, approved network charges of E.ON's transmission system operator as well as its regional distribution network operators averaged a 13.7 percent reduction from the network charges E.ON originally filed for approval, while approved network charges for E.ON's regional gas distribution network operators averaged a 10.0 percent reduction from those initially proposed by the Company. The approved network charges were based on a different interpretation of Germany's new energy law by the BNetzA than that used by E.ON's network operators (and the majority of German network operators) to calculate their network charges.

In Germany, the state antitrust authorities as well as the German Federal Cartel Office (*Bundeskartellamt*) regularly examine gas tariffs of utilities for household customers to determine whether these prices constitute market abuse. The companies belonging to the E.ON Energie group have delivered the information required. No formal proceedings are pending.

The Federal Cartel Office has opened proceedings against E.ON Energie and RWE, alleging that these two companies are abusing their dominant position in the energy market by including the costs for CO<sub>2</sub> emission certificates in the calculation of energy prices for industrial customers. In this context, RWE has already received a statement of objections from the Federal Cartel Office. E.ON believes that the way the Group's businesses calculate their electricity prices is in accordance with accepted calculation methods and therefore there have been no illegal acts by the Group in this regard. Should the Federal Cartel Office qualify E.ON's calculation method as an abuse of a dominant position, E.ON would appeal against the decision. However, the outcome of such an appeal cannot be predicted.

Electricity and gas prices and sales practices have also been the subject of periodic challenges by the German antitrust authorities, although to date E.ON has prevailed in such cases, sometimes on appeal after a negative ruling by a court of first instance. Currently, 54 customers of E.ON Hanse AG (E.ON Hanse) have brought a claim asserting that recent price increases violate certain provisions of the German Civil Code (*Bürgerliches Gesetzbuch*). In order to support its case that the price increases were reasonable within the meaning of applicable law, E.ON Hanse has disclosed the basis on which it calculates prices for household customers to the District Court (*Landgericht*) in Hamburg. The court is currently examining E.ON Hanse's submissions in this respect. In an unrelated proceeding, E.ON Westfalen Weser AG (E.ON Westfalen Weser) has brought suit against a group of customers that have refused to pay the increased prices. No assurances can be given as to the outcome of either of these proceedings.



With effect from April 2005, regulators in the United Kingdom renewed a price control framework for electricity distribution customers that is in effect through the five year period ending March 2010.

In the United States, the rates for E.ON U.S.'s retail electric and gas customers in Kentucky, its principal area of operations, are set by state regulators and remain in effect until such time as an adjustment is sought and approved. E.ON U.S.'s affected utilities applied for and received increases in regulated tariffs effective as of July 1, 2004.

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For additional information on these developments, see Item 4. Information on the Company's Regulatory Environment. For all of its operations, adverse changes in price controls, rate structures or the level of competition could have an adverse effect on the Company's financial condition and results of operations.

***Rising fuel prices could materially and adversely affect the Company's results of operations and financial condition.***

A significant portion of the expenses of the Company's regional market units are made up of fuel costs, which are heavily influenced by prices in the world market for oil, natural gas, fuel oil and coal. Similarly, the majority of E.ON Ruhrgas's expenses are for purchases of natural gas under long-term take or pay contracts that link the gas prices to that of fuel oil and other competing fuels. The prices for such commodities have historically been volatile and there is no guarantee that prices will remain within projected levels. The price of oil in particular rose in 2006, although it declined somewhat in the second half of the year, while the recent fall in oil prices is not yet reflected in the average price of Germany's natural gas imports due to time lags in indexation. The Company's electricity operations do maintain some flexibility to shift power production among different types of fuel, and the Company is also partially hedged against rising fuel prices. However, increases in fuel costs could have an adverse effect on the Company's operating results or financial condition if it is not able (or not permitted by regulatory authorities) to shift production to lower-cost fuel or to adjust its rates to offset such increases in fuel prices on a timely or complete basis.

For more information about E.ON Ruhrgas's take or pay contracts, including a discussion of the so-called time lag effect, see the discussion on E.ON Ruhrgas's long-term gas supply contracts below. The Company could also incur losses if its hedging strategies are not effective. For more information about the Company's hedging policies and the instruments used, see Financial below, Item 5. Operating and Financial Review and Prospects Exchange Rate Exposure and Currency Risk Management and Item 11. Quantitative and Qualitative Disclosures about Market Risk.

***Recent events have heightened concerns about the reliability of Russian gas supplies, on which E.ON Ruhrgas depends.***

E.ON Ruhrgas currently obtains nearly 30 percent of its total gas supply from Russia pursuant to long-term supply contracts it has entered into with OOO Gazexport (now Gazprom export), a subsidiary of OAO Gazprom (Gazprom) (in which E.ON Ruhrgas holds a 3.5 percent direct interest and an additional stake of 2.9 percent). Recent events in some countries of the former Soviet Union have heightened concerns in parts of Western Europe about the reliability of Russian gas supplies. Historically cold temperatures in Russia in the winter of 2005-2006 increased gas consumption, leading some Western European countries to report declines in pressure in gas pipelines and shortfalls in the volume of gas they received from Russia. In addition, a dispute between Russia and Ukraine over the imposition of significant price increases on Russian gas delivered to Ukraine at the beginning of 2006 led to interruptions in the supply of Russian gas to Ukraine (and through Ukraine to other countries) in the early days of January. In late 2006, a similar price dispute between Russia and Belarus led to Belarus blocking the transit of gas and oil through that country, while in early 2007 Poland attempted to raise transit fees charged to Gazprom for Russian gas and oil being shipped to Western Europe through Poland, leading to speculation that Gazprom might retaliate by halting gas and oil shipments. Economic or political instability or other disruptive events in any transit country through which Russian gas must pass before it reaches its final destination in Western Europe can have a material adverse effect on the supply of such gas, and all such events are completely outside the control of E.ON Ruhrgas. Although E.ON Ruhrgas has to date not experienced any interruptions in supply or declines in delivered gas volumes below those which are guaranteed to it under its long-term contracts, no assurance can be given that such interruptions or declines will not occur. The terms of E.ON Ruhrgas's long-term supply contracts for Russian gas require that the contracted volumes of gas be delivered to E.ON Ruhrgas at the German border, with the risk of ownership only passing to E.ON Ruhrgas at that point, but provide that such obligations can be suspended due to events of *force majeure*. Any prolonged

interruption or decline in the amount of gas delivered to E.ON Ruhrgas under its contracts with Gazprom, its subsidiaries or any other party would result in E.ON Ruhrgas having to use its storage reserves to make up the shortfall with respect to amounts it is contracted to deliver to customers, and could have a material adverse effect on E.ON's results of operations and financial condition.

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***The Company's revenues and results of operations fluctuate by season and according to the weather, and management expects these fluctuations to continue.***

The demand for electric power and natural gas is seasonal, with the Company's operations generally experiencing higher demand during the cold weather months of October through March and lower demand during the warm weather months of April through September. The exception to this is the Company's U.S. power business, where hot weather results in an increased demand for electricity to run air conditioning units. As a result of these seasonal patterns, the Company's revenues and results of operations are higher in the first and fourth quarters and lower in the second and third quarters, with the U.S. power business having its highest revenues in the third quarter and a secondary peak in the first and fourth quarters. Revenues and results of operations for all of the Company's energy operations can be negatively affected by periods of unseasonably warm weather during the autumn and winter months, as occurred at certain of E.ON's market units in 2006. The Company's Nordic operations could be negatively affected by a lack of precipitation (which would lead to a decline in hydroelectric generation, as occurred in 2006) and its European energy operations could also be negatively affected by a summer with higher than average temperatures to the extent its plants were required to reduce or shut down operations due to a lack of water needed for cooling the plants. Management expects seasonal and weather-related fluctuations in revenues and results of operations to continue. Particularly severe weather can also lead to power outages, as discussed in more detail below.

**Operational**

The Company's core energy businesses operate technologically complex production facilities and transmission systems. Operational failures or extended production downtimes could negatively impact the Company's financial condition and results of operations. The Company's businesses are also subject to risks in the ordinary course of business such as the loss of personnel or customers, and losses due to bad debts. The Company believes it has appropriate risk control measures in effect to counteract and address these types of risks. The following are additional operational risks the Company faces:

***E.ON Ruhrgas' long-term gas supply contracts expose it to volume and price risks, and it has had to terminate certain of its long-term sales contracts due to a negative decision by the German Federal Cartel Office.***

As is typical in the gas industry, E.ON Ruhrgas enters into long-term gas supply contracts with natural gas producers to secure the supply of almost all the gas E.ON Ruhrgas purchases for resale. These contracts, which generally have terms of around 20 to 25 years, require E.ON Ruhrgas to purchase minimum amounts of natural gas over the period of the contract or to pay for such amounts even if E.ON Ruhrgas does not take the gas, a standard industry practice known as "take or pay." The minimum amounts are generally about 80 percent of the firmly contracted quantities. Historically, E.ON Ruhrgas has also entered into long-term gas sales contracts with its customers, although these contracts are shorter than the gas supply contracts (for distributors and municipal utilities, which constitute the majority of E.ON Ruhrgas' customers, the contracts generally have longer terms, while contracts for industrial customers usually have terms between one and five years), and, as described in more detail below, have been challenged by the German Federal Cartel Office. In addition, the majority of these gas sales contracts do not include fixed take or pay provisions. Since E.ON Ruhrgas' gas supply contracts have longer terms than its gas sales contracts, and commit E.ON Ruhrgas to paying for a minimum amount of gas over a long period, E.ON Ruhrgas is exposed to the risk that it will have an excess supply of natural gas in the long term should it have fewer committed purchasers for its gas in the future and be unable to otherwise sell its gas on favorable terms. Such a shortfall could result if a significant number of E.ON Ruhrgas' customers (or their end customers) shifted from natural gas to other forms of energy or if E.ON Ruhrgas' customers began to acquire increased volumes of gas from other sources. The ministerial approval E.ON obtained for the acquisition of Ruhrgas required E.ON Ruhrgas to divest its stakes in two gas distributors, as well as granting these distributors the right to terminate their gas sales contracts with E.ON Ruhrgas. The ministerial approval also gave most of E.ON Ruhrgas' distribution customers the right to reduce the amounts of

natural gas purchased from E.ON Ruhrgas. To date, most customers have decided not to exercise these options. For additional information on these developments, see Item 4. Information on the Company Business Overview Pan-European Gas Sales.

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In January 2006, the German Federal Cartel Office (*Bundeskartellamt*) issued a decision prohibiting E.ON Ruhrgas from enforcing its existing long-term gas sales contracts with regional and local distribution companies after October 1, 2006 and from entering into new sales contracts with those customers that are identical or similar in nature. For details on this decision and the effect on E.ON Ruhrgas, see Item 4. Information on the Company Business Overview Pan-European Gas Sales. E.ON Ruhrgas believes that the Federal Cartel Office is overlooking the negative impact its decision would have on security of supply and that by excluding suppliers from competing to supply additional volume, the Federal Cartel Office inadmissibly interferes with freedom of contract. Therefore, E.ON Ruhrgas has appealed against the decision issued by the Federal Cartel Office and sought temporary relief in a summary proceeding in order to prevent the decision from taking immediate effect. In June 2006, the State Superior Court (*Oberlandesgericht*) in Düsseldorf decided in the summary proceeding that E.ON Ruhrgas will not be granted temporary relief. Consequently, E.ON Ruhrgas had to terminate the supply contracts with regional and local distribution companies that are covered by the Federal Cartel Office decision as of October 1, 2006. E.ON Ruhrgas is currently challenging the Federal Cartel Office decision in a full proceeding before the State Superior Court, which is expected to last through 2007. In the meantime, it has concluded new contracts having a duration of only 1 or 2 years with virtually all of the regional and local distribution companies whose prior contracts it had been required to cancel. Although the court's negative decision on E.ON Ruhrgas' application for an injunction is not determinative in the full proceeding, no assurance can be given that E.ON Ruhrgas will be successful in that proceeding or any subsequent appeals, or otherwise be allowed to conclude contracts that exceed the combination of supply share and duration set by the decision of the Federal Cartel Office and/or bid for the remaining volumes.

If these or other developments were to cause the volume of gas E.ON Ruhrgas is able to sell to fall below the volume it is required to purchase, the take or pay provisions of some of E.ON Ruhrgas' gas supply contracts may become applicable, which would negatively affect its results of operations. In addition, due to increasing competition linked to the liberalization of the gas market and the entry of new competitors, E.ON Ruhrgas may not be able to renew some of its existing gas sales contracts as they expire, or to gain new contracts. This may also have the effect of leaving E.ON Ruhrgas with an excess supply of natural gas and/or decrease in margins.

As is standard in the gas industry, the price E.ON Ruhrgas pays for gas under its long-term gas supply contracts is calculated on the basis of complex formulas incorporating variables based on current market prices for fuel oil, gas oil, coal and/or other competing fuels, with prices being automatically re-calculated periodically, usually quarterly, by reference to market prices of the relevant fuels during a prior period. Price terms in E.ON Ruhrgas' gas sales contracts are generally pegged to the price of competing fuels and provide for automatic quarterly price adjustments based on fluctuations in underlying fuel prices, again by reference to market prices during a prior period. Since E.ON Ruhrgas supply and sales contracts are generally indexed to different types of oil and related fuels, in different proportions and are adjusted according to different formulas, E.ON Ruhrgas' margins for natural gas may be significantly affected in the short term by variations in the price of oil or other fuels, which are generally reflected in prices payable under its supply contracts before they are reflected in prices paid under sales contracts, the so-called "time lag" effect. Although E.ON Ruhrgas seeks to manage this risk by matching the general terms of its portfolio of sales contracts with those of its supply contracts, there can be no assurance that it will always be successful in doing so, particularly in the short term. For more information on E.ON Ruhrgas' gas supply and sales contracts, see Item 4. Information on the Company Business Overview Pan-European Gas.

***If the Company's plans to make selective acquisitions and investments to enhance its core energy business are unsuccessful, the Company's future earnings and share price could be materially and adversely affected.***

The Company's business strategy involves selective acquisitions and investments in its core business area of energy. This strategy depends in part on the Company's ability to successfully identify and acquire companies that enhance its business on acceptable terms. In order to obtain the necessary approvals for acquisitions, the Company may be required to divest other parts of its business, or to make concessions or undertakings which materially affect its

operations. For example, the Company's efforts to obtain control of Ruhrgas through a series of purchases from the holders of Ruhrgas interests were initially blocked by the German Federal Cartel Office and then by a series of plaintiffs who succeeded in convincing the State Superior Court in Düsseldorf to issue a temporary injunction preventing the Company from completing the transaction. In order to receive the ministerial approval of the German

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Economics Ministry that overruled the initial decision of the Federal Cartel Office, the Company was required to make significant concessions, including committing to divest certain operations, to have E.ON Ruhrgas sell a significant quantity of natural gas at auction (with opening bids set at below-market prices) and to offer certain customers the option of reducing the volume of gas they had contracted for. In addition, in settling the claims of the plaintiffs who had received the temporary injunction, the Company agreed to divest certain of its operations, to provide certain of the plaintiffs with energy supply contracts and network access, and to make certain infrastructure improvements, as well as making financial payments. For more information, see Item 4. Information on the Company History and Development of the Company Ruhrgas Acquisition. Each of these matters delayed completion of the Ruhrgas acquisition and had the effect of increasing the cost of the transaction to the Company.

In February 2006, E.ON announced that it would launch an all cash tender offer for 100 percent of the share capital of Endesa, S.A. ( Endesa ), the largest electric utility in Spain and Portugal, which also has significant operations in Latin America and southern Europe. E.ON's original bid set an offer price of 27.50 per Endesa ordinary share and American Depositary Share ( ADS ). Over the course of the following twelve months, E.ON raised its offer price twice, first to 35.00 for each Endesa security and then to 38.75. The potential cost to E.ON for the acquisition of 100 percent of Endesa has therefore increased from approximately 29.1 billion to approximately 41 billion. E.ON intends to finance the acquisition through a combination of its own resources and new financing in the form of a committed line of credit provided by a syndicate of international banks that incorporates a number of conditions. The offer has also been subject to a series of legal challenges in Spain and the United States, a number of which remain pending. No assurance can be given that E.ON will be able to complete the transaction successfully on the proposed terms or at all. For additional information, see Item 4. Information on the Company History and Development of the Company Proposed Endesa Acquisition.

In addition, there can be no assurances that the Company will be able to achieve the benefits it expects from any acquisition or investment. For example, the Company may fail to retain key employees, may be unable to successfully integrate new businesses with its existing businesses, may incorrectly judge expected cost savings, operating profits or future market trends and regulatory changes, or may spend more on the acquisition, integration and operations of new businesses than anticipated. Legal challenges may also have an impact. Especially large acquisitions, such as that of Ruhrgas, the purchase of which was completed in March 2003, or the proposed acquisition of Endesa, present particularly difficult challenges. Investments and acquisitions in new geographic areas or lines of business require the Company to become familiar with new markets and competitors and expose the Company to commercial and other risks, as well as additional regulatory regimes relating to the acquired businesses that may be stricter than the ones the Company is currently subject to. Because of the risks and uncertainty associated with acquisitions and investments, any acquired businesses or investments may not achieve the profitability expected by the Company.

***The Company could be subject to environmental liability associated with its nuclear and conventional power operations that could materially and adversely affect its business. In addition, new or amended environmental laws and regulations may result in significant increases in costs for the Company.***

Under German law, the owner of an electric power generation facility is subject to liability provisions that guarantee comprehensive compensation to all injured parties in the event of environmental damages caused by the facility. In addition, there has been some relaxation in the evidence required under the German Environmental Liability Law (*Umwelthaftungsgesetz*) to establish, prove and quantify environmental claims. Under German law and in accordance with contractual indemnities, the Company may still be subject to future environmental claims with respect to alleged historical environmental damage arising from certain of its discontinued and disposed of operations, including, but not limited to, the VEBA Oel oil business, the VAW aluminum operations and the Klöckner & Co AG distribution and logistics businesses, as well as Degussa's operations. If claims were to be asserted against the Company in relation to environmental damages and plaintiffs were successful in proving their claims, such claims could result in material losses to the Company.



German law also provides that in the case of a nuclear accident in Germany, the owner of the reactor, the factory or the nuclear material storage facility is subject to liability provisions that guarantee comprehensive compensation to all injured parties. Under German nuclear power regulations, the owner is strictly liable, and the geographical scope of its liability is not limited to Germany. E.ON's Swedish nuclear power stations also expose the

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Company to liability under applicable Swedish law. In 2006 an inquiry opened by the Swedish government proposed both unlimited liability for nuclear plant operators and that such operators be obligated to purchase greater insurance coverage, although it is unclear what effect the inquiry's proposals of new legislation will have. The Company does not operate or have interests in nuclear power plants outside of Germany, Sweden and Switzerland, including in the United Kingdom, the United States or the countries in Eastern Europe in which it operates. The Company takes extensive safety and risk management measures in the operation of its nuclear power operations, and has mandatory insurance with respect to its nuclear operations as described in Item 4. Information on the Company Environmental Matters Germany: Electricity and Nordic. However, any claims against the Company arising in the case of a nuclear power accident could exceed the coverage of such insurance, and cause material losses to the Company.

The Company expects that it will incur costs associated with future environmental compliance, especially compliance with clean air laws. For example, the U.S. Environmental Protection Agency (EPA) has introduced regulations regarding the reduction of nitrogen oxide (NO<sub>x</sub>) and sulphur dioxide (SO<sub>2</sub>) emissions from electricity generating units. These regulations require E.ON U.S. to make significant additional capital expenditures in pollution control equipment. E.ON U.S. expects to incur total costs of \$1.1 billion in installing these pollution controls during the 2007 through 2009 time period. E.ON U.S. expects to recover a significant portion of these costs over time from customers of its regulated utility businesses. In the United Kingdom, legislation to implement the EU Large Combustion Plants Directive has been adopted which requires E.ON UK to make decisions as to whether it will invest in enhanced pollution control devices, reduce operating time at certain of its plants or consider closing certain plants in the future. Similarly, the German government has amended an ordinance of the German Federal Pollution Control Act (*Bundesimmissionsschutzgesetz*, or BImSchG) to introduce lower emission limits for air pollutants such as carbon monoxide and NO<sub>x</sub>. This amendment requires both E.ON Energie and E.ON Ruhrgas to make investments in pollution control devices. Currently, none of E.ON's market units can predict the extent to which their respective operations will be affected by the new legislation and/or regulations. Revisions to existing environmental laws and regulations and the adoption of new environmental laws and regulations may result in significant increases in costs for the Company. Any such increase in costs that cannot be fully recovered from customers may adversely affect the Company's operating results or financial condition.

Although environmental laws and regulations have an increasing impact on the Company's activities in almost all the countries in which it operates, it is impossible to predict accurately the effect of future developments in such laws and regulations on the Company's future earnings and operations. For example, the EU has published a package of measures for a new energy policy which includes ambitious targets for cutting greenhouse gas emissions, but the Company cannot predict when or in what form these measures might be passed into law, or how the Company might be impacted. For detail, see the discussion on changes in laws and regulations above. Some risk of environmental costs and liabilities is inherent in particular operations and products of the Company, as it is with other companies engaged in similar businesses, and there can be no assurance that material costs and liabilities will not be incurred. For more information on environmental matters, see Item 4. Information on the Company Environmental Matters.

***If power outages or shutdowns involving the Company's electricity operations occur, the Company's business and results of operations could be negatively affected.***

Significant parts of Europe and the United States and Canada have experienced major power outages in recent years. The reasons for these blackouts vary, although generally they involved a locally or regionally inadequate balance between power production and consumption, with single failures triggering a cascade-like shutdown of lines and power plants following overload or voltage problems. The likelihood of this type of problem has increased in recent years following the liberalization of EU electricity markets, partly due to an emphasis on unrestricted cross-border physically-settled electricity trading that has resulted in a substantially higher load on the international network, which was originally designed mainly for purposes of mutual assistance and operations optimization. As a result, there are transmission bottlenecks at many locations in Europe, and the high load has resulted in lower levels of safety reserves

in the network. In Germany, where power plants are located in closer proximity to population centers than in many other countries, the risk of blackouts is lower due to shorter transmission paths and a strongly meshed network. In addition, the spread of a power failure is less likely in Germany due to the organization of the German power grid into four balancing zones. Nevertheless, the Company's German or international electricity

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operations could experience unanticipated operating or other problems leading to a power failure or shutdown. For example:

On January 8-9, 2005, a severe storm hit Sweden, destroying the electricity distribution grid in some areas in the south of the country. Approximately 250,000 E.ON Sverige customers were affected by the resulting power outage, and some customers were left without electricity for several weeks. In 2005, E.ON Sverige recorded related costs for rebuilding its distribution grid and compensating customers of approximately 140 million.

In July 2006, a transmission-related incident at the Forsmark nuclear power plant in Sweden (in which E.ON Sverige owns a minority interest) resulted in an emergency shutdown of the plant and subsequent modifications to the plant's transmission infrastructure. Reviews of similar infrastructure at other reactors following the Forsmark incident took a number of Swedish reactors out of service for a period of several weeks and revealed the need for a significant overhaul at the Oskarshamn I reactor operated by E.ON Sverige, which was only restarted in January 2007.

On November 4, 2006, an overload in the northwestern German power transmission grid occurred, leading to disturbances in other parts of the continental European power grid and an interruption of the power supply for more than 15 million European households located in parts of Germany, France, Belgium, the Netherlands, Italy and Spain. According to initial findings, the overload occurred after the E.ON Netz GmbH (E.ON Netz, a subsidiary of E.ON Energie) control center made an erroneous estimation in its planned interruption of a high voltage power line across the Ems river in Germany to allow the passage of a Norwegian cruise liner. Functioning safety mechanisms and close cooperation among European transmission system operators ensured that a full reconnection of the power grids and stabilization of the system occurred within 38 minutes after the grid separated into three islands, thus avoiding an uncontrolled blackout. A further investigation of the circumstances leading to the power blackout (including whether other factors played a role) will determine if consumers affected by the power interruption are entitled to compensation by E.ON Netz.

On January 14, 2007, another severe storm hit southern Sweden. Approximately 170,000 E.ON Sverige customers were affected by the resulting power outage, and some customers were left without electricity for up to ten days. Preliminary estimates of the costs to be incurred by E.ON Nordic for rebuilding its distribution grid and compensating affected customers are in the range of 95 million.

On January 18 and 19, 2007, a severe storm hit several European countries, damaging the electricity distribution grid of E.ON Energie in some areas of Germany, the Czech Republic, Hungary and Romania. In Germany, approximately 750,000 customers were disconnected from the grid (in the Czech Republic: approximately 500,000 customers; in Hungary: approximately 90,000 customers; and in Romania: approximately 5,000 customers). Approximately 80 percent of the affected customers were reconnected within one day, and nearly all customers were reconnected within three days. The costs of repairing the damages are not expected to be significant.

For more information on these events, see Item 4. Information on the Company Business Overview Central Europe and Nordic. The areas of the United States in which E.ON U.S. operates are also from time to time subject to severe weather, such as ice storms, which could cause power outages. In Germany, about 40 percent of the country's wind turbines are connected to the power grid of E.ON Energie, mostly in the north of Germany. In the case of a power grid failure, older wind power plants may switch off automatically; this possible separation of a number of wind power plants from the grid may in turn increase the impact of the original power failure in the grid. The Company can give no assurances that power failures or shutdowns involving its operations will not occur in the future, or that any such power failure or shutdown would not have a negative effect on the Company's business and results of operations.



**Table of Contents****Financial**

*The Company is exposed to financial risks that could have a material effect on its financial condition.*

During the normal course of its business, the Company is exposed to the risk of energy price volatility, as well as interest rate, commodity price, currency and counterparty risks. These risks are partially hedged on a Group-wide (or market unit-wide) basis, but the Company may incur losses if any of the variety of instruments and strategies it uses to hedge exposures are not effective. For more information about these risks and the Company's hedging policies and instruments, see Item 5. Operating and Financial Review and Prospects Exchange Rate Exposure and Currency Risk Management and Item 11. Quantitative and Qualitative Disclosures about Market Risk. For more information about E.ON Ruhrgas take or pay contracts, see the discussion on E.ON Ruhrgas long-term gas contracts above.

The Company is also exposed to other financial risks. For example, it holds certain stock investments which may expose it to the risk of stock market declines. Financial markets have experienced volatility in recent years, and markets may decline again or become even more volatile. In addition, a significant portion of the Company's outstanding debt bears interest at floating rates; the Company's interest expense will therefore increase if the relevant base rates rise. The value of the Company's investments in fixed rate bonds will be adversely affected by a rise in market interest rates.

The Company also faces risks arising from its energy trading operations. In general, the Company seeks to hedge risks associated with volatile energy-related prices (including the prices of CO<sub>2</sub> emission certificates) by entering into fixed-price bilateral contracts, fuel-price indexed bilateral contracts, futures and options contracts traded on commodities exchanges, and swaps and options traded in over-the-counter financial markets. To the extent the Company is unable to hedge these risks, or enters into hedging contracts that fail to address its exposure or incorrectly anticipate market movements, it may suffer losses, some of which could be material. In addition to the risks associated with adverse price movements, credit risk is also a factor in the Company's energy marketing, trading and treasury activities, where loss may result from the non-performance of contractual obligations by a counterparty. The Company maintains credit policies and control procedures with respect to counterparties to protect it against losses associated with such types of credit risk, although there can be no assurance that these policies and procedures will fully protect the Company. The marking to market of many of E.ON's hedging instruments required by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ), has also increased the volatility of the Company's results of operations, though it has not had a material effect on E.ON's overall risk exposure. For example, in 2006, unrealized losses from the marking to market of derivatives, principally at the U.K. market unit, reduced other non-operating expenses by approximately 2.7 billion. For more information about the Company's energy trading operations, its hedging policies and the instruments used, see Item 4. Information on the Company Business Overview Central Europe Trading, Pan-European Gas Trading, U.K. Energy Wholesale Energy Trading, Trading and U.S. Midwest Power Generation Asset-Based Energy Marketing, Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31, 2006 Compared with Year Ended December 31, 2005, Year Ended December 31, 2005 Compared with Year Ended December 31, 2004 and Exchange Rate Exposure and Currency Risk Management and Item 11. Quantitative and Qualitative Disclosures about Market Risk.

**Item 4. Information on the Company.****HISTORY AND DEVELOPMENT OF THE COMPANY**

E.ON AG is a stock corporation organized under the laws of the Federal Republic of Germany. It is entered in the Commercial Register (*Handelsregister*) of the local court of Düsseldorf, Germany, under HRB 22315. E.ON's registered office is located at E.ON-Platz 1, D-40479 Düsseldorf, Germany, telephone +49-211-45 79-0. E.ON's agent

in the United States is E.ON North America, Inc., 405 Lexington Avenue, New York, NY 10174.

The State of Prussia established VEBA in 1929 when it consolidated state-owned coal mining and energy interests (hence the original name VEBA, Vereinigte Elektrizitäts- und Bergwerks-Aktiengesellschaft ).

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Ownership of VEBA was transferred from the dissolved Prussian state to the Federal Republic of Germany. VEBA was partially privatized in 1965, leaving the German government with a 40.2 percent share. After several subsequent offerings, privatization was completed in 1987 when the German government offered its remaining 25.5 percent share to the public. During and since the privatization process, VEBA AG evolved into a management holding company, providing strategic leadership and resource allocation for the entire Group.

## **VEBA-VIAG MERGER**

On June 16, 2000, VEBA AG merged with VIAG AG, one of the largest industrial groups in Germany. VEBA AG was subsequently renamed E.ON AG. The merger of VEBA and VIAG to form E.ON has created the largest industrial group in Germany, based on market capitalization at year-end 2006, with sales of € 67.8 billion in 2006.

In order to effectuate the merger, VEBA and VIAG submitted an application to the Merger Task Force of the European Commission on December 14, 1999. The EU Commission examined the planned merger and, with its notification of June 13, 2000, declared it to be compatible with the common market. The EU Commission's approval required VEBA and VIAG to commit to make certain divestments in their combined electricity and chemical operations, and to give undertakings to 1) waive transfer charges for cross-zone deliveries of electricity within Germany, 2) purchase a certain minimum amount of electricity from Vattenfall Europe (formerly VEAG Vereinigte Energiewerke Aktiengesellschaft ( VEAG )), a utility primarily active in the eastern part of Germany, at market rates during the period ending on December 31, 2007, and 3) provide additional interconnector capacity on the border between Germany and Denmark.

The merger of VEBA and VIAG was legally implemented by merging VIAG AG into VEBA AG, with VEBA AG continuing as the surviving entity. The newly-merged company then received the new name E.ON AG. On June 16, 2000, the merger was entered into the Commercial Register in Düsseldorf. Upon registration with the Commercial Register in Düsseldorf, the merger was completed and became effective for purposes of U.S. GAAP as of July 1, 2000. VIAG AG was dissolved and its assets and liabilities were transferred to VEBA AG. Simultaneously, each VIAG shareholder, with the exception of VEBA AG, received two shares of the new company in exchange for each five VIAG shares held. Pursuant to this exchange ratio, the former VIAG shareholders (with the exception of VEBA AG) therefore held 33.1 percent of the company immediately after the merger, while the former VEBA shareholders held 66.9 percent.

## **POWERGEN GROUP ACQUISITION**

In 2002, E.ON acquired the London- and Coventry-based British utility Powergen. As agreed between E.ON and Powergen, upon satisfaction of all conditions E.ON implemented the transaction under an alternative U.K. legal procedure known as a "scheme of arrangement" instead of a tender offer. The scheme of arrangement provided for the acquisition of all outstanding Powergen shares by virtue of an order of the English courts following approval of the transaction at a meeting of Powergen shareholders convened by order of the court. Following the receipt of the necessary regulatory approvals, E.ON completed its acquisition of the Powergen Group, which is now wholly owned by E.ON, on July 1, 2002. In March 2003, E.ON transferred LG&E Energy (Powergen's former principal U.S. operating subsidiary; now named E.ON U.S.) and its direct parent holding company to a direct subsidiary of E.ON AG. In July 2004, Powergen was renamed E.ON UK.

The total purchase price amounted to € 7.6 billion (net of € 0.2 billion cash acquired), and the assumption of € 7.4 billion of debt. Goodwill in the amount of € 8.9 billion resulted from the purchase price allocation. A significant deterioration in the market environment for the Powergen Group's U.K. and U.S. operations triggered an impairment analysis as of the acquisition date that resulted in an impairment charge of € 2.4 billion, thus reducing the amount of goodwill associated with the transaction to € 6.5 billion.



For more information on E.ON UK and E.ON U.S., see [Business Overview U.K.](#) and [U.S. Midwest](#).

**Table of Contents****RUHRGAS ACQUISITION**

E.ON Ruhrgas is one of the leading non-state-owned gas companies in Europe and the largest gas business in Germany in terms of gas sales. Prior to its acquisition by E.ON, Ruhrgas was owned by a number of holding companies, with indirect stakes dispersed among a number of major industrial and energy companies both within and outside Germany.

In 2001, E.ON concluded contracts for the purchase of significant shareholdings in Ruhrgas with BP p.l.c. ( BP ) and Vodafone Group Plc ( Vodafone ). E.ON also reached an agreement in principle with RAG Aktiengesellschaft ( RAG ) to acquire its Ruhrgas stake. In January and February 2002, the German Federal Cartel Office blocked the consummation of the transactions with the aforementioned parties on the grounds that the proposed purchase would have a negative effect on competition in the German gas and electricity markets. E.ON appealed the decision to the German Federal Ministry for Economics and Labor (now renamed the Federal Ministry for Economics and Technology) (*Bundesministerium für Wirtschaft und Technologie*), which has the power to overrule the Cartel Office if it determines a transaction would result in an overriding general benefit to the German economy.

Between May and July 2002, E.ON reached agreements with ThyssenKrupp AG, Esso Deutschland GmbH, Deutsche Shell GmbH and TUI AG with respect to E.ON's acquisition of each company's respective stake in Ruhrgas. E.ON also reached a definitive agreement with RAG to acquire RAG's more than 18 percent interest in Ruhrgas and to sell E.ON's majority interest in Degussa to RAG in a two-step transaction. The successful completion of each of these arrangements would make E.ON the sole owner of Ruhrgas.

In July 2002, E.ON was granted the ministerial approval it had requested for the acquisition of a majority shareholding in Ruhrgas. The ministerial approval was linked with stringent requirements designed to promote competition in the gas sector. Ruhrgas was required to auction a specified volume of natural gas to its competitors and to legally unbundle its transmission system from its other operations. In addition, E.ON and Ruhrgas were required to divest several shareholdings. E.ON immediately completed the acquisition of 38.5 percent of Ruhrgas from BP, Vodafone and ThyssenKrupp AG.

A number of companies with alleged interests in the German energy industry filed complaints against the ministerial approval with the State Superior Court (*Oberlandesgericht*) in Düsseldorf and petitioned the court to issue a temporary injunction blocking the transaction. The court subsequently issued a series of orders in July, August and September 2002 that temporarily enjoined the Company's acquisition of a majority stake in Ruhrgas and prohibited the Company from exercising its shareholders' rights with respect to the Ruhrgas stake it had already acquired.

In September 2002, Germany's Federal Minister of Economics confirmed the essential aspects of the July 5 ministerial approval for E.ON's acquisition of Ruhrgas. However, the ministry linked its decision to a tightening of the requirements. Ruhrgas was also required to sell its stakes in two regional gas companies, and each of the companies required to be disposed of was granted a special right to terminate its existing purchase agreements with E.ON and Ruhrgas on a staggered basis. In addition, customers purchasing a majority of their gas requirements from Ruhrgas were granted the right to unilaterally reduce the contracted volumes, and Ruhrgas was required to auction 200 billion kilowatt hours ( kWh ) of natural gas to its competitors, with the minimum bid in such auctions being lower than the average border-crossing price. The approval also provided that the ministry has the right to take further action in the event of any sale by E.ON of a controlling interest in E.ON Ruhrgas or a change in control over E.ON. On this basis, the ministry asked the State Superior Court to lift its temporary injunction. E.ON and E.ON Ruhrgas have complied with all of the conditions imposed by the ministerial approval.

In December 2002, the State Superior Court decided not to lift the temporary injunction, and formal proceedings (*Hauptverfahren*) regarding the injunction began in January 2003. On January 31, 2003, E.ON reached settlement agreements with all plaintiffs who had contested the validity of the ministerial approval. In accordance with these agreements, E.ON exchanged shareholdings with certain plaintiffs and agreed to enter into gas and/or electricity supply contracts, make certain infrastructure improvements (particularly with regard to gas distribution), and provide specified access to the gas and electricity supply grids, with others, as well as agreeing to

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make other financial payments to the plaintiffs. In addition, Ruhrgas reconfirmed to all the parties its commitment to open and fair competition in the gas market.

In March 2003, E.ON acquired the remaining shares of Ruhrgas. The total cost of the transaction to E.ON, including settlement costs and excluding dividends received on Ruhrgas shares owned by E.ON prior to its consolidation, amounted to 10.2 billion. Beginning as of February 1, 2003, E.ON fully consolidated Ruhrgas, which was renamed E.ON Ruhrgas on July 1, 2004.

Upon termination of the court proceedings, the Company completed the first step of the RAG/Degussa transaction, *i.e.*, the Company acquired RAG's Ruhrgas stake for total consideration of 2.0 billion, and E.ON tendered 37.2 million of its shares in Degussa to RAG at the price of 38 per share, receiving total proceeds of 1.4 billion. Following this transaction and the completion of the subsequent mandatory tender offer to the other Degussa shareholders, RAG and E.ON each held a 46.5 percent interest in Degussa, with the remainder being held by the public. In the second step of the transaction, E.ON sold a further 3.6 percent of Degussa's stock to RAG with effect from June 1, 2004, giving RAG a 50.1 percent interest in Degussa. Total proceeds from the sale of this 3.6 percent stake amounted to 283 million. In December 2005, E.ON and RAG signed a framework agreement on the sale of E.ON's remaining 42.9 percent stake in Degussa to RAG. As part of the implementation of that framework agreement, E.ON transferred its stake in Degussa to RAG Projektgesellschaft mbH ( RAG Projektgesellschaft ) in March 2006 and agreed on the forward sale of that entity to RAG for a purchase price of approximately 2.8 billion (equal to 31.50 per Degussa share). The transaction closed in July 2006. As a result, E.ON no longer holds any equity interest in Degussa.

In accordance with the obligations set out in the ministerial approvals mandating the auctioning of an aggregate amount of 200 billion kWh of baseload gas, on July 30, 2003, E.ON Ruhrgas offered approximately 33 billion kWh of natural gas from its portfolio of long-term supply contracts in the first of six internet-based annual auctions. Approximately 15 billion kWh of this gas were sold. On May 19, 2004, E.ON Ruhrgas offered approximately 39 billion kWh of gas under its long-term supply contracts in the second auction. The offered volume included one third of the volumes (approximately 6 billion kWh) left unsold in the first auction. In the 2004 auction, seven bidders purchased an aggregate volume of approximately 35 billion kWh of gas. On May 18, 2005, E.ON Ruhrgas offered approximately 39 billion kWh of gas under its long-term supply contracts in a third auction, which again included one-third of the volumes (approximately 6 billion kWh) not sold in the first auction. In the 2005 auction, seven bidders purchased the total volume of gas offered. In the fourth auction on May 17, 2006, E.ON Ruhrgas offered approximately 39 billion kWh of natural gas (including the remaining third of the volumes not sold in the first auction, *i.e.* approximately 6 billion kWh), and sold these volumes to seven bidders. The prices E.ON Ruhrgas obtained in the first two auctions were in line with the minimum prices set by the German Federal Ministry for Economics and Labor (now renamed the Federal Ministry for Economics and Technology) (*Bundesministerium für Wirtschaft und Technologie*). In the auctions conducted in 2005 and 2006, the quantities on offer were sold at a premium to the minimum price. E.ON Ruhrgas is required to hold two more annual gas auctions in 2007 and 2008, respectively.

For more information on E.ON Ruhrgas, see Business Overview Pan-European Gas.

**PROPOSED ENDESA ACQUISITION***Overview*

On February 21, 2006, E.ON (acting through its wholly owned subsidiary E.ON Zwölfte Verwaltungs GmbH ( E.ON 12 )) announced its intent to make an offer to acquire all the outstanding ordinary shares, par value 1.20 per share ( Endesa ordinary shares ), and ADSs ( Endesa ADSs ), and together with the Endesa ordinary shares, the Endesa securities ) of Endesa, S.A., a Spanish public limited company, for 27.50 in cash, without interest. As explained in more detail below, the offer consists of an offer to all holders of Endesa ordinary shares (the Spanish Offer ) and a

separate, concurrent offer to all holders of Endesa ordinary shares who are resident in the United States and to all holders of Endesa ADSs, wherever located (the U.S. Offer , and together with the Spanish Offer, the Offers ). The U.S. Offer is being made pursuant to the Offer to Purchase dated January 26, 2007, as amended and supplemented by the Supplement to the Offer to Purchase dated February 14, 2007 (as so amended and supplemented, the Offer to Purchase ), which has been filed with the SEC as an exhibit to the tender offer

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statement on Schedule TO filed by E.ON and E.ON 12 on January 26, 2007 (file number 005-80961) (as amended and supplemented prior to the date hereof, the Schedule TO ). This summary of the terms of the Offers and certain related matters does not purport to be complete, and is subject to, and is qualified in its entirety by reference to, the Schedule TO. The offer for Endesa was, at the time of the announcement, a competing offer to the one made by Gas Natural SDG, S.A. ( Gas Natural ) for 100 percent of the shares of Endesa on September 5, 2005, which was authorized by the Comisión Nacional del Mercado de Valores (the CNMV ) on February 27, 2006. On February 1, 2007, Gas Natural announced that it terminated and withdrew its offer for Endesa.

The initial offer price of 27.50 was subsequently reduced by the amount of the special dividend paid by Endesa of 2.095 per Endesa ordinary share and Endesa ADS in July 2006, and the interim dividend paid by Endesa of 0.50 per Endesa ordinary share and Endesa ADS on January 2, 2007, in each case, pursuant to the terms of the originally announced offer price. As a result of an announcement made on September 26, 2006, E.ON committed to increase its offer price to at least 35.00 in cash for each Endesa ordinary share and each Endesa ADS. This commitment was reduced to at least 34.50 as a result of the interim dividend paid by Endesa of 0.50 per Endesa ordinary share and Endesa ADS on January 2, 2007. On February 2, 2007, pursuant to the Spanish sealed envelope procedure, E.ON 12 submitted proposed revised terms of the Spanish Offer to the CNMV for approval. The proposed revised terms, which provided for an increased offer price for the Spanish Offer of 38.75 in cash per Endesa ordinary share, were published by the CNMV later that day.

On February 6, 2007, the CNMV approved the proposed revised terms of the Spanish Offer, including the increased offer price of 38.75 in cash per Endesa ordinary share. The offer price under the U.S. Offer was increased by E.ON 12 to 38.75 in cash per Endesa ordinary share and Endesa ADS on February 8, 2007. As a matter of Spanish law, E.ON 12 is not permitted to further increase the offer price under the Offers. Given that Gas Natural announced the withdrawal of its offer on February 1, 2007, E.ON 12's offer is the only offer which is currently in force for the Endesa ordinary shares and Endesa ADSs. The new purchase price of 38.75 would result in an aggregate purchase price of approximately 41 billion if all Endesa securities were to be tendered.

On February 6, 2007, Endesa's board of directors unanimously determined that the offer price of 38.75 is fair from a financial point of view to Endesa's shareholders. However, no assurance can be given that E.ON will be able to complete the Offers successfully on the proposed terms or at all. See also Item 3. Key Information Risk Factors.

***Acquisition of Endesa Ordinary Shares by Enel S.p.A. ( Enel )***

On February 27, 2007, Enel announced that it had purchased a 9.99 percent stake in Endesa. In the context of that announcement, Enel made a series of public disclosures on February 28, 2007 in response to questions raised by the CNMV. These disclosures, together with other public statements made by Enel since that date, are summarized below. E.ON takes no responsibility whatsoever for the accuracy of these statements by Enel, as it has no way of independently confirming their validity.

On February 27, 2007, Enel announced that a total of 105,800,000 Endesa ordinary shares were acquired by UBS, a bank acting pursuant to a mandate and purchase order from Enel, at a price of 39 per share. The purchase of the stake was finalized the following day by Enel Energy Europe S.r.l. ( Enel Energy Europe ), a wholly owned subsidiary of Enel. As of February 28, 2007, Enel had not entered into any contract for derivatives, futures, equity swaps or any other financial instrument linked to Endesa shares, though it reserves the right to do so in the future. Enel also does not rule out any intention to acquire additional Endesa securities so as to bring its stake up to 24.99 percent, subject to the authorization of the relevant Spanish authorities and favorable market conditions. As of February 28, 2007, Enel announced that it is maintaining all of its options open and that neither Enel nor its executives have had any relation, written or oral, or have coordinated actions or have defined any written or oral pact with any of the significant shareholders of Endesa. As of February 28, 2007, there is no decision on behalf of Enel about the Offers currently

underway by E.ON.

In the first days of March, 2007, Enel announced that Enel Energy Europe had entered into a series of share swap transactions with UBS Limited and Mediobanca, with the underlying securities being an aggregate of up to 127,101,597 additional Endesa ordinary shares (equal to 12.01 percent of Endesa's share capital). The swaps provide for cash settlement, with Enel Energy Europe having a conditional right to elect physical settlement (with

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the conditions including Enel's obtaining the required administrative authorizations needed to complete its acquisition of Endesa shares). Enel also reported that Enel Energy Europe had obtained collaterals or financing sources for a total of 127,101,597 Endesa ordinary shares in order to satisfy its obligations under the swaps, at an average price of \$39 per share.

E.ON will continue with its offer for Endesa.

### ***Offer Structure, Conditions and Expected Timing***

The U.S. Offer was initially subject to the following conditions:

receipt of valid tenders in the U.S. Offer and the Spanish Offer for at least an aggregate of 529,481,934 Endesa ordinary shares (including Endesa ordinary shares represented by Endesa ADSs), representing 50.01 percent of Endesa's share capital (the minimum tender condition);

certain modifications being made to Endesa's articles of association with regard to limitations on voting rights, qualifications for directors and other corporate governance matters; and

the completion of the Spanish Offer.

On March 6, 2007, E.ON, acting with the required consent of the Mandated Lead Arrangers (as defined below) for the financing for the Offers, withdrew the condition requiring Endesa's shareholders to approve the specified changes to the articles of association.

The Spanish Offer is subject to the same conditions as the U.S. Offer, except that while the U.S. Offer is conditioned on the completion of the Spanish Offer, the Spanish Offer is not conditioned on the U.S. Offer. Notwithstanding any other provision of the U.S. Offer and subject to applicable law, E.ON will have the right to withdraw the U.S. Offer and not accept, purchase or pay for, and shall have the right to extend the period of time during which the U.S. Offer is open and postpone acceptance and payment for any Endesa ordinary shares and Endesa ADSs deposited pursuant to the U.S. Offer, unless each of the above conditions are waived or satisfied by E.ON 12.

Whether the minimum tender condition has been satisfied will be determined as of the expiration of the acceptance period under the Offers. E.ON 12 has received relief from the SEC to permit E.ON 12, following the expiration of the acceptance period of the U.S. Offer, to reduce or waive the minimum tender condition in accordance with Spanish law and practice in the event that the minimum tender condition has not been satisfied, without extending the acceptance period of, or extending withdrawal rights under, the U.S. Offer. E.ON 12 may also waive the minimum tender condition at any time prior to the expiration of the acceptance period of the U.S. Offer. Pursuant to Spanish law, E.ON 12 is required to determine whether or not to reduce or waive the minimum tender condition no later than the day after the CNMV's notification to E.ON 12 of the anticipated number of acceptances of the Offers. This notification is expected to be made no later than three Spanish Exchange days after the expiration date of the Spanish Offer.

As of the date of this annual report, E.ON expects that the timetable for the Spanish Offer will be as follows, though (as noted above) E.ON may choose to withdraw the Offers at any time they are open or choose to extend the acceptance period of the Offers. Although the U.S. Offer is conditioned on the completion of the Spanish Offer, it is expected that the payment for the Endesa securities accepted for payment by E.ON in the U.S. Offer will occur simultaneously with or shortly after the payment with respect to the Spanish Offer. No assurance can be given that the Offers will in fact be completed in accordance with this expected timetable or at all.



**Expected Date**

**Action**

March 29, 2007

End of acceptance period of the Offers

April 3, 2007

CNMV informs E.ON about acceptance levels

April 5, 2007

Spanish stock exchanges publish results in official bulletins

April 12, 2007

Settlement of tendered shares

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***Financing for the Proposed Offer***

In order to finance the Offers, E.ON, as borrower, initially entered on February 20, 2006 into a euro syndicated term and guarantee facility agreement for a total amount of 32 billion.

As a result of the announcement by E.ON of the increase of the offer price on September 26, 2006, a new euro syndicated term and guarantee facility agreement dated October 16, 2006 (the Facility Agreement), was entered into by E.ON as borrower and HSBC Bank plc, Citigroup Global Markets Limited, J.P. Morgan plc, BNP Paribas, The Royal Bank of Scotland plc and Deutsche Bank AG, acting as mandated lead arrangers (the Mandated Lead Arrangers) for a total amount of up to 37.1 billion. In order to finance the Offers at the increased offer price of 38.75, E.ON entered into a new additional syndicated term loan and guarantee facility agreement with the same banks on February 2, 2007 (the Supplemental Facility Agreement). The total amount of financing made available under the Supplemental Facility Agreement was up to 5.3 billion in one tranche. On February 2, 2007, the supplemental facility was utilized in the sum of 3,926,644,534 to provide additional guarantees to the CNMV. Under the terms of the Supplemental Facility Agreement, the unutilized portion of the guarantee commitment was immediately cancelled and the size of the facility was reduced to 3,926,644,534. To date, the Facility Agreement and the Supplemental Facility Agreement have been used for the issuance of financial guarantees (Avales) required by the CNMV in connection with the Spanish Offer; no cash drawdowns have yet been made.

E.ON will provide to E.ON 12 the funds that are obtained under the Facility Agreement and the Supplemental Facility Agreement, as well as any other funds which may be used in the Offers, through intra-Group loan agreements or capital contribution. E.ON will ensure that E.ON 12 is duly financed and capitalized at all times.

Below is a description of the material terms and conditions of the Facility Agreement. The terms and conditions of the Supplemental Facility Agreement are materially similar to those contained in the Facility Agreement (which are described below) except for the following: The date of maturity under the Supplemental Facility Agreement is February 20, 2009. The rate of interest under the Supplemental Facility Agreement is linked to a ratings based margin ratchet. Based on an expected initial A rating from Standard & Poor's and an initial A2 rating from Moody's the interest rate will be EURIBOR plus 27.5 basis points per annum for the first three months and EURIBOR plus 32.5 basis points per annum for the periods thereafter. The mandatory prepayment arrangements relating to the Facility Agreement do not apply to the Supplemental Facility Agreement.

*Amount and Maturity of the Facility*

The amount of financing made available under the Facility Agreement is up to 37.1 billion. It is divided into two tranches:

Tranche A (2/3 of facility amount) with a maturity on February 18, 2008 and

Tranche B (1/3 of facility amount) with a maturity on February 20, 2009.

*Interest*

The rate of interest under the Facility Agreement is linked to a ratings based margin ratchet. Based on an expected initial A rating from Standard & Poor's and an initial A2 rating from Moody's the margin will be EURIBOR plus 22.5 basis points per annum for Tranche A and EURIBOR plus 27.5 basis points per annum on Tranche B.

*Mandatory Prepayment*

The Facility Agreement includes a mandatory prepayment clause which requires E.ON to prepay and cancel the facility:

upon a change of control if so requested by the majority of banks within 30 days of the occurrence of a change of control event;

out of the net proceeds of amounts raised pursuant to the refinancing strategy for the amounts borrowed that E.ON intends to carry out;

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out of the net proceeds of any disposal required by any applicable law, regulation or any decision taken by a competent antitrust or other authority in connection with the acquisition of Endesa and received by E.ON (or capable of being made available to E.ON by way of inter-company loan or dividend); and

out of the net proceeds of material disposals that are received by E.ON (or capable of being made available to E.ON by way of inter-company loan or dividend) in excess of 1 billion (either on its own or aggregated) as long as the total term loan commitments exceed 17 billion at the time of disposal.

*Other Commitments*

The Facility Agreement sets out, among others, general restrictions that will apply to E.ON and, after the settlement of the Offer, to Endesa and to its subsidiaries on the creation of new, or the maintenance of any existing, encumbrances, except those arising in the ordinary course of business and other exceptions to this general rule as set out in the Facility Agreement.

The Facility Agreement also contains restrictions on E.ON's ability to dispose of all or a substantial portion of its assets, which restrictions are subject to standard exceptions contained in financings of this type.

Furthermore, the Facility Agreement establishes general undertakings, including compliance with law and regulations, pari passu ranking, insurance and change of business restrictions which are in line with the Loan Market Association standard documentation.

The Facility Agreement does not contain any restriction on the dividend or investment policy of E.ON. Furthermore there is no restriction on the level of dividends paid or investments made by Endesa.

The Facility Agreement does not require E.ON to comply with any financial covenants, *i.e.*, it does not require the fulfillment of any financial ratios.

*Events of Default*

The Facility Agreement includes some events of default usually included in this kind of financing, including failure to pay, non-fulfillment of financial obligations, breach of representations and warranties and insolvency.

*Security*

The Facility Agreement does not require E.ON to provide any security in the form of pledges. Endesa is not a party to the Facility Agreement. E.ON does not foresee that it will pledge the ordinary shares of Endesa which it may purchase as a result of the Offers. The Facility Agreement does not require Endesa or the companies of its group to provide any security in the form of pledges or any other kind of guarantees as a result of the Offers.

*Repayment Plans*

Initially the whole settlement amount for the Offers will be funded with drawings under the Facility Agreement and, if necessary, the Supplemental Facility Agreement, but E.ON intends to repay the drawings as soon as possible (which could imply early repayment), and has four main sources of funds to do this, namely existing and future cash, equity or equity like issues, debt capital market issues and asset disposals. The timing and size of these funding sources will depend on prevailing market conditions and no decision in this regard has been made by E.ON at the date of this annual report, apart from what is indicated below.

*Existing and Future Cash.* Initially the entire settlement amount for the Offers will be funded with bank debt, but part of this will be refinanced with existing cash resources. At the date of this annual report, it is expected that between 4 and 6 billion of liquid funds will be available for the refinancing of part of the bank debt. Also, E.ON's business is highly cash generative, and it is foreseen that strong cash flows will be available that are sufficient to comply with the investment plans and also repayment plans.

*Equity or Equity like Issues.* Depending on the volume of acceptances of the Offers, E.ON may issue equity or equity like instruments to repay part of the bank debt and help to meet E.ON's rating objective. E.ON will consider issuing up to 10 percent of its equity capital.

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*Debt Capital Market Issues.* Subject to market conditions, E.ON intends to access the debt capital markets quickly, but in an orderly manner and will consider debt instruments in euros, sterling, U.S. dollars and possibly other currencies. E.ON has an existing 10 billion commercial paper program, and a 20 billion MTN program. Both programs have been already partially used but can be increased in size if required.

*Asset Disposals.* If necessary, E.ON may also consider asset disposals to repay part of the bank debt and help to meet its rating objective. The proceeds of such sales would be used to repay the bank debt in line with the mandatory prepayment clause.

### ***Certain Information on Endesa***

The following information concerning Endesa is based on publicly available information (including Endesa's SEC filings and filings made by Endesa with the CNMV). Publicly available information concerning Endesa may contain errors. E.ON cannot take responsibility for the accuracy or completeness of the information contained in such public information, or for any failure by Endesa to disclose events which may have occurred or may affect the significance or accuracy of any such information but which are unknown to E.ON.

Endesa is a company (*sociedad anónima*) organized under the laws of the Kingdom of Spain with limited liability. The principal executive offices of Endesa are located in Madrid at Calle Ribera del Loira, 60, Spain. Endesa's telephone number is +34 91 213 10 00.

Endesa was incorporated by notarial deed on November 18, 1944 under the corporate name Empresa Nacional de Electricidad, S.A, and is registered with the Commercial Registry of Madrid in Book 323, Folio 1, Sheet number 6405. It changed its corporate name to Endesa, S.A. pursuant to a shareholders' resolution dated June 25, 1997.

Endesa is engaged in the electricity business, which is principally focused on Spain and Portugal, the Southern European region (including Italy and France) and Latin America. Endesa is also involved in other activities related to its core energy business, such as renewable energy, and the distribution and supply of natural gas. At December 31, 2005, Endesa had a total installed capacity of 45,908 megawatts ( MW ), and in 2005, generated 185,264 gigawatt hours ( GWh ) and sold 203,335 GWh, supplying electricity to approximately 23.2 million customers in 15 countries. At that date, Endesa had 27,204 employees, 53.2 percent of whom were located outside Spain and Portugal, and its total assets amounted to approximately 55 billion, 43.3 percent of which were located outside Spain and Portugal.

As of the date of this annual report, Endesa's share capital amounts to 1,270,502,540 and is represented by 1,058,752,117 issued shares of a single series, each with a nominal value of 1.20. All of the Endesa ordinary shares are fully subscribed, paid up and represented by account entries.

All of the Endesa ordinary shares are listed on the Madrid, Barcelona, Bilbao and Valencia Stock Exchanges and are integrated in the Stock Markets Interconnection System. The Endesa ordinary shares are also listed on the Santiago Off Shore Stock Exchange in Chile. The Endesa ADSs, each representing one Endesa ordinary share, are listed on the NYSE and are evidenced by ADRs.

### ***Strategic Considerations Supporting the Proposed Offer***

The purpose of the Offers is to acquire all the outstanding Endesa ordinary shares and Endesa ADSs and obtain control of Endesa. E.ON's business purpose for the acquisition of Endesa is, among other things, to consolidate E.ON's business presence in the main countries of the European Union.

E.ON aims to operate the businesses of E.ON and Endesa as a complementary portfolio of assets, and execute them on a strategic business model designed to deliver value to both companies. Accordingly, E.ON has no plan to merge Endesa or any of the Endesa group of companies with E.ON 12 or any of the companies in the E.ON Group, dissolve Endesa or any of the Endesa group of companies or to effect any significant reorganization of the Endesa group. It is E.ON's intention for Endesa to be responsible for managing a new market unit of the E.ON Group based in Madrid that will be responsible for Southern Europe and Latin America. The Offers are not being made for the purpose of generating synergies. E.ON believes that the acquisition of Endesa will be profitable whether or not there are specific cost savings that are realized as a result of the acquisition of Endesa. As of the date of this annual report, E.ON expects that the acquisition of Endesa will generate additional value that will reach its full effect starting in 2010.

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E.ON has emphasized the importance of creating leading market positions as a key source of competitive advantage, both by creating economies of scale to reduce costs and by managing volatile commodity markets to reduce risks. E.ON believes that the Offers are fully in line with this strategy, as the acquisition of Endesa by E.ON would create a combined company with a competitive position (and sometimes a leading position) in Europe's principal regional power markets. In strategic terms, this transaction is a major step forward for E.ON in delivering its vision to create the world's leading power and gas company. The combination of E.ON and Endesa would:

broaden the dimensions of E.ON in Europe's gas and power markets, given the positions of Endesa in Southern Europe;

add Endesa's outstanding position in fast growing markets to E.ON's strong asset portfolio; and

bring together two companies with the same vision of creating a leading integrated power and gas business, with the aim of investing for the long term to create value for both investors and customers.

Taken together, E.ON and Endesa serve more than 50 million customers and operate in more than 30 countries with a staff of more than 107,000 employees in 2005. The aggregate sales for the two companies in 2005 amounted to 608,000 million kWh of power and 945,000 million kWh of gas. Total capacity of the combined company would be approximately 100,000 MW, and total energy production would exceed 520 terawatt hours.

E.ON plans to maintain Endesa's current business policy and strategy and to continue developing Endesa's main business areas. The following is a brief description of E.ON's plans with respect to Endesa, should E.ON obtain control over Endesa, with respect to the corporate and territorial organization of Endesa and Endesa's assets. These plans and the related commitments assumed by E.ON have been made in light of the current Spanish regulatory framework and may be altered in the event of a material change in that regulatory framework.

E.ON intends immediately to take full advantage of one of Endesa's key areas of expertise, Endesa's Centre for Excellence in Distribution based in Barcelona. E.ON intends to build this center into a Global Centre of Excellence which will serve as a key resource of the entire E.ON Group.

As of the date of this annual report, E.ON does not have any specific plans regarding the use or disposal of Endesa's assets outside of the ordinary course of its business. E.ON is not planning to sell Endesa's assets. To the contrary, Endesa may benefit from the transfer of additional assets from E.ON to Endesa. There is no material overlap in the activities of E.ON and Endesa (except in certain regions of Northern Italy) and there is no need to sell any assets of Endesa to finance the Offers. However, E.ON will ensure that Endesa's business will stay in line with major business trends and may decide to sell assets of Endesa in the future, depending on the circumstances that exist at the time.

### ***Antitrust and Regulatory Approvals***

In connection with the Offers, the approval of various domestic and foreign regulatory authorities having jurisdiction over E.ON or Endesa, and their respective subsidiaries and their respective businesses, is required. The principal approvals required are described below.

#### ***Antitrust Approvals***

##### ***European Union***

E.ON and Endesa each conduct business in the member states of the European Union. Council Regulation (EC) No. 139/2004 requires that certain mergers or acquisitions involving parties with aggregate worldwide sales and



individual European Union sales exceeding specified thresholds be notified to and approved by the European Commission before such mergers and acquisitions are consummated. This Regulation also gives the member states of the European Union the right to request that the European Commission refer jurisdiction to review a merger to their national competition authorities under the provisions of the relevant national merger law where it may have an effect on competition in a distinct national market. Such a request must be notified to the European Commission within 15 working days of the transaction's notification to the European Commission. There was no such referral in connection with the Offers.

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E.ON, as sole shareholder of E.ON 12, submitted its proposed acquisition of Endesa to the European Commission on March 16, 2006. The European Commission reviewed the acquisition of Endesa pursuant to the Offers to determine whether the acquisition is compatible with the common market. The European Commission concluded that the proposed transaction would not significantly impede effective competition in the European Economic Area or any substantial part of it and therefore, on April 25, 2006, decided not to oppose the acquisition.

*Litigation of Iberdrola against the EU Approval*

On July 25, 2006, Iberdrola filed an appeal with the EC Court of First Instance against the decision of the European Commission as of April 25, 2006. The appeal does not automatically suspend the execution of the European Commission's decision. If the appeal were totally or partially upheld and the EC Court of Justice subsequently would confirm such decision of the Court of First Instance, pursuant to Article 10(5) of Council Regulation (EC) No. 139/2004, the acquisition of Endesa by E.ON 12 would be re-examined by the European Commission in the light of current market conditions. If the re-examination of the transaction led the European Commission to declare it incompatible with the common market or to declare it compatible with the common market subject to conditions, E.ON 12 understands that the European Commission may require them to dispose of all the Endesa ordinary shares or assets acquired, in order to restore the situation prevailing prior to the implementation of the concentration. However, such a disposition would not affect the purchase of Endesa's securities pursuant to the Offers. E.ON's outside counsel has received telephonic notice from the Court of First Instance that Iberdrola has withdrawn its appeal. Neither E.ON nor its counsel have as yet received written confirmation of such withdrawal.

*Spain*

According to Council Regulation (EC) No. 139/2004 and article 14.1 of Spanish Law 16/1989, of July 17, on the Defense of Competition, the acquisition by E.ON 12 of Endesa has been notified to the European Commission and not to the Service for the Defense of Competition, the Spanish competition authority, since it represents a combination involving parties with aggregate worldwide sales and individual European Union sales exceeding specified thresholds.

*Other Jurisdictions*

E.ON 12 is not required to file any notification with the competition authorities of the European Union member states with respect to the acquisition of Endesa by E.ON 12.

Based on its review of publicly available information regarding the businesses in which Endesa and its respective subsidiaries are engaged, the acquisition by E.ON 12 of Endesa is subject to the following notification requirements and/or approvals in non-European Union countries:

*Argentina.* The antitrust authorization period is 45 days from the date notice is complete, unless it is suspended by the Commission for the Defense of Competition in order to request additional information from E.ON 12. Therefore, in practice, it may take several months to obtain the authorization from the Argentine antitrust authority. If the authorization period is not suspended and the 45-day period expires without the Commission for the Defense of Competition having taken any decision, the Offers shall be deemed to have been tacitly approved by the Commission for the Defense of Competition.

E.ON 12 notified the Argentine competition authorities on May 22, 2006. After submitting its notice, the Commission for the Defense of Competition requested that E.ON 12 provide additional information in order to complete such notification, which suspended the 45-day deadline for the authorization of the transaction, and requested the opinion of the Argentine gas regulator (ENARGAS) and of the Argentine electricity regulator (ENRE) on the transaction. ENARGAS issued its opinion on November 15, 2006, expressing no concerns about the transaction, but ENRE has

not yet started its review of the transaction. On November 22, 2006, the Commission for the Defense of Competition resumed its assessment of the transaction upon approval of E.ON 12's bid by the CNMV on November 16, 2006, but stated that it would not issue a final decision without the opinion of ENRE. The Offers do not need to be suspended pending the authorization. Nevertheless, should the authorization be denied after the completion of the Offers, E.ON 12 would be required to sell the assets and companies of Endesa in Argentina.

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E.ON 12 believes that no circumstances exist that would prevent the acquisition of Endesa from being authorized by the Argentine competition authorities.

*Brazil.* On March 15, 2006, E.ON 12 filed a request for authorization with the Brazilian competition authorities. The antitrust authorization period is generally between two and three months, unless it is suspended by the Brazilian competition authorities in order to request additional information from E.ON 12. On March 27, 2006, the investigation department of the Brazilian Electric Energy Agency issued an opinion recommending the approval of the Offers. Furthermore, the investigation department of the Brazilian Ministry of Justice has requested the Brazilian Electric Energy Agency (the ANEEL ) to issue an opinion regarding the Offers. The Offers are currently under review by the ANEEL.

The Offers need not be suspended pending the authorization. Should the authorization be denied following the completion of the Offers, E.ON 12 would be required to sell the assets and companies of Endesa in Brazil. E.ON 12 believes that no circumstances exist that would prevent the acquisition of Endesa from being authorized by the Brazilian competition authorities.

*Peru.* Neither E.ON nor Endesa conduct business in Peru. Therefore, the acquisition of Endesa by E.ON 12 is not subject to any notification to the Peruvian competition authorities. E.ON 12 has received oral confirmation by the Peruvian competition authorities that it is not required to file a notification of the combination. Although not mandatory, E.ON 12 notified the Peruvian competition authorities on June 23, 2006, for information purposes only.

Based on its review of publicly available information regarding the businesses in which Endesa and its respective subsidiaries are engaged, E.ON 12 is not aware of any other authorization that would be necessary for E.ON 12 to obtain from other competition authorities in addition to the notifications and authorizations described above.

As of the date of this annual report, E.ON 12 is not able to accurately assess the financial and business impact that the failure to obtain any or all of the previous authorizations would have on the combined businesses of E.ON and Endesa. Notwithstanding this, it is not foreseeable that any such impact would be significant. In the event that the operation could be prohibited in some of the above countries, E.ON will sell the correspondent assets by means of a tender or by any other adequate procedure.

### ***Other Regulatory Approvals***

#### ***Spanish General Secretary of Energy***

On March 8, 2006, E.ON 12 filed a notification of the Spanish Offer to the General Secretary of Energy (*Secretaría General de Energía*) of the Spanish Ministry of Industry, Tourism and Trade, in accordance with Article 3 and Transitory Provision Third of Law 5/1995, of March 23, on the applicable regime for the sale of government shareholdings in certain companies and golden shares (*Ley 5/1995, de 23 de marzo, de regimen jurídico de enajenación de participaciones públicas en determinadas empresas*).

On April 6, 2006, the General Secretary of Energy resolved, in light of the notification filed by E.ON 12, not to initiate the proceedings contemplated under article 4 of Spanish Law 5/1995.

The regime governing golden shares in Spanish Law 5/1995 was revoked by Spanish Law 13/2005, of May 26.

#### ***General Directorate for Energy of the Regional Government of the Balearic Islands***

E.ON 12 filed an application to the General Directorate for Energy (*Dirección General de Energía*) of the Regional Government of the Balearic Islands on May 18, 2006, for the purposes of Decree 6/2006, of January 27, on the regulation of the procedure for the authorization of the transfer of electricity distribution facilities (*Decreto 6/2006, de 27 de enero, sobre la regulación del procedimiento de autorización de la transmisión de instalaciones de distribución de energía*). On November 15, 2006, the General Directorate for Energy granted the requested authorization.

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*National Commission for Energy*

On March 23, 2006, E.ON 12 filed with the Spanish National Commission for Energy (*Comisión Nacional de Energía*) (the CNE ) an application requesting authorization to proceed with the Spanish Offer under the Royal Decree-Law 4/2006, of February 24, which amended the functions of the CNE.

On July 27, 2006, the CNE issued a resolution authorizing the Offers, subject to the fulfillment of 19 conditions.

On August 10, 2006, E.ON 12 filed an administrative appeal against the resolution of the CNE with the Spanish Ministry of Industry, Tourism and Trade (the Spanish Ministry of Industry ), in which E.ON 12 argued that the conditions are excessive and unlawful.

On September 26, 2006, the European Commission declared that the conditions imposed on E.ON 12 by the CNE are incompatible with European Union law, and demanded their removal. On October 18, 2006, the European Commission initiated an infringement procedure against Spain for breach of European Union law by not complying with the order to remove the conditions.

On November 3, 2006, the Spanish Ministry of Industry confirmed the authorization of the Spanish Offer that had been granted by the CNE, removed some of the conditions and modified other conditions. The remaining conditions are outlined below:

E.ON 12 must keep Endesa as the parent company of its group and may not merge any of its subsidiaries with E.ON 12 for a period of five years after having obtained control of Endesa. Endesa must keep its brand, registered office and administrative body.

E.ON 12 must adequately fund Endesa in order to maintain a ratio of net financial debt to EBITDA of less than 5.25 for a period of three years after having obtained control of Endesa.

Until the year 2010, member companies of the combined E.ON and Endesa group carrying out regulated activities in Spain may only pay dividends if the resources generated by them are sufficient to meet their financial and investment commitments.

E.ON 12 must make all investments in regulated activities of gas and electricity as set out in the Endesa investment plans for the period 2006-2009 and certain other plans, and must furnish certain information and plans to the competent authorities.

In the period from 2010 to 2015, E.ON 12 must annually inform the CNE about its future investment plans regarding regulated activities and strategic assets of gas and electricity.

E.ON 12 must maintain Endesa's ordinary generation facilities for their remaining usable life as currently intended by Endesa.

Until the year 2009, E.ON 12 may not redirect any natural gas to markets other than the Spanish market, if the annual volume of gas as set out in the natural gas supply plans submitted by Endesa to the CNE is not met.

All nuclear facilities owned by Endesa must comply with the obligations and regulations regarding nuclear matters and all applicable law and agreements as to the management of such nuclear facilities regarding questions of security and supply of uranium.

For a period of five years after obtaining control of Endesa, E.ON 12 must maintain the current companies owning assets used for the generation, distribution or transmission of insular or extra-peninsular electricity systems.

For a period of five years after obtaining control of Endesa, E.ON 12 must guarantee that the aggregated annual consumption of each of Endesa's plants that currently consume Spanish coal is not less than the aggregated annual volume set out in the National Plan of Coal Mining 2006-2012.

Future acquisitions of shares in Endesa shall be governed by the same set of rules as in force.

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E.ON 12 must not adopt strategic decisions as to Endesa which will affect the security of supply contrary to the Spanish law.

Any violation of the conditions set out by the decision of the Spanish Ministry of Industry may lead to legal proceedings under the applicable Spanish energy regulations.

If, during a period of ten years after E.ON 12 obtained control of Endesa, any third party acquires or attempts to acquire, directly or indirectly, shares in E.ON amounting to more than 50 percent of the share capital or granting more than 50 percent of the voting rights, E.ON must notify CNE, which will be entitled to modify the decision of the Spanish Ministry of Industry set forth above. In this case, CNE may require E.ON to dispose of all the ordinary shares of Endesa.

The CNE may request the Spanish government to adopt measures based on the relevant Spanish regulations in order to guarantee the supply of energy in emergency situations.

E.ON 12 considers the conditions set forth in the decision of the Spanish Ministry of Industry acceptable and does not intend to challenge its decision in court.

However, on December 20, 2006, the European Commission ruled that the conditions set forth in the decision of the Spanish Ministry of Industry as of November 3, 2006 were incompatible with EU law and requested the Spanish government to withdraw the modified conditions by January 19, 2007. The Spanish government has not withdrawn the modified conditions. On January 31, 2007, according to Article 226 of the EC Treaty, the Commission sent a letter to Spain requesting it to comply with the Commission's Decisions of September 26 and December 20, 2006. If Spain does not comply with the Decisions, the Commission may issue a reasoned opinion against Spain. Finally, on January 25, 2007, the European Commission brought an action against Spain before the European Court of Justice regarding the approval of Royal Decree-Law 4/2006, of February 24, which amended the functions of the CNE.

*Other Jurisdictions*

*Brazil.* On July 3, 2006, E.ON 12 filed a request for authorization with the Brazilian energy regulatory agency (ANEEL) to acquire a controlling interest in Endesa's subsidiaries that hold public service concessions. In response to such request, the Secretary of Economic and Financial Control of ANEEL ruled by official letter dated August 14, 2006, that Endesa was required to request authorization, not E.ON 12. E.ON 12 has asked that Endesa undertake all necessary measures to enable the acquisition by E.ON 12 of Endesa's public service concessionaire subsidiaries in Brazil. On January 25, 2007, Endesa filed the new request for authorization with ANEEL. Although Brazilian law does not provide for a time limit for ANEEL to issue its authorization, this authorization may take approximately 45 business days to obtain.

If E.ON 12 does not obtain such authorization prior to the settlement of the Offers, E.ON 12 would be prevented from exercising control and, therefore, participating in the management of Endesa's subsidiaries. Furthermore, if the authorization is denied, E.ON 12 may be required to sell Endesa's public service concessionaire subsidiaries as well as the other subsidiaries operating under government authorization in Brazil. E.ON 12 would dispose of these assets by means of an auction or other efficient procedure. Finally, ANEEL may also decide to subject the grant of its authorization to certain conditions or restrictions. E.ON 12 is not able to estimate the impact of such restrictions.

*Argentina.* Authorization for the acquisition of indirect control over the subsidiaries of Endesa in Argentina is not required. However, each of the relevant subsidiaries of Endesa must communicate such event to the energy regulator in Argentina following the settlement of Offers. This reporting obligation is made for the purpose of updating the



corresponding registers in the Argentine energy sector. The deadline for notification is 10 days following the settlement of the Spanish Offer.

*Colombia.* Acquisition of indirect control of the subsidiaries of Endesa in Colombia must be communicated to the Colombian energy regulator. Such communication is an informational obligation following the settlement of the Spanish Offer, for which no specific deadline is stipulated under Colombian law. The Colombian energy regulator could impose conditions relating to the terms of the government authorizations under which the

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Colombian subsidiaries of Endesa operate. However, E.ON 12 believes that, in principle, there are no circumstances which might give rise to the imposition of conditions as a result of the acquisition of indirect control over the subsidiaries of Endesa in Colombia.

*Turkey.* Endesa has a 50 percent shareholding in a Turkish company, and accordingly, E.ON 12 has requested the compulsory authorization from the Turkish regulatory authorities in the energy sector prior to the acquisition of such shareholding.

E.ON 12 requested the corresponding authorization from the Turkish regulatory authorities in the energy sector on September 5, 2006. On September 13, 2006, the Turkish regulatory authorities stated that no decision can be made because the Offers are subject to conditions.

In the event that, after E.ON has obtained control of Endesa and authorization were denied, E.ON 12 would have to sell Endesa's holding in the Turkish company. However, E.ON 12 believes that the authorization will be obtained.

*Poland.* The acquisition of indirect control of the subsidiaries of Endesa in Poland is not subject to any authorization. However, E.ON 12 is required to provide notification of the transaction to the Polish energy regulator following the settlement of the Offers, although no specific deadline for doing so is specified under Polish law. This notification has the purpose of updating the registers in the Poland energy sector, and under no circumstances could it have an impact on the Offers or require E.ON 12 to proceed with the sale of Endesa's subsidiaries in Poland or of the assets of such subsidiaries.

Based on its review of publicly available information regarding the businesses in which Endesa and its respective subsidiaries are engaged, E.ON 12 is not aware of any other license or regulatory permits from the other regulatory authority within the energy sector that would be necessary for E.ON 12 to obtain in addition to the notification or authorization above described.

As of the date of this annual report, E.ON 12 is not able to accurately assess the financial and business impact that the failure to obtain any or all of the previous authorizations would have on the combined businesses of E.ON and Endesa. However, E.ON 12 does not estimate that there would be any significant impact. In any jurisdiction in which the transaction were not authorized, E.ON 12 would expect to dispose of the relevant assets by means of an auction or any other efficient procedure.

### ***Other Legal Actions***

#### ***Acciona Litigation***

On October 12, 2006, E.ON and E.ON 12 filed a complaint against Acciona S.A. ( Acciona ) and Finanzas Dos, S.A. ( Finanzas ), a wholly owned subsidiary of Acciona, in the U.S. District Court for the Southern District of New York (the Court ) alleging that a Schedule 13D filed by Acciona and Finanzas with the SEC on October 5, 2006, with respect to the acquisition of Endesa shares, was materially false and misleading. The complaint sought certain injunctive relief, including relief in the form of a declaration that the Schedule 13D violates Section 13(d) of the Exchange Act, an order requiring that Acciona and Finanzas correct by public means their material misstatements and omissions and be enjoined from purchasing or making any arrangement to purchase any Endesa ordinary shares until such time as they have filed an accurate Schedule 13D.

On October 13, 2006, E.ON and E.ON 12 filed a motion for a preliminary injunction as well as a motion for expedited scheduling and discovery, and the parties participated in an initial hearing with the Court to discuss the litigation. The Court scheduled a second hearing for October 20, 2006 to consider plaintiffs' motions and to schedule further

proceedings in connection with plaintiffs' application for a preliminary injunction. On October 19, 2006, Acciona and Finanzas amended their Schedule 13D and made public certain information previously omitted from their Schedule 13D, including the existence of fourteen total return swap agreements with Banco Santander Central Hispano, S.A. ( Banco Santander ) related to Endesa shares. Acciona and Finanzas also moved to dismiss the complaint asserting, among other things, that the amended Schedule 13D mooted E.ON's action. At the October 20, 2006 hearing, the Court requested that E.ON file an amended complaint addressing the amended Schedule 13D.

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On November 3, 2006, E.ON filed an amended complaint (in which a wholly owned subsidiary of E.ON AG, BKB AG, was added as a plaintiff), a brief in opposition to Acciona's and Finanzas' motion to dismiss, and a renewed application for preliminary injunctive relief. The amended complaint alleges that the initial Schedule 13D filed by Acciona and Finanzas, as well as the Schedule 13D as amended on October 19, 2006, and October 25, 2006, are materially false and misleading and seeks certain injunctive relief, including relief in the form of a declaration that the Schedule 13D, as amended, violates Section 13(d) of the Exchange Act, an order requiring that Acciona and Finanzas correct by public means their material misstatements and omissions and be enjoined from purchasing or making any arrangement to purchase any Endesa ordinary shares in connection with the settlement of the total return swaps it entered into with Banco Santander.

On November 16, 2006, the Court advised that it would deny Acciona's motion to dismiss, and it granted E.ON's motion for expedited scheduling and discovery. On November 20, 2006, the Court issued an Opinion and Order denying Acciona's motion to dismiss.

On November 17, 2006, E.ON supplemented its amended complaint to add allegations that Acciona's acquisition of 13.692 percent of Endesa's shares on September 25, 2006 (the initial 10 percent acquired directly by Acciona on September 25, 2006, plus an additional 3.692 percent acquired by Banco Santander and subjected to the first total return swap with Acciona) were acquired by means of an illegal tender offer in violation of Sections 14(d) and 14(e) of the Exchange Act. E.ON seeks an order that Acciona be required to offer withdrawal rights (through an offer of rescission) to all Endesa shareholders who sold shares to Acciona or Banco Santander in response to Acciona's illegal tender offer.

On December 11, 2006, Acciona filed a motion to dismiss E.ON's illegal tender offer claim. On January 9, 2007, the Court issued an Opinion and Order denying that motion to dismiss.

On February 5, 2007, the Court granted E.ON's and E.ON 12's motion for a preliminary injunction against Acciona and Finanzas prohibiting them from any further violation of Section 13(d) under the Exchange Act and any other disclosure provision of the U.S. securities laws. The Court denied all other preliminary injunctive relief sought by E.ON and E.ON 12. On February 7, 2007, the Court set the initial scheduling conference for May 11, 2007.

On February 7, 2007, E.ON and E.ON 12 appealed the February 5, 2007 opinion and order of the Court to the extent that it denied preliminary injunctive relief sought by E.ON and E.ON 12 to the U.S. Court of Appeals for the Second Circuit (the "Second Circuit"). Also on February 7, 2007, E.ON and E.ON 12 filed with the Second Circuit a motion to expedite the appeal. On February 14, 2007, E.ON's and E.ON 12's motion to expedite the appeal was denied.

*Barcelona Litigation I*

On July 28, 2006, Gas Natural filed a pre-trial proceeding request with the Court for Business Matters No. 1 in Barcelona (Juzgado de lo Mercantil nº 1 de Barcelona) based on the Spanish Unfair Competition Law requesting Endesa, E.ON, HSBC Bank plc, BNP Paribas, Citigroup Global Markets Limited, J.P. Morgan plc and Deutsche Bank AG (the "Requested Parties") to furnish certain information and documents on the contacts maintained amongst them in connection with the Spanish Offer, alleging possible unfair competition practices and the use of inside information. On October 25, 2006, the Court for Business Matters No. 1 in Barcelona ordered the Requested Parties to provide copies of certain documents relating to the Spanish Offer within 15 days as from the notification of such decision. The requested documents, relating to the Spanish Offer, include, but are not limited to, the confidentiality agreements entered into by the Requested Parties, Board minutes, minutes of meetings, the agreements and mandate letters among Endesa, E.ON and their respective advisors, due diligence reports, and copies of all mailings amongst the Requested Parties. After the requested documents are furnished, the Court for Business Matters No. 1 in Barcelona will decide which of such documents shall be provided to Gas Natural. This decision will depend on the eventual relevance of

such documents to serve as a basis for a possible future lawsuit.

The request for pre-trial proceedings does not imply the initiation of further jurisdictional proceedings against the Requested Parties. It is a pre-trial activity only, which purpose is to furnish the requesting party with sufficient information to decide whether or not to file a lawsuit. No request for precautionary measures has been filed. As of

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the date hereof, Endesa, Deutsche Bank, JP Morgan and HSBC have appeared in the pre-trial proceedings. E.ON has not yet been formally notified of the proceedings.

Because this is pre-trial activity only and, as mentioned above, Gas Natural has not filed a request for precautionary measures, the Offers should not be affected by these proceedings. However, Gas Natural could file a lawsuit on the basis of information obtained in these proceedings and possibly request that the Spanish Offer be suspended.

### *Barcelona Litigation II*

Gas Natural filed a lawsuit against E.ON with the Court for Business Matters No. 5 in Barcelona. Gas Natural alleges that E.ON is abusing a dominant position in violation of article 82 of the EC Treaty, and requests a Court judgment declaring the Offers void. On January 25, 2007, E.ON was served in Germany with the German versions of the complaint and court order, but not the Spanish versions. E.ON voluntarily appeared before the court on January 26, 2007, requesting that the court provide the entire court records in Spanish. This request does not imply any waiver of rights or tacit submission to the court. On January 30, 2007, the court provided E.ON with the Spanish version of the complaint together with its exhibits. As the vast majority of the exhibits which were given were in German, E.ON has filed a writ requesting the Spanish translations of the exhibits and a suspension of the deadline to file the answer to the claim, until the Spanish versions of the exhibits have been provided. The Court has granted Gas Natural a 10-day deadline to furnish the translation of the exhibits requested by E.ON, and has ordered that the course of the proceedings be suspended until Gas Natural furnishes the Spanish version of the exhibits. At this stage, Gas Natural has not yet provided the requested translations. In addition, E.ON has filed an appeal for reversal requesting the Court to fix the amount of the claim so as to render a resolution whereby it determines the amount of the claim is 36,526,948,036. Gas Natural has thereafter filed an opposition to the appeal for reversal requesting that the Court order the dismissal of the said appeal, leaving the amount in dispute as undetermined. Gas Natural has further filed complementary allegations to its opposition to E.ON's appeal for reversal.

### *Gas Natural New York Litigation*

On November 30, 2006, Gas Natural filed a complaint against E.ON and E.ON 12 in the U.S. District Court for the Southern District of New York alleging that on November 17, 2006, E.ON and E.ON 12 had filed a false and misleading Schedule TO-C with the SEC containing a preliminary offer document in connection with the proposed tender offer for Endesa. On December 4, 2006, Gas Natural moved for a preliminary injunction seeking, among other things, to require E.ON and E.ON 12 to make additional disclosures to correct allegedly false and misleading statements and to prevent E.ON and E.ON 12, until additional disclosures were made, from taking further steps to consummate a U.S. tender offer or purchasing Endesa ordinary shares from U.S. holders. On December 11, 2006, E.ON and E.ON 12 moved to dismiss the lawsuit. On December 19, 2006, the Court dismissed most of the claims. The remaining claim concerns Gas Natural's allegation that E.ON and E.ON 12 failed to disclose material agreements with Endesa; the Court expressed no view on the merits of that claim, but held only that it had been pleaded with sufficient specificity to survive a motion to dismiss. By stipulation entered by the Court on December 27, 2006, Gas Natural withdrew without prejudice its motion for a preliminary injunction and the case was stayed until the earlier of 45 days from entry of the stipulation or E.ON's or E.ON 12's commencement of a tender offer in the U.S. for Endesa ordinary shares or ADSs.

The stay expired on January 26, 2007, when E.ON 12 commenced its U.S. tender offer for Endesa. On February 7, 2007, the Court set the initial scheduling conference for May 11, 2007. Gas Natural's complaint and other papers filed in the course of this proceeding are publicly available for a fee from the website of the PACER Service Center (<http://pacer.psc.uscourts.gov>), the U.S. Federal Judiciary's centralized system for electronic access to court records, by selecting on the PACER website the U.S. District Court for the Southern District of New York and querying the party name E.ON. Material appearing on the website is not incorporated by reference in this annual report.



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### *E.ON s Complaint Filed against Acciona, Gas Natural and Other Natural or Legal Persons before the CNMV*

On January 2, 2007, E.ON filed a complaint against Acciona with the CNMV alleging that Acciona and Gas Natural are acting in concert without launching a joint tender offer in Spain and therefore are violating Spanish law. In its complaint, E.ON requests that Acciona shall be enjoined from acquiring Endesa ordinary shares and prohibited from exercising the voting rights of the Endesa ordinary shares already held.

### *Complaint Filed by Acciona with the CNMV against E.ON 12*

On January 16, 2007, the CNMV received a letter from Acciona, in which Acciona claimed that, according to reports published in the press, E.ON 12 held certain information concerning Endesa that was not known to Endesa s shareholders. Acciona further stated in its letter that E.ON 12 should be compelled to disclose this information, and any future plans of E.ON 12 based on this information, to the Endesa shareholders and, in particular, to Acciona, in accordance with the principles of equal treatment and the protection of investors and so that shareholders are able to form a reasoned judgment regarding the Offers.

Specifically, Acciona requested that the Spanish Prospectus authorized on November 16, 2006, by the CNMV be modified to include this information or that the CNMV take any other measure to ensure that the Endesa shareholders are furnished with this information.

### *Acciona s Request for Preliminary Inquiries in Madrid*

Acciona filed a request for pre-trial proceedings against E.ON before the courts in Madrid alleging possible unfair competition practices and the use of inside information between Endesa and E.ON. On March 2, 2007, E.ON was served with a resolution from the Court for Commercial Business nº 2 of Madrid which rejected most of the preliminary inquiries sought by Acciona. Notwithstanding this, the resolution orders E.ON to furnish certain information referring to some currency exchange values in Latin America and to a joint venture contract entered into by Endesa and Medgaz. Additionally, E.ON is requested to furnish its confidentiality agreement with Endesa, as well as the due diligence reports and the list of insiders in connection with its bid for Endesa.

In any case, this request for pre-trial proceedings does not necessarily imply the initiation of further jurisdictional proceedings against E.ON. It is merely a pre-trial activity, which has the purpose of furnishing Acciona with sufficient information to decide whether or not to file a lawsuit.

### *Obligation to Make Tender Offers in Other Jurisdictions*

If the Offers are successful, pursuant to local laws in the countries of some of Endesa s subsidiaries, E.ON 12 may be required to make tender offers for the outstanding shares of certain subsidiaries. The only offers which might be made for the stock of publicly traded subsidiaries of Endesa are the following:

#### *Brazil*

In accordance with Law 6404/76 on stock companies, and Brazilian Securities Commission (*Commissao de Valores Mobiliarios*) Instruction 361/2002, upon taking effective control of Endesa, E.ON 12 might be required to launch a tender offer for Ampla Energia e Servicos, S.A., Ampla Investimentos e Servicos, S.A. and Companhia Energetica do Ceara (COELCE), Endesa subsidiaries whose shares are listed on the Sao Paulo Stock Exchange. Pursuant to the applicable Brazilian laws, these offers must be made for the whole share capital of such subsidiaries within 30 days after E.ON 12 takes effective control of Endesa. Anyway, pursuant to a recent interpretation of the applicable laws by the Brazilian Securities Commission, it is likely that E.ON 12 will not be requested to make any of these tender offers.



*Peru*

Pursuant to sections 68° to 74° of the Unified Text of the Securities Market Law, approved by the Supreme Decree N° 093-2002-EF enacted on June 15, 2002, and the regulation enacted by the Peruvian Securities Exchange Commission (CONASEV) under the Resolution N° 009-2006-EF/94.10, in force since May 2006 and amended by Peruvian Securities Exchange Commission (CONASEV) under Resolution N° 020-2006-EF/94.10 enacted in April

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2006, if the Offers are successful, E.ON 12 would be required to launch a tender offer for Edegel S.A.A., Edelnor S.A.A., Generandes Perú S.A. and Empresa Eléctrica de Piura S.A., Endesa's subsidiaries which have at least one class of shares listed on the Lima Stock Exchange. Pursuant to the above regulations, these tender offers should be launched within four months after the settlement of the Offers and must be for the share capital of such subsidiaries not controlled by Endesa.

*Chile*

On December 7, 2005, the SVS confirmed, through *Oficio Ordinario n° 12.825*, that E.ON 12 is not required to launch a tender offer pursuant to Chilean Securities Law 18.045 or pursuant to the Chilean Stock Companies Law 18.046 for Enersis, S.A., Endesa Chile, S.A., Chilectra, S.A. and E.E. Pehuenche, S.A., Endesa subsidiaries which are listed on the Santiago de Chile Stock Exchange.

E.ON 12 estimates that the amount that would have to be spent for mandatory tender offers for minority interests in Brazil and Peru, as described above, would be approximately \$50 million.

**GROUP STRATEGY***E.ON's Business Model*

E.ON's strategy is grounded in an integrated business model that is based on the following key points:

*An Integrated Power and Gas Business.* E.ON intends to follow a long-term strategy with a clear focus on integrated power and gas operations that enjoy leading positions in their respective markets. In doing so, it seeks to develop positions throughout the energy value chain, including positions in infrastructure where they are seen as enhancing E.ON's access to markets and customers.

*A Clear Geographic Focus.* E.ON seeks to strengthen its leading positions and performance in its existing markets (Central Europe, Pan-European Gas, U.K., Nordic and U.S. Midwest), while taking focused steps in new markets such as Italy, Russia, Turkey and through the proposed acquisition of Endesa also Spain and Latin America.

*Clear Strategic Priorities.* E.ON's first priority is to strengthen and grow its position in European markets while maintaining a strong and diversified generation portfolio and enhancing its gas supply position through investments in equity gas produced from fields in which E.ON holds an interest, as well as the potential development of liquefied natural gas (LNG) as an alternative form of gas delivery. E.ON currently views the United States as an opportunity for more long-term growth.

*Strict Investment Criteria.* In following this model, E.ON applies strict strategic and financial criteria to each potential investment, focusing on those which management believes exhibit the potential for material value creation.

*Strategy*

Building on this model, E.ON's corporate strategy is to maximize the value of its portfolio of focused energy businesses through:

Creating value from the convergence of European energy markets (e.g., as the United Kingdom becomes a net importer of gas and can take advantage of greater pipeline capacity connecting it to continental Europe, E.ON

will be able to supply its retail gas business in the United Kingdom from its Pan-European Gas supply business);

Creating value from vertical integration (*i.e.*, establishing a presence in all parts of the value chains for both power and gas);

Creating value from the convergence of the electricity and gas value chains (*e.g.*, offering retail electricity and gas customers energy from a single source), thus providing E.ON with opportunities to realize economies of scale in servicing costs while increasing customer loyalty;

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Enhancing operational performance through identifying and transferring best practice for common activities throughout the Group's different market units (*e.g.*, effective programs for enhancing E.ON's electricity generation, distribution and retailing businesses);

Improving the Group's competitive position in its target markets, both through organic growth and through pursuing selective investments which contribute to these objectives or provide stand alone value creation opportunities, as described below;

Creation of a common corporate culture under the OneE.ON initiative, which seeks to enhance integration of all market units and their subsidiaries under the E.ON banner so as to help the E.ON Group realize its vision and strategic goals, while maintaining its commitment to corporate social responsibilities; and

Tapping value-enhancing growth potential in new markets such as Italy, Russia, Turkey and Spain and Latin America.

In addition, E.ON has set a number of specific objectives for its market units in implementing its corporate strategy within each of its target markets, namely:

Central Europe Fortifying strong market positions, enhancing the company's competitive activities in the mass market and developing new growth potential through:

consolidation of distribution and sales activities and capitalizing on opportunities from power-gas convergence;

significant investment in power generation to maintain the market position;

hedging exposure to price risks through vertical integration of generation and sales operations;

participating in the privatization of power and downstream gas companies in Eastern Europe, as well as significant investments in power generation; and

continued growth in the market of Italy, *i.e.* in power generation, trading and the retail business.

Pan-European Gas Strengthening and diversifying E.ON Ruhrgas' current position through:

selective equity investments in gas production in the North Sea and Russia;

pursuing LNG options (including upstream positions) to maintain long-term supply diversification;

securing security of supply through new (and renewed) long-term supply contracts with producers; and

participating in infrastructure projects to enhance gas supply position in Europe.

U.K. Enhancing profitability of the U.K. businesses through:

investing in flexible generation assets and low carbon intensive generating technologies, such as Combined Cycle Gas Turbine (CCGT), to maintain a low cost hedge for changes in retail electricity demand;

investing in the generation of power from renewable resources to capture value from the U.K. government's renewable obligation mandate; and

investing in gas storage assets to hedge against potentially volatile gas price movements as the United Kingdom starts to become a net importer of gas.

Nordic Strengthening E.ON's position through:

expanding its presence in power generation;

enhancing scale through synergistic acquisitions in distribution and district heating; and

continued participation in gas supply and infrastructure developments.

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U.S. Midwest Focusing on optimizing E.ON U.S.'s current operations in Kentucky and delivering additional performance improvements. This could include investments in generation capacity if the demand for electricity grows.

As it focuses on energy, E.ON will seek to maximize the value of its remaining non-core businesses by divesting them at an appropriate time and allocating the proceeds to strategic investments. As part of its strategy to focus on its core energy business, E.ON completed its disposal of Viterra and Ruhrgas Industries GmbH (Ruhrgas Industries) in 2005 and the disposal of its remaining minority interest in Degussa in 2006.

The transformation of the Company into a focused energy business has entailed further divestment and acquisition activities in recent years. For more detailed information on the principal activities in implementing the transformation, see Powergen Group Acquisition, Ruhrgas Acquisition and the respective market unit descriptions in Business Overview.

## **OTHER SIGNIFICANT EVENTS**

In November 2004, E.ON Ruhrgas International AG (ERI) signed an agreement for the acquisition of 75.0 percent minus one share each of the gas trading and gas storage businesses of the Hungarian oil and gas company MOL RT. (MOL) and its 50.0 percent interest in the gas importer Panrusgáz Zrt. (Panrusgáz). In addition, MOL received a put option to sell to ERI up to 75.0 percent minus one share of its gas transmission business and put options to sell to ERI the remaining 25.0 percent plus one share in the MOL gas trading and gas storage businesses. As a condition of antitrust approval by the European Commission, MOL is obliged to sell the remaining 25.0 percent plus one share of the gas trading and storage businesses as well. As a result, ERI signed an agreement for the acquisition of the remaining 25.0 percent plus one share of each of these two companies. The acquisition of 100 percent of the gas trading and gas storage businesses was completed at the end of March 2006. The acquisition of MOL's 50.0 percent interest in Panrusgáz was completed at the end of October 2006.

In December 2005, E.ON AG and RAG signed a framework agreement on the sale of E.ON's remaining 42.9 percent stake in Degussa to RAG. The transaction was completed on July 3, 2006.

In February 2006, E.ON Nordic and Fortum Power and Heat Oy (Fortum) signed an agreement providing for Fortum's acquisition of E.ON Nordic's entire 65.6 percent stake in E.ON Finland. On June 26, 2006, E.ON Nordic and Fortum finalized the transfer of all of E.ON Nordic's shares in E.ON Finland to Fortum.

In February 2006, E.ON filed a takeover offer for 100 percent of the share capital of Endesa.

See also Proposed Endesa Acquisition, the respective market unit descriptions in Business Overview and the descriptions in Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions and Liquidity and Capital Resources.

## **CAPITAL EXPENDITURES**

E.ON's aggregate capital expenditures for property, plant and equipment were 4.0 billion in 2006 (2005: 2.9 billion, 2004: 2.5 billion). For a detailed description of these capital expenditures, as well as E.ON's expected capital expenditures for the period beginning in 2007, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

## **BUSINESS OVERVIEW**

## INTRODUCTION

E.ON is the largest industrial group in Germany, measured on the basis of market capitalization at year-end 2006. In 2006, the Group's core energy business was organized into the following separate market units: Central Europe, Pan-European Gas, U.K., Nordic and U.S. Midwest, as well as the Corporate Center.

**Central Europe.** E.ON Energie is the lead company of the Central Europe market unit. E.ON Energie is one of the largest non-state-owned European power companies in terms of electricity sales, with revenues of

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28.4 billion (which included 1.1 billion of energy taxes that were remitted to the tax authorities) in 2006. E.ON Energie's core business consists of the ownership and operation of power generation facilities and the transmission, distribution and sale of electric power, gas and heat in Germany and continental Europe. The Central Europe market unit owns interests in and operates power stations with a total installed capacity of approximately 36,800 MW, of which Central Europe's attributable share is approximately 28,200 MW (not including mothballed, shutdown and reduced power plants). Through its own operations, as well as through distribution companies, in most of which it owns a majority interest, E.ON Energie also distributes electricity, heat and gas to regional and municipal utilities, commercial and industrial customers and residential customers. In 2006, E.ON Energie supplied approximately 18 percent of the electricity consumed by end users in Germany. The Central Europe market unit contributed 41.9 percent of E.ON's revenues and recorded adjusted EBIT of 4.2 billion in 2006.

**Pan-European Gas.** E.ON Ruhrgas is the lead company of the Pan-European Gas market unit. E.ON Ruhrgas is one of the leading non-state-owned gas companies in Europe and the largest gas business in Germany in terms of gas sales, with 709.7 billion kWh of gas sold in 2006. E.ON Ruhrgas's principal business is the supply (including gas exploration and production), transmission, storage and sale of natural gas. E.ON Ruhrgas imports gas from Russia, Norway, the Netherlands, the United Kingdom and Denmark, and also purchases gas from domestic sources. E.ON Ruhrgas sells this gas to regional and supraregional distributors, municipal utilities and industrial customers in Germany and increasingly also delivers gas to customers in other European countries. In addition, E.ON Ruhrgas is active in gas transmission within Germany via a network of approximately 11,400 kilometers ( km ) of gas pipelines and operates a number of underground storage facilities in Germany. E.ON Ruhrgas also holds numerous stakes in German and other European gas transportation and distribution companies, as well as a small shareholding in Gazprom, Russia's main natural gas exploration, production, transportation and marketing company. In 2006, the Pan-European Gas market unit recorded revenues of 25.0 billion (which included 2.1 billion in natural gas and electricity taxes that were remitted, directly or indirectly, to the tax authorities) and adjusted EBIT of 2.1 billion. The Pan-European Gas market unit contributed 36.9 percent of E.ON's revenues in 2006.

**U.K.** E.ON UK is the lead company of the U.K. market unit. E.ON UK is an integrated energy company with its principal operations focused in the United Kingdom. E.ON UK and its associated companies are actively involved in the ownership and operation of power generation facilities, as well as in the distribution of electricity and supply of electric power and gas and in energy trading. E.ON UK owns interests in and operates power stations with a total installed capacity of approximately 10,800 MW, of which its attributable share is approximately 10,500 MW. E.ON UK served approximately 8.4 million electricity and gas customer accounts at December 31, 2006 and its Central Networks business served 4.9 million customer connections. In 2006, E.ON UK recorded revenues of 12.6 billion or 18.5 percent of E.ON's revenues, and adjusted EBIT of 1.2 billion.

**Nordic.** E.ON Nordic is the lead company of the Nordic market unit. It currently operates mainly through E.ON Sverige, an integrated energy company in which it holds a majority stake. E.ON Nordic and its associated companies are actively involved in the ownership and operation of power generation facilities, as well as the distribution and supply of electric power, gas and heat, primarily in Sweden but to a smaller extent also in Denmark and Finland. Through E.ON Sverige, E.ON Nordic owns interests in power stations with a total installed capacity of approximately 14,800 MW, of which its attributable share is approximately 7,300 MW (not including mothballed and shutdown power plants). In June 2006, E.ON Nordic and Fortum finalized the transfer of all of E.ON Nordic's 65.6 percent stake in E.ON Finland to Fortum pursuant to an agreement signed in February 2006. In 2006, E.ON Nordic recorded revenues of 3.2 billion (including 377 million of electricity and natural gas taxes that were remitted to the tax authorities) or 4.7 percent of E.ON's revenues, and adjusted EBIT of 619 million.

**U.S. Midwest.** E.ON U.S. is the lead company of the U.S. Midwest market unit. E.ON U.S. is a diversified energy services company with businesses in power generation, retail gas and electric utility services, as well as asset-based energy marketing. E.ON U.S.'s power generation and retail electricity and gas services are located principally in



Kentucky, with a small customer base in Virginia and Tennessee. E.ON U.S. owns interests in and operates power stations with a total installed capacity of approximately 7,600 MW, of which its attributable share is approximately 7,500 MW (not including mothballed and shutdown power plants). In 2006, the U.S. Midwest market unit recorded revenues of 1.9 billion or 2.9 percent of E.ON's revenues, and adjusted EBIT of 391 million.

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**Corporate Center.** The Corporate Center consists of E.ON AG itself, those interests owned directly and indirectly by E.ON AG that have not been allocated to any of the other segments, including its remaining telecommunications interests, and consolidation effects at the Group level, including the elimination of intersegment sales.

For information on E.ON's discontinued operations, including its former oil and aluminum divisions, as well as its real estate subsidiary Viterra and certain activities of the Pan-European Gas, Nordic and U.S. Midwest market units, see Discontinued Operations.

E.ON's financial reporting mirrors the E.ON group structure, with each of the five market units and the results of the Corporate Center (including consolidation effects) constituting a separate segment for financial reporting purposes. Until the sale of E.ON's remaining stake in Degussa in July 2006, the results of E.ON's minority interest in Degussa continued to be presented outside of the core energy business as part of E.ON's Other Activities, which was reported as a separate segment. The primary measure by which management evaluates the performance of each segment in accordance with SFAS 131 is adjusted EBIT. E.ON defines this measure as an adjusted figure derived from income/(loss) from continuing operations (before intra-Group eliminations when presented on a segment basis) before income taxes and minority interests, excluding interest income. Adjustments include net book gains resulting from disposals, as well as cost-management and restructuring expenses and other non-operating earnings of an exceptional nature. In addition, interest income is adjusted using economic criteria. In particular, the interest portion of additions to provisions for pensions and nuclear waste management is allocated to adjusted interest income. Management believes that this measure is the most useful segment performance measure because it better depicts the performance of individual business units independent of changes in interest income and taxes. However, on a consolidated Group basis adjusted EBIT is considered a non-GAAP measure that must be reconciled to the most directly comparable GAAP measure. For a reconciliation of Group adjusted EBIT to net income for each of 2006, 2005 and 2004, see Item 5. Operating and Financial Review and Prospects Results of Operations Business Segment Information. Adjusted EBIT should not be considered in isolation as a measure of E.ON's profitability and should be considered in addition to, rather than as a substitute for, the most directly comparable U.S. GAAP measures. In particular, there are material limitations associated with the use of adjusted EBIT as compared with such U.S. GAAP measures, including the limitations inherent in E.ON's determination of each of the adjustments noted above. E.ON seeks to compensate for those limitations by providing a detailed reconciliation of adjusted EBIT to income from continuing operations before income taxes and minority interests and net income, the most directly comparable U.S. GAAP measures, in the section of Item 5 noted above, as well as the more detailed textual analysis of year-on-year changes in the key components of each of the reconciling items appearing under the caption Reconciliation of Adjusted EBIT in Item 5. Operating and Financial Review and Prospects Results of Operations Business Segment Information, Year Ended December 31, 2006 Compared with Year Ended December 31, 2005 and Year Ended December 31, 2005 Compared with Year Ended December 31, 2004. As a result of these limitations and other factors, adjusted EBIT as used by E.ON may differ from, and not be comparable to, similarly titled measures used by other companies.

The following table sets forth the revenues of E.ON's market units as well as the Corporate Center for 2006, 2005 and 2004:

	2006		2005		2004	
	( in millions)	%	( in millions)	%	( in millions)	%
Central Europe(1)	28,380	41.9	24,295	43.3	20,752	44.6
Pan-European Gas(2)(3)	24,987	36.9	17,914	32.0	13,227	28.5
U.K.	12,569	18.5	10,176	18.1	8,490	18.3
Nordic(2)(4)	3,204	4.7	3,213	5.7	3,094	6.7

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U.S. Midwest(2)	1,947	2.9	2,045	3.6	1,718	3.7
Corporate Center(2)(5)	(3,328)	(4.9)	(1,502)	(2.7)	(792)	(1.8)
Total Revenues(6)	67,759	100.0	56,141	100.0	46,489	100.0

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- (1) Includes energy taxes of 1,124 million in 2006, 1,049 million in 2005 and 1,051 million in 2004.
- (2) Excludes the sales of certain activities now accounted for as discontinued operations. For more details, see Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.
- (3) Sales include natural gas and electricity taxes of 2,061 million in 2006, 3,110 million in 2005 and 2,923 million in 2004.
- (4) Sales include electricity and natural gas taxes of 377 million in 2006, 382 million in 2005 and 376 million in 2004.
- (5) Includes primarily the parent company and effects from consolidation, as well as the results of its remaining telecommunications interests, as noted above.
- (6) Excludes intercompany sales.

Most of E.ON's operations are in Germany. German operations produced 62.2 percent of E.ON's revenues (measured by location of operation) in 2006 (2005: 65.3 percent; 2004: 64.6 percent). E.ON also has a significant presence outside Germany representing 37.8 percent of revenues by location of operation for 2006 (2005: 34.7 percent; 2004: 35.4 percent). In 2006, approximately 56.1 percent (2005: 59.8 percent; 2004: 61.6 percent) of E.ON's revenues were derived from customers in Germany and 43.9 percent (2005: 40.2 percent; 2004: 38.4 percent) from customers outside Germany. For more details about the segmentation of E.ON's revenues by location of operation and customers for the years 2006, 2005 and 2004, see Note 31 of the Notes to Consolidated Financial Statements. At December 31, 2006, E.ON had 80,612 employees, approximately 42.2 percent of whom were employed in Germany. For more information about employees, see Item 6. Directors, Senior Management and Employees Employees.

E.ON believes that as of December 31, 2006, it had close to 478,000 shareholders worldwide. E.ON's shares, all of which are Ordinary Shares, are listed on all seven German stock exchanges. They are also actively traded over the counter in London. E.ON's ADSs are listed on the New York Stock Exchange ( NYSE ). Until March 28, 2005, one ADS represented one Ordinary Share. Since March 29, 2005, three ADSs represent one Ordinary Share.

## **CENTRAL EUROPE**

### *Overview*

The Central Europe market unit is led by E.ON Energie. E.ON Energie, which is wholly owned by E.ON, is one of the largest non-state-owned European power companies in terms of electricity sales. E.ON Energie had revenues of 28.4 billion (which included 1.1 billion of energy taxes that were remitted to the tax authorities), 23.6 billion of which in Germany, and adjusted EBIT of 4.2 billion in 2006. E.ON Energie, together with E.ON Ruhrgas and E.ON Nordic, is responsible for all of E.ON's energy activities in Germany and continental Europe and is one of the four interregional electric utilities in Germany that are interconnected in the western European power grid.

In order to further focus its energy business in Germany and in continental Europe, E.ON Energie entered into the following transactions in 2006:

In February 2006, E.ON Energie and RWE signed agreements to swap certain shareholdings in the Czech Republic and Hungary. These transactions were completed in August 2006.

In July 2006, E.ON Ruhrgas and OAO Gazprom signed a framework agreement memorializing the basic understanding of the parties regarding a swap of assets, including a 25.0 percent plus one share interest in E.ON Hungária Energetikai Zrt. ( E.ON Hungária ), currently wholly owned by E.ON Energie, which is to be transferred to OAO Gazprom. For details, see Pan-European Gas Overview.

In December 2006, E.ON Energie acquired 75.0 percent of the share capital of Dalmine Energie S.p.A. ( Dalmine ), an Italian company that focuses on electricity and gas wholesale.

For details, see Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions.

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E.ON Energie is also embarking on a significant program to build new generating capacity in many of the countries in which it operates:

Construction has already begun on new facilities at Irsching, Germany (a 530 MW advanced natural gas plant to be built in cooperation with Siemens AG, scheduled to begin operations in 2011), Datteln, Germany (a 1,100 MW hard coal plant, scheduled to begin operations in 2011) and Livorno Ferraris, Italy (an 800 MW natural gas plant, scheduled to begin operations in 2008).

E.ON Energie is also committed to building a new plant at Irsching, Germany (an 800 MW natural gas plant). In addition, E.ON Energie plans to build new plants at the location of Staudinger, Germany (a 1,100 MW hard coal plant) and Maasvlakte, the Netherlands (a 1,100 MW hard coal plant) if all requirements are met.

E.ON Energie plans to build various power plants in Eastern Europe.

For more information, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Expected Investment Activity.

E.ON Energie's company structure reflects its operations in western and eastern Europe and, in addition, reflects the individual segments of its electricity business: generation, transmission, distribution, sales and trading. The following chart shows the major subsidiaries of the Central Europe market unit as of December 31, 2006, their respective fields of operation and the percentage of each held by E.ON Energie as of that date.

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**CENTRAL EUROPE MARKET UNIT**

**Holding Company**

**E.ON Energie AG**

Leading entity for the management and coordination of the group activities.  
Centralized strategic, controlling and service functions.

***Western Europe***

**Conventional Power Plants**

**E.ON Kraftwerke GmbH (100%)**

Power generation by conventional power plants.  
Waste incineration.  
Renewables.  
District heating.  
Industrial power plants.

**Nuclear Power Plants**

**E.ON Kernkraft GmbH (100%)**

Power generation by nuclear power plants.

**Hydroelectric Power Plants**

**E.ON Wasserkraft GmbH (100%)**

Power generation by hydroelectric power plants.

**E.ON Benelux Holding B.V. (100%)**

Power generation by conventional power plants in the Netherlands.  
District heating in the Netherlands.  
Sales of power and gas in the Netherlands.

**Transmission**

**E.ON Netz GmbH (100%)**

Operation of high voltage grids (380 kilovolt-110 kilovolt).  
System operation, including provision of regulating and balancing power.

**Distribution, Sales and Trading of Electricity, Gas and Heat**

**E.ON Sales & Trading GmbH (100%)**

Supply of electricity and energy services to large industrial customers, as well as to regional and municipal distributors.  
Centralized wholesale functions.  
Optimization of energy procurement costs.  
Physical energy trading and trading of energy-based financial instruments and related risk management.  
Optimization of the value of the power plants assets in the market place.

Emissions trading.

Seven regional energy companies across Germany (shareholding percentages range from 62.8 to 100.0 percent)

Distribution and sales of electricity, gas, heat and water to retail customers.

Ownership and operation of regional grid companies in compliance with the Energy Law of 2005.

Energy support services.

Waste incineration.

Ruhr Energie GmbH (100%)

Customer service and electricity and heat supply to utilities and industrial customers in the Ruhr region.

***Eastern Europe***

**E.ON Hungária Energetikai ZRt. (100%) (1)**

Generation, distribution and sales of electricity and gas in Hungary through its group companies.

**E.ON Czech Holding AG (100%)**

Generation, distribution and sales of electricity and gas in the Czech Republic through its group companies.

**E.ON Moldova S.A. (51.0%)**

Distribution and sales of electricity in Romania.

**E.ON Bulgaria EAD (100%)**

Distribution and sales of electricity in Bulgaria through its group companies.

**Západoslovenská energetika a.s. (49.0% held at equity)**

Distribution and sales of electricity in Slovakia.



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**Consulting and Support Services**

**E.ON Engineering GmbH (57.0%) (2)**

Provision of consulting and planning services in the energy sector to companies within the Group and third parties. Marketing of expertise in the area of conventional, renewable, cogeneration and nuclear power generation and pipeline business.

**E.ON IS GmbH (60.0%) (3)**

Provision of information technology services to companies within the Group and third parties.

**E.ON Facility Management GmbH (100%)**

Infrastructure services.

- (1) According to the framework agreement between E.ON Ruhrgas and OAO Gazprom regarding a swap of assets, including a 25.0 percent plus one share interest in E.ON Hungária, E.ON Energie's interest in E.ON Hungária will be reduced to 75.0 percent minus one share. For details, see [Pan-European Gas Overview](#).
- (2) The remaining 43.0 percent is held by E.ON Ruhrgas.
- (3) The remaining 40.0 percent is held by E.ON AG and E.ON Ruhrgas.

For financial reporting purposes, the Central Europe market unit comprises four business units: Central Europe West Power, Central Europe West Gas, Central Europe East and Other/Consolidation. The Central Europe West Power business unit reflects the results of the conventional (including waste incineration), nuclear and hydroelectric generation businesses, transmission of electricity, the regional distribution of power and the retail electricity business in Germany, as well as its trading business. In addition, Central Europe West Power also includes the results of E.ON Benelux Holding B.V. ( E.ON Benelux ), which operates power generation, district heating and gas and electricity retail businesses in the Netherlands. The Central Europe West Gas business unit reflects the results of the regional distribution of gas and the gas retail business in Germany. The Central Europe East business unit primarily includes the results of the regional distribution companies in Bulgaria, the Czech Republic, Hungary, Romania and Slovakia (with the Slovak activities being valued under the equity method given E.ON Energie's minority interest). Other/Consolidation primarily includes the results of E.ON Energie's retail business in Italy, other national and international shareholdings, service companies and E.ON Energie AG, as well as intrasegment consolidation effects.

***Operations***

Electricity generated at power stations is delivered to customers through an integrated transmission and distribution system. The principal segments of the electricity industry in the countries in which E.ON Energie operates are:

- |               |  |
|---------------|--|
| Generation:   | the production of electricity at power stations;   |
| Transmission: | the bulk transfer of electricity across an interregional power grid, which consists mainly of overhead transmission lines, substations and some underground cables (at this level there is a market for bulk trading of electricity, through which sales and purchases of electricity are made between generators, regional distributors, and other suppliers of electricity); |
| Distribution: | the transfer of electricity from the interregional power grid and its delivery, across local distribution systems, to customers;   |

Sales: the sale of electricity to customers; and  
Trading: the buying and selling of electricity and related products for purposes of portfolio optimization, arbitrage and risk management.

E.ON Energie and its associated companies are actively involved in all segments of the electricity industry. Its core business consists of the ownership and operation of power generation facilities and the transmission, distribution and sale of electricity and, to a lesser extent, gas and heat, to interregional, regional and municipal utilities, traders and industrial, commercial and residential customers. Furthermore, E.ON Energie operates waste incineration facilities.

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The following table sets forth the sources of E.ON Energie's electric power in kWh in 2006 and 2005:

<b>Sources of Power</b>	<b>2006 million kWh</b>	<b>2005 million kWh</b>	<b>% Change</b>
Own production	131,304	129,063	+1.7
Purchased power	149,867	142,215	+5.4
<i>from power stations in which E.ON Energie has an interest of 50 percent or less</i>	<i>12,287</i>	<i>12,019</i>	<i>+2.2</i>
<i>from other suppliers</i>	<i>137,580</i>	<i>130,196</i>	<i>+5.7</i>
Total power procured(1)	281,171	271,278	+3.6
Power used for operating purposes, network losses and pump storage	(12,951)	(12,735)	+1.7
Total	268,220	258,543	+3.7

(1) Excluding physically-settled electricity trading activities at E.ON Sales & Trading GmbH (EST). EST's physically-settled electricity trading activities amounted to 161,892 million kWh and 113,666 million kWh in 2006 and 2005, respectively.

In 2006, E.ON Energie procured a total of 281.2 billion kWh of electricity, including 13.0 billion kWh used for operating purposes, network losses and pumped storage. E.ON Energie purchased a total of 12.3 billion kWh of power from power stations in which it has an interest of 50 percent or less. In addition, E.ON Energie purchased 137.6 billion kWh of electricity from other utilities, 15.2 billion kWh of which were from Vattenfall Europe, the eastern German interregional utility, for redistribution by eastern German regional distributors. In addition, E.ON Energie purchased power from local generators in Hungary, the Czech Republic, Bulgaria and Romania totaling 39.7 billion kWh. The increase in purchased power compared to 2005 primarily reflects the first-time inclusion of a full year of results from operations acquired during 2005 (mainly in Bulgaria and Romania) as well as the purchase of significantly higher volumes of renewable source electricity, which is regulated under Germany's Renewable Energy Law (as defined in Regulatory Environment) (approximately 3.4 TWh). The increase in power used for operating purposes, network losses and pump storage is largely due to higher technical and non-technical network losses at the subsidiaries in Bulgaria and Romania, the results of which were included for an entire year for the first time in 2006.

E.ON Energie supplied approximately 18 percent of the electricity consumed by end users in Germany in 2006. Electricity accounted for 75.3 percent of E.ON Energie's 2006 sales (2005: 77.8 percent), gas revenues represented 17.6 percent (2005: 15.3 percent), district heating 2.2 percent (2005: 1.9 percent) and other activities 4.9 percent (2005: 5.0 percent).

The following table sets forth data on the sales of E.ON Energie's electric power in 2006 and 2005:

<b>Sale of Power(1) to</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>	<b>% Change in Total</b>
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Non-consolidated interregional, regional and municipal utilities	145,688	138,425	+5.2
Industrial and commercial customers	77,238	77,175	
Residential and small commercial customers	45,294	42,943	+5.5
Total	268,220	258,543	+3.7

(1) Excluding physically-settled electricity trading activities at EST. EST's physically-settled electricity trading activities amounted to 161,892 million kWh and 113,666 million kWh in 2006 and 2005, respectively.

The increase in the total sale of power primarily reflects the first-time inclusion of a full year of results from operations acquired during 2005 (mainly in Bulgaria and Romania as well as the Netherlands). For further information, see Item 5. Operating and Financial Review and Prospects Results of Operations.

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The following table sets forth data on the gas sales of E.ON Energie in 2006 and 2005:

<b>Sale of Gas to</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>	<b>% Change in Total</b>
Non-consolidated interregional, regional and municipal utilities	30,631	29,475	+3.9
Industrial and commercial customers	53,208	46,199	+15.2
Residential and small commercial customers	44,629	36,653	+21.8
<b>Total</b>	<b>128,468</b>	<b>112,327</b>	<b>+14.4</b>

E.ON Energie's total gas sales volume amounted to 128.5 billion kWh in 2006, a 14.4 percent increase from 112.3 billion kWh in 2005. The increase primarily reflects the first-time inclusion of a full year of results from Középdunántúli Gázszolgáltató ZRt. ( KÖGÁZ ) and Dél-dunántúli Gázszolgáltató ZRt. ( DDGÁZ ) in Hungary, NRE Energie b.v. ( NRE ) in the Netherlands and Gasversorgung Thüringen GmbH ( GVT ), which has since been merged into Thüringer Energie AG ( TEAG ). A slight increase also resulted from the Czech company Jihoceska plynárenská a.s. ( JCP ), in which E.ON Energie increased its interest during the year, as well as from the newly-acquired Italian company Dalmine (included as of September and December 2006, respectively).

**Western Europe****Power Generation**

*General.* In Germany, E.ON Energie owns interests in and operates electric power generation facilities with a total installed capacity of approximately 34,500 MW, its attributable share of which is approximately 26,000 MW (not including mothballed, shutdown or reduced power plants). The German power generation business is subdivided into three units according to fuels used: E.ON Kraftwerke GmbH owns and operates the power stations using fossil fuel energy sources, as well as waste incineration plants and renewable generation facilities, E.ON Kernkraft GmbH ( E.ON Kernkraft ) owns and operates the nuclear power stations and E.ON Wasserkraft GmbH owns and operates the hydroelectric power plants.

In the Netherlands, E.ON Energie operates, through its subsidiary E.ON Benelux, hard coal and natural gas power plants for the supply of electricity and heat to bulk customers and utilities. In 2006, it had a total installed generation capacity of approximately 1,900 MW.

Based on the consolidation principles under U.S. GAAP, E.ON Energie reports 100 percent of revenues and expenses from majority-owned power plants in its consolidated accounts without any deduction for minority interests. Conversely, 50 percent and minority-owned power plants are accounted for by the equity method. Power generation capacity in jointly owned plants is generally reported based on E.ON's ownership percentage.

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The following table sets forth E.ON Energie's major electric power generation facilities (including cogeneration plants) in Germany and the Netherlands, the total capacity and the capacity attributable to E.ON Energie for each facility as of December 31, 2006, and their start-up dates.

**E.ON ENERGIE'S ELECTRIC POWER STATIONS IN GERMANY AND THE NETHERLANDS**

Power Plants	Total Capacity Net MW	Capacity		Start-up Date
		Attributable to E.ON Energie %(1)	MW	
<b>Nuclear</b>				
Brokdorf	1,370	80.0	1,096	1986
Brunsbüttel	771	33.3	257	1976
Emsland	1,329	12.5	166	1988
Grafenrheinfeld	1,275	100.0	1,275	1981
Grohnde	1,360	83.3	1,133	1984
Gundremmingen B	1,284	25.0	321	1984
Gundremmingen C	1,288	25.0	322	1984
Isar 1	878	100.0	878	1977
Isar 2	1,400	75.0	1,050	1988
Krümmel	1,260	50.0	630	1983
Unterweser	1,345	100.0	1,345	1978
Total	13,560		8,473	
<b>Lignite</b>				
Buschhaus	352	100.0	352	1985
Lippendorf S	891	50.0	446	1999
Schkopau	900	55.6	500	1995
Others (< 100 MW)	33	n/a	17	n/a
Total	2,176		1,315	
<b>Hard Coal</b>				
Bexbach 1	714	8.3	59	1983
Datteln 3	113	100.0	113	1969
Farge	345	100.0	345	1969
GKW Weser/Veltheim 3	303	67.0	203	1970
Heyden	875	100.0	875	1987
Kiel	323	50.0	162	1970
Knepper C	345	100.0	345	1971
Maasvlakte 1 (NL)(2)	532	100.0	532	1988
Maasvlakte 2 (NL)(2)	520	100.0	520	1987
Mehrum C	690	50.0	345	1979
Rostock	508	50.4	256	1994
Scholven B	345	100.0	345	1968
Scholven C	345	100.0	345	1969

Scholven D	345	100.0	345	1970
Scholven E	345	100.0	345	1971
Scholven F	676	100.0	676	1979

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<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>Capacity Attributable to E.ON Energie</b>		<b>Start-up Date</b>
		<b>%(1)</b>	<b>MW</b>	
<b>Hard Coal (continued)</b>				
Shamrock	132	100.0	132	1957
Staudinger 1	249	100.0	249	1965
Staudinger 3	293	100.0	293	1970
Staudinger 5	510	100.0	510	1992
Wilhelmshaven	747	100.0	747	1976
Zolling	449	100.0	449	1986
Others (< 100 MW)	353	n/a	322	n/a
<b>Total</b>	<b>10,057</b>		<b>8,513</b>	
<b>Natural Gas</b>				
Kirchlengern	180	62.9	113	1980
Burghausen (CHP)	120	100.0	120	2001
Obernburg (CHP)	100	50.0	50	1995
Franken I/1	383	100.0	383	1973
Franken I/2	440	100.0	440	1976
Galileistraat (NL) (CHP)	209	100.0	209	1988
GKW Weser/Veltheim 4 GT	390	67.0	261	1975
Huntorf	290	100.0	290	1977
Irsching 3	415	100.0	415	1974
Jena-Süd	199	62.9	125	1996
Kirchmöser	160	100.0	160	1994
RoCa 3 (NL) (CHP)(2)	220	100.0	220	1996
Robert Frank 4	491	100.0	491	1973
Staudinger 4	622	100.0	622	1977
Emden 4(3)	433	100.0	433	1972
Others (< 100 MW)	737	n/a	599	n/a
<b>Total</b>	<b>5,389</b>		<b>4,931</b>	
<b>Fuel Oil</b>				
Ingolstadt 3	386	100.0	386	1973
Ingolstadt 4	386	100.0	386	1974
Others (< 100 MW)	381	n/a	381	n/a
<b>Total</b>	<b>1,153</b>		<b>1,153</b>	



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<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>Capacity Attributable to E.ON Energie %(1)</b>	<b>MW</b>	<b>Start-up Date</b>
<b>Hydroelectric</b>				
Braunau-Simbach	100	50.0	50	1953
Erzhausen	220	100.0	220	1964
Happurg	160	100.0	160	1958
Jochenstein	132	50.0	66	1955
Langenprozelten	164	100.0	164	1975
Reisach	105	100.0	105	1955
Walchensee	124	100.0	124	1924
Waldeck 1	120	100.0	120	1931
Waldeck 2	440	100.0	440	1975
Others (< 100 MW)	1,843	n/a	1,664	n/a
<b>Total</b>	<b>3,408</b>		<b>3,113</b>	
<b>Others (waste, wind, biomass et al.)</b>				
Waste	261		163	
Wind, biomass et al.	332		210	
<b>Total</b>	<b>593</b>		<b>373</b>	
<b>Total</b>	<b>36,336</b>		<b>27,871</b>	
<b>Mothballed/Shutdown/Reduced Mothballed</b>				
Irsching 1	151	100.0	151	1969
Irsching 2	312	100.0	312	1972
Pleinting 1	292	100.0	292	1968
Pleinting 2	402	100.0	402	1976
Staudinger 2	249	100.0	249	1965
<b>Dismantling</b>				
Arzberg 5	104	100.0	104	1966
Arzberg 6	252	100.0	252	1974
Arzberg 7	121	100.0	121	1979
Offleben	280	100.0	280	1972
Rauxel 2	164	100.0	164	1967
Scholven G	672	50.0	336	1974
Scholven H	672	50.0	336	1975
Stade	640	66.7	417	1972
<b>Total</b>	<b>4,311</b>		<b>3,416</b>	

- (1) Percentage of total capacity attributable to E.ON Energie.
- (2) Power station operated by E.ON Benelux under long-term cross-border leasing arrangement.
- (3) Emden 4 was restarted on January 13, 2006.

(CHP) Combined Heat and Power Generation.

(NL) Located in the Netherlands.

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For more information about E.ON Energie's power generation facilities in eastern Europe, see Eastern Europe.

*Germany.* E.ON Energie's German plants generate electricity primarily with nuclear power, bituminous coal (commonly referred to as hard coal), lignite, gas, fuel oil and water. The existing nuclear and hydroelectric power plants are E.ON Energie's source of power with the lowest variable costs and, together with lignite-based power plants, are used mainly to cover the base load. Hard coal is utilized mainly for middle load, while the other energy sources are used primarily for peak load.

*Nuclear Power.* E.ON Energie operates its German nuclear power plants through E.ON Kernkraft. These nuclear power plants are required to meet applicable German safety standards, which are among the most stringent standards in the world (see Environmental Matters Germany: Electricity). Until June 30, 2005, E.ON Energie's nuclear power plants delivered spent nuclear fuel elements to AREVA NC (formerly Compagnie Générale des Matières Nucléaires S.A. (COGEMA)) in France and British Nuclear Group Sellafield Ltd (formerly British Nuclear Fuels plc.) in the United Kingdom for the reprocessing of their nuclear waste. Since June 30, 2005, German law has prohibited the delivery of spent nuclear fuel rods for reprocessing. Instead, operators must store spent fuel rods in interim facilities on the premises of the nuclear plants. For more details, see the description below under Termination of Fuel Reprocessing. Under German law, the Federal Republic of Germany is responsible for the final storage of all domestic nuclear waste at the expense of the generator.

Operators of nuclear power plants are required under German law to establish sufficient financial provisions for future obligations that arise from the use of nuclear power. The three required provisions are for: (1) management of spent nuclear fuel rods, (2) disposal of contaminated operating waste and (3) the eventual decommissioning of nuclear plants. At year-end 2006, E.ON Energie had a total of approximately 13.2 billion provided for these purposes in respect of nuclear power plants included in its consolidated accounts, consisting of 4.2 billion for management of spent nuclear fuel rods, 0.5 billion for disposal of operational waste and 8.5 billion for decommissioning costs. These provisions are stated net of advance payments of 0.9 billion. In determining its pro rata share of these provisions, provisions attributed to minority interests included in E.ON Energie's consolidated accounts have been deducted and provisions for nuclear plants in which E.ON Energie has a minority interest are added. At year-end 2006, on such a pro rata basis, E.ON Energie's provisions for these purposes totaled 13.8 billion, as compared to 13.5 billion at year-end 2005.

In June 2004, German legislators passed an amendment to Germany's Ordinance on Advance Payments for the Establishment of Federal Facilities for Safe Custody and Final Storage for Radioactive Wastes (*Endlager-Vorausleistungsverordnung*). Under the amended ordinance, construction costs for the final nuclear waste storage facilities, located in Gorleben and Konrad, Germany, are now shared by the nuclear plant operators and other users, such as research institutes, in line with their expected usage of the storage facilities. Overall, this lowered E.ON's share of the costs and led to a reduction of the Company's provisions for nuclear waste management in 2004. Partially offsetting this reduction, the post-operation phase at nuclear power stations that use MOX fuel elements, which are fuel elements containing plutonium produced in the reprocessing process, was extended beginning in 2004 as a result of a change in the delivery schedule for MOX fuel elements.

E.ON Kernkraft purchases uranium and fuel elements for its nuclear power plants from independent domestic and international suppliers, primarily under long-term contracts. E.ON Energie considers the supply of uranium and fuel elements on the world market to be generally adequate.

In May 1995, PreussenElektra decided to shut down its nuclear power plant at Würgassen for economic reasons and, in October 1995, it applied for and received permission from the German authorities to decommission and dismantle the Würgassen plant in accordance with German nuclear energy legislation. E.ON Energie expects the decommissioning of Würgassen, which began in October 1995, to last until approximately 2015. In 2000, E.ON

Energie also decided to shut down the nuclear power plant Stade. In July 2001, E.ON Kernkraft filed an application with the Lower Saxonian Ministry of Environment to decommission and dismantle Stade. E.ON Energie received the approval for decommissioning/dismantling in September 2005. Stade was shut down in November 2003, and E.ON Energie expects its decommissioning to last until approximately 2015. E.ON Energie has established a provision of 1.7 billion for the decommissioning of Würgassen and Stade, including the management of spent nuclear fuel rods and the dismantling of the plants.

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After the German Social Democratic Party and the German Green Party (*Bündnis 90/Die Grünen*) (together, the Coalition ) were elected to lead the German federal government in 1998, the Coalition agreed to phase out the generation of nuclear energy in Germany. The Coalition also agreed to hold consensus-forming discussions with operators of nuclear power plants in order to find a solution to various issues in the area of nuclear energy agreeable to all parties. The discussions began in January 1999 and resulted in an agreement on nuclear power in June 2001 and in an amendment of the German Nuclear Power Regulations Act (*Atomgesetz*, or *AtG* ), which was passed by the German parliament in December 2001 and took effect in April 2002.

Among other things, the amendment provides as follows:

**Nuclear Phase-out:** The operators of the nuclear plants have agreed to a specified number of operating kWh for each nuclear plant. This number has been calculated on the basis of 32 years of plant operation using a high load factor. The operators may trade allocated kWh among themselves. This means that if one nuclear plant closes before it has produced the allocated amount of kWh, the remaining kWh may be transferred to another nuclear power plant.

**Termination of Fuel Reprocessing:** The transport of spent fuel elements for reprocessing was allowed until June 30, 2005. Following this deadline, the operators must store spent fuel in interim facilities on the premises of the nuclear plants. Such storage requires the approval and construction of interim storage facilities. The Company is to construct five interim on-site storage facilities. Two of these, Grafenrheinfeld and Grohnde, went into operation in the first quarter of 2006, while the remaining three interim on-site storage facilities (Brokdorf, Isar and Unterweser) are scheduled to go into operation in the first half of 2007.

As part of the agreement, the German federal government has agreed not to institute any future changes in German tax law which discriminate against nuclear power operations or other measures creating economic disadvantages in comparison with other forms of power generation.

The Company considers its provisions with respect to nuclear power operations to be adequate with respect to the costs of implementing the agreement. E.ON Energie has no plans to construct any new nuclear power plants in Germany.

In 2006, the Company concluded its discussions with the tax authorities regarding the treatment of its nuclear provisions for the years prior to 2002, and the tax calculations for these years have been agreed. All of the resulting tax has already been paid and the Company has established a provision to cover the potential tax amounts for the years 2002 onwards, which are still under review.

*Hard Coal.* In 2006, approximately 30 percent of the hard coal used by E.ON Energie's German operations was mined in Germany. Traditionally, hard coal is mined in Germany under much more difficult conditions than in other countries. Therefore, German coal production costs are substantially above world market levels, and E.ON Energie strongly believes they will continue to remain high. Although electricity producers were in the past required to purchase German coal, they are now free to purchase coal from any source. To encourage the purchase of German coal, the German federal government has been paying direct subsidies to German producers enabling them to offer domestic coal at world market prices, although it is now in the process of reducing such subsidies. Due to high production costs and the reduction in subsidies, the volume of German coal production has shown a relatively steady decline in the past and is expected to continue to decline further. However, E.ON Energie expects that adequate supplies of imported coal for its operations will be available on the world coal market at acceptable prices. Hard coal is generally available from multiple sources, though prices are determined on international commodities markets and are therefore subject to fluctuations. E.ON Benelux also uses imported hard coal in its power plants.

*Lignite.* German lignite, also known as brown coal, has approximately one-third of the heating value of hard coal. E.ON Energie participates in lignite-based energy generation in western Germany through BKB Aktiengesellschaft ( BKB ) and in eastern Germany through Kraftwerk Schkopau GbR and a portion of one unit of Kraftwerk Lippendorf. Lignite is a readily available domestic fuel source that E.ON Energie obtains from its own reserves or under long-term contracts with German producers. The price of lignite is not generally volatile and is generally determined by reference to published indices in Germany. However, the price can fluctuate based on the underlying price of hard coal in global commodities markets.

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*Gas and Oil.* In Germany, the price of natural gas is linked to the price of oil and other competing fuels. This mechanism has been enforced in order to reduce the influence of, and dependence on, gas-producing countries. Only about 16 percent of gas demand in Germany is satisfied by German deposits, while about 84 percent is satisfied through imports from foreign producers, primarily from Russia, Norway and the Netherlands. For its gas-fired power plants, E.ON Energie purchases gas from E.ON Ruhrgas and other international suppliers, mainly under short-term contracts. Fuel oil power plants are only used for peak load operations. E.ON Energie purchases its fuel oil from traders or directly from a number of oil companies. As with natural gas, the price of fuel oil depends on the price of crude oil. E.ON Benelux purchases predominantly Dutch gas under one-year contracts for its gas-fired power plants.

*Water.* This domestic source of energy is primarily available in southern Germany due to the presence of mountains and rivers. The variable costs of production are extremely low in the case of run-of-river plants and consequently, these plants are used to cover base load requirements. Storage and pump storage facilities are used to meet peak demand and for back-up power purposes.

*Waste Incineration.* E.ON Energie also has a waste incineration business, led by BKB and E.ON Westfalen Weser. In 2006, incinerated waste volumes totaled approximately 2.1 million tons. The waste incineration plants have a total power generation capacity of 261 MW of electricity, of which 163 MW is attributable to E.ON Energie. In December 2006, E.ON Energie acquired a 49.9 percent interest in the waste treatment and recycling company SOTEC GmbH ( SOTEC ). SOTEC is the owner of five waste incineration plants with a total power generation capacity of approximately 70 MW.

Demand for power tends to be seasonal, rising in the winter months and typically resulting in additional electricity sales by E.ON Energie in the first and fourth quarters. E.ON Energie believes it has adequate sources of power to meet foreseeable increases in demand, whether seasonal or otherwise. In order to benefit from economies of scale associated with large stations, E.ON Energie has built large capacity power station units in conjunction with other utilities where it does not require all of the electricity produced by such plants. In these cases, the purchase price of electricity is determined by the production cost plus a negotiated fee.

Although E.ON's power plants are maintained on a regular basis, there is a certain risk of failure for power plants of every fuel type (for example, in 2005 the breakdown of generators in the non-nuclear part of the Unterweser power plant and in the coal-fired Heyden power plant resulted in the plants being out of service for 12 and 8 weeks, respectively). Depending on the associated generation capacity, the length of the outage and the cost of the required repair measures, the economic damage due to such failure can vary significantly. In order to meet contractual commitments, electricity which cannot be generated at these plants has to be bought from other generators or has to be generated from more expensive plants. Thus, power plant outages can negatively affect the market unit's financial and operating results.

***Transmission***

The German power transmission grid of E.ON Energie, which operates with voltages of 380, 220 and 110 kilovolts, has a system length of over 41,000 km and a coverage area of nearly 200,000 km<sup>2</sup>. It is located in the German states of Schleswig-Holstein, Lower Saxony, Mecklenburg-Western Pomerania, Brandenburg, North Rhine-Westphalia, Saxony-Anhalt, Hesse, Thuringia and Bavaria, and reaches from the Scandinavian border to the Alps. The grid is interconnected with the western European power grid with links to the Netherlands, Austria, Denmark and Eastern Europe. The system is mainly operated by E.ON Netz. The network of E.ON Netz allows long-distance power transport at low transmission losses and covers about 40 percent of the surface area of Germany. This system is operated from two main system control centers, one in Lehrte near Hanover and one in Karlsfeld near Munich, and from several regional control and service units at decentralized locations within the E.ON Netz grid area.

In November 2006, the E.ON Netz network control center made an erroneous estimation in the planned interruption of a high voltage power line across the Ems river in Germany, which led to a short but widespread power outage that affected a number of countries throughout Europe. For more information, see Item 3. Key Information Risk Factors.



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Access to E.ON Energie's power transmission grid is open to all potential users. The Company believes its usage fees and conditions comply with existing German regulations governing grid access. For further information about the impact of recent regulatory developments on E.ON Energie's transmission business and results, see [Regulatory Environment](#) and [Item 5. Operating and Financial Review and Prospects](#) [Results of Operations](#) [Year Ended December 31, 2006 Compared with Year Ended December 31, 2005](#) [Central Europe](#).

The Baltic Cable links the transmission grid of E.ON Energie to Scandinavia. For details, see [Nordic Electricity Distribution](#).

### ***Distribution***

*Electricity.* The German utilities historically established defined supply areas which were coextensive with their distribution grids. The following map shows E.ON Energie's current distribution area in Germany through its majority shareholdings in regional energy distribution companies:

In 2006, E.ON Energie's regional distribution companies were greatly affected by the implementation of the German Energy Law of 2005. According to this law, the legal unbundling of the formerly integrated distribution and sales business (for both electricity and gas) is mandatory as of July 1, 2007. Within the E.ON Energie group, the regional energy company E.ON Thüringer Energie AG ( ETE ) was the first to establish a separate network operator, TEN Thüringer Energienetze GmbH, on April 1, 2006. This new company now operates and maintains the distribution grid, although the grid assets are still owned by ETE. All of E.ON Energie's other regional energy companies have similarly completed legal unbundling by January 1, 2007. In addition, the regulation of electricity network charges started in July 2005, and network operators had to submit their calculated network charges to Germany's energy regulator by the end of October 2005 for approval. The energy regulator approved reduced charges for each of E.ON Energie's network operators between July and October 2006. For more information, see [Regulatory Environment](#) [EU/Germany: General Aspects \(Electricity and Gas\)](#) [Revisions of the German Energy Law](#) and [Germany: Electricity](#) [Electricity Network Charges](#).

In January 2007, a severe storm damaged the power grid of E.ON Energie in some areas of Germany. For more information, see [Item 3. Key Information](#) [Risk Factors](#).

*Gas.* E.ON Energie's distribution subsidiaries supply natural gas to households, small businesses and industrial customers in many parts of Germany. Similar to [Electricity](#) above, E.ON Energie's regional distribution companies had to submit their calculated gas network charges to Germany's energy regulator by the end of January 2006. The energy regulator approved reduced charges for each of E.ON Energie's network operators between September and November 2006. For more information, see [Regulatory Environment](#) [Germany: Gas](#) [Gas Network Charges](#).

**Table of Contents****Sales**

In Germany, E.ON Energie supplies electricity, gas and heat, mainly through the regional energy companies in which it holds majority interests. As described below, E.ON Energie's wholly-owned subsidiary EST supplies electricity to these regional energy companies as well as to large municipal distributors and very large national and international industrial customers.

E.ON Energie's customers are interregional, regional and municipal utilities, traders, industrial and commercial customers and, only through regional distributors, residential and small commercial customers predominantly in those parts of Germany highlighted on the map shown in Distribution above. E.ON Energie supplied approximately 18 percent of the electricity consumed by end users in Germany in 2006. In compliance with the European Commission's conditions upon approving the VEBA-VIAG merger, E.ON Energie's majority-owned regional energy companies E.ON edis and ETE in eastern Germany purchase power primarily from E.ON Energie's competitor Vattenfall Europe. E.ON Energie's majority-owned energy company E.ON Avacon AG (E.ON Avacon) likewise purchases its power primarily from Vattenfall Europe for those of its customers situated in the eastern German state of Saxony-Anhalt.

The following table sets forth the sale of electric power by E.ON Energie's German companies (excluding that used in physically settled trading activities), primarily in Germany, in 2006 and 2005:

<b>Sale of Power to</b>	<b>2006 million kWh</b>	<b>2005 million kWh</b>	<b>% Change in Total</b>
Non-consolidated interregional, regional and municipal utilities(1)	135,112	116,654	+15.8
Industrial and commercial customers(2)(3)	53,896	59,134	-8.9
Residential and small commercial customers	29,736	29,978	-0.8
Total(3)	218,744	205,766	+6.3

- (1) The sale of power to non-consolidated interregional, regional and municipal utilities increased in 2006 compared with 2005, primarily reflecting two effects. Sales volumes of EST outside of Germany increased markedly, partially due to the transfer of contracts from companies outside of Germany to EST. The increase also reflects the reclassification in 2006 of sales that had been previously attributed to industrial and commercial customers.
- (2) The sale of power to industrial and commercial customers decreased in 2006 compared with 2005 due to the reclassification in 2006 of sales that are now attributed to non-consolidated interregional, regional and municipal utilities.
- (3) The sale of power includes sales of EST in other European countries.

In order to offer optimized services to major customers and to equalize supply and demand at all times with respect to the costs of procurement, E.ON Energie has integrated its trading and wholesale operations into EST. EST focuses on the national and international wholesale business for regional utilities, large municipal utilities and major industrial customers, and is also responsible for E.ON Energie's trading operations. The regional energy companies manage the

main part of E.ON Energie's retail business, which is the supply of power to municipal

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utilities, industrial and commercial customers, as well as residential and small commercial customers. In addition, in February 2007, E.ON Energie launched the new company E WIE EINFACH Strom & Gas GmbH ( E wie einfach (meaning E like easy)), which is targeted at attracting additional residential and small business power and gas customers in the mass market throughout Germany. The following chart sets forth the principal supply structure of E.ON Energie's electricity sales.

(1) Supply expected to start on April 1, 2007.

The supply contracts under which E.ON Energie's regional energy companies (all are majority-owned) regularly order their required load for upcoming years have historically had relatively long terms. Typical supply contracts now last for one to three years. Potential alternative sources of electricity include the purchase of electricity from other utilities and auto-generation by municipalities, regional distributors or industrial customers. The regional distributors' contracts with municipal utilities contain varying terms and conditions. Long-term concession contracts permit municipal utilities and regional distributors to supply electricity to residential customers within a municipality.

*Gas.* E.ON Energie's gas sales volume in Germany in 2006 amounted to 106.2 billion kWh compared with 100.5 billion kWh in 2005. The increase is mainly due to the impact of the first full year of results from GVT, which was consolidated in July 2005.

*Heat.* E.ON Energie is one of the leading suppliers of district heating in Germany. It operates its own district heating networks and supplies several additional networks owned by other companies. E.ON Energie's regional energy companies are also involved in district heat and steam delivery. E.ON Energie's total district heat deliveries in Western Europe increased from 13.0 billion kWh in 2005 to 16.2 billion kWh in 2006, of which 11.3 billion kWh were supplied in Germany. The increase mainly reflects a business enlargement at E.ON Benelux (approximately 2.6 billion kWh).

*Water.* E.ON's regional water business is conducted through certain of its distribution companies, particularly E.ON Hanse, E.ON Avacon and E.ON Westfalen Weser.

*Customers.* Through its subsidiaries and companies in which it has shareholdings, E.ON Energie serves approximately 9.5 million electricity customers in Germany. E.ON Energie's German operations also supply approximately 1.9 million customers with gas and more than 0.5 million customers with water.

*The Netherlands.* In the Netherlands, E.ON Benelux acquired the Dutch power and gas company NRE in 2005. In 2006, the company supplied approximately 1.7 TWh of electricity and approximately 4.0 TWh of gas to approximately 0.3 million electricity and gas customers in the Netherlands.

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*Italy.* Sales activities in Italy are conducted through E.ON Italia S.p.A. ( E.ON Italia ) (electricity) and Dalmine (electricity and gas). Both focus on industrial customers and local utilities. E.ON Italia is wholly owned by E.ON Energie. In 2006, E.ON Italia supplied 1.9 TWh of electricity. The 75.0 percent stake in Dalmine was acquired in December 2006 by EST. In 2006, the company supplied approximately 3.0 TWh of electricity and approximately 10.4 TWh of gas.

**Trading**

E.ON Energie has integrated its trading and wholesale operations into EST. An international team of traders buys and sells electricity on the spot and forward markets. E.ON Energie's trading operations offer customized and standard products that are traded on a bilateral basis, as well as trading in standard exchange-traded instruments. EST's trading focuses on Germany and continental Europe, including important European power exchanges such as the European Energy Exchange in Leipzig, the Amsterdam Power Exchange in the Netherlands, Powernext in France and the Energy Exchange Austria. EST also supplies cross border trading and risk management processes for optimizing international power procurement to E.ON Energie's operations in Eastern Europe and is the procurer for E.ON Energie's operations in Italy. As the central trading desk of the E.ON Energie group, EST is also responsible for CO<sub>2</sub> emissions trading. For further information on CO<sub>2</sub> emissions trading, see Regulatory Environment EU/Germany: General Aspects (Electricity and Gas) Greenhouse Gas Emissions Trading. The volume of CO<sub>2</sub> emission certificates traded by EST amounted to 15.1 million tons in 2006 compared with 8.7 million tons in 2005.

E.ON Energie believes that its trading activities provide valuable market insight and have strengthened its competitive position in the European electricity market. E.ON Energie's trading activities are focused on asset-backed trading in order to optimize the value of its generation portfolio, though E.ON Energie also engages in a limited amount of proprietary trading within its established risk limits.

E.ON Energie's trading business has incorporated a complete and systematic risk management system in compliance with legal and regulatory requirements of the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or BAFin ), including the minimum requirements for risk management. An important aspect of the system is that the trading activities are monitored by a board independent from the trading operations. For more detailed information on E.ON Energie's management of the risks related to its trading activities, see Item 11. Quantitative and Qualitative Disclosures about Market Risk Commodity Price Risk Management.

The volume of EST's energy trading activities increased in 2006, reflecting higher liquidity and price volatility in the power markets. In addition, EST concluded a number of long-term contracts with industrial customers and regional and local utilities that allow the customers to purchase specified volumes of power for periods of up to 20 years at prices that are either fixed by the parties at the time of signing or indexed to fuel prices (predominantly coal). The following table sets forth the total volume of EST's traded electric power in 2006 and 2005.

	<b>2006</b>	<b>2005</b>	<b>%</b>
	<b>million</b>	<b>million</b>	<b>Change</b>
<b>Trading of Power</b>	<b>kWh</b>	<b>kWh</b>	<b>in Total</b>
Power sold	201,543	164,109	+22.8
Power purchased	222,843	168,734	+32.1
Total	424,386	332,843	+27.5

***Other***

*Consulting and Support Services.* E.ON Engineering GmbH offers internal and external consulting, planning and construction services in the energy sector in fields such as chemical analytics and electrical, mechanical and civil engineering, with a focus on conventional and renewable power generation, cogeneration, use of biomass, pipeline construction, development of energy strategies and CO<sub>2</sub>-emissions reduction. Building on their shareholdings in municipal and regional utilities, E.ON Energie and the regional distributors also establish partnerships and cooperative relationships with local authorities. E.ON Energie and the regional distributors

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operate their own electricity and gas supply systems, and provide the local authorities with consulting, technical and managerial support to promote the efficient use of electricity and gas. E.ON Facility Management GmbH ( E.ON Facility Management ) provides technical, commercial and infrastructural facility management services, mainly for E.ON Energie group companies. In August 2004, E.ON Facility Management purchased Arena One GmbH ( Arena One ), which operates in the areas of catering, event and facility management. Since its acquisition by E.ON Facility Management, Arena One has itself acquired another catering company. E.ON IS GmbH ( E.ON IS ) is the provider for all information technology services needed in the E.ON Group. The company also offers information technology services for third parties. E.ON IS is wholly-owned by the E.ON Group, with E.ON Energie holding a 60.0 percent stake, E.ON AG holding a 26.0 percent stake and E.ON Ruhrgas holding the remaining 14.0 percent stake.

*Other Minority Shareholdings.* In the Alpine region, E.ON Energie owns a 21.0 percent equity interest and 20.0 percent voting interest in BKW FMB Energie AG ( BKW ), an integrated Swiss utility that owns important hydropower assets, as well as a single nuclear power station and interests in other nuclear power stations.

**Eastern Europe**

E.ON Energie has significant shareholdings in Hungary, the Czech Republic, Bulgaria, Romania and Slovakia, in which it has already built up a portfolio of activities. In Eastern Europe, E.ON Energie's power generation facilities have a total installed capacity of approximately 490 MW, E.ON Energie's attributable share of which is approximately 300 MW. National holding companies such as E.ON Hungária, E.ON Czech Holding AG and E.ON Bulgaria EAD coordinate E.ON Energie's activities in the region.

In Hungary, E.ON Energie holds all of the shares (except for a golden share held by the Hungarian government) of the regional electricity distributors E.ON Dél-dunántúli Áramszolgáltató ZRt., E.ON Észak-dunántúli Áramszolgáltató ZRt. and E.ON Tiszántúli Áramszolgáltató ZRt. E.ON Hungária is active in the Hungarian sales market through its electricity and gas sales company E.ON Energiakereskedő Kft. In 2006, 2.5 million customers were provided with approximately 15.0 TWh of electricity. E.ON Energie also holds a 100.0 percent stake in the natural gas power generation companies Debreceni Kombinált Ciklusú Erőmű Kft. (95 MW) and Nyíregyházi Kombinált Ciklusú Erőmű Kft. (49 MW, scheduled to start production in April 2007). In March 2006, E.ON Hungária merged all of its small generation assets (an aggregate of 75 MW) into its wholly-owned subsidiary E.ON Energiatermelő Kft. In the gas sector, E.ON Energie holds a 98.1 percent stake in the gas distribution and supply company KÖGÁZ and a 99.9 percent stake in the gas distributor DDGÁZ. KÖGÁZ and DDGÁZ have been fully consolidated since April 2005. In 2006, the two companies provided approximately 0.6 million customers with approximately 15.4 TWh of gas. The agreement between E.ON Energie and RWE signed in February 2006, to swap certain of their respective shareholdings in Hungary and the Czech Republic, was closed in August 2006. Pursuant to this agreement, E.ON Energie acquired 49.9 percent of the shares of DDGÁZ and RWE acquired E.ON Energie's 16.3 percent interest in Fővárosi Gázművek Részvénytársaság ( FÖGÁZ ). As of February 1, 2007, E.ON Hungária completed a reorganization to fulfill legal unbundling requirements. Business administration services are now in the newly-founded company E.ON Gazdasági Szolgáltató Kft., while the newly-founded companies E.ON Ügyfélszolgálati Kft. and E.ON Hálózati Szolgáltató Kft. handle customer services and network services, respectively. All sales activities are now carried out in E.ON Energiakereskedő Kft.

In the Czech Republic, E.ON Energie controls significant participations in the energy sector. As of January 1, 2005, E.ON Energie fulfilled legal unbundling requirements by creating three wholly-owned subsidiaries, E.ON Česká republika, a.s., E.ON Distribuce, a.s. and E.ON Energie, a.s. On a combined basis, these companies provided approximately 1.4 million customers with approximately 11.9 TWh of electricity in 2006. Under the swap of shareholdings with RWE noted above, in the gas sector E.ON Energie increased its interest in the distributor JCP to 59.8 percent. After the swap, E.ON Energie acquired an additional 39.2 percent stake in JCP from Oberösterreichische Ferngas AG ( Oberösterreichische Ferngas ) and other minority shareholders. As of December 31, 2006, E.ON Energie

held a 99.0 percent interest in JCP. In January 2007, E.ON Energie received the remaining 1.0 percent interest from a squeeze-out proceeding and now holds 100 percent of JCP. As part of the asset swap, E.ON Energie also acquired a 25.0 percent minority interest in Prazská plynárenská Holding, a.s. ( PPH ) and a 49.3 percent minority interest in the gas distributor Prazská plynárenská, a.s. ( PP ). In return, RWE received E.ON Energie's interests in the distribution companies Stredoceska plynárenská a.s. (14.3 percent),



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Severomoravská plynárenská a.s. (9.6 percent), Západočeská plynárenská a.s. (47.9 percent) and Východočeská plynárenská a.s. (16.5 percent). E.ON Energie now owns minority shareholdings in the distributors Jihomoravská plynárenská a.s. (43.7 percent) and PP (49.3 percent), as well as in the holding company PPH (49.0 percent). In the generation sector, in August 2006, E.ON Energie acquired a 66.0 percent interest in the combined heat and power plant Teplárna Otrokovice a.s. ( Teplárna Otrokovice ) from the energy group Czech Coal a.s. Teplárna Otrokovice has an installed capacity of approximately 50 MW, E.ON Energie's attributable share of which is approximately 33 MW. Czech Coal is to retain a 34.0 percent interest in the entity, which is located in the eastern part of the country near the Slovak border.

In February 2005, E.ON Energie acquired 67.0 percent stakes in each of the two northeastern Bulgarian electricity distribution companies Elektrozpredelenie Varna AD ( Varna ) and Elektrozpredelenie Gorna Oryahovitza AD ( Gorna Oryahovitza ). The companies had combined sales of approximately 5.2 TWh and served approximately 1.2 million customers in 2006. As of January 1, 2007, the legal unbundling requirements were fulfilled through the foundation of E.ON Bulgaria Sales AD, which is now the sales company for the entire territory of northeastern Bulgaria, and E.ON Bulgaria Grid AD, which is now the distribution company for the entire territory of northeastern Bulgaria. The sales and distribution businesses of each of the former companies of Varna and Gorna Oryahovitza were integrated into these companies.

In September 2005, E.ON Energie acquired a 24.6 percent stake in the Romanian electricity distribution company Electrica Moldova S.A. ( Electrica Moldova ) renamed E.ON Moldova S.A. ( E.ON Moldova ) and simultaneously increased its stake in the company to 51.0 percent by subscribing to a capital increase. In 2006, the company sold approximately 3.3 TWh of electricity to approximately 1.4 million customers.

In 2002, E.ON Energie entered the Slovakian energy market by acquiring a 49.0 percent interest in the Slovakian electricity supplier Západoslovenská energetika a.s., which provided approximately 0.9 million customers with approximately 7.8 TWh of electricity in 2006.

In June 2006, E.ON Energie transferred its 20.3 percent interest in the eastern Lithuanian electricity distribution company Rytu Skirstomieji Tinklai to ERI.

E.ON Energie does not have interests in companies operating nuclear power plants other than those in Germany and Switzerland.

***Competitive Environment***

Since 1998, liberalization of the electricity markets in the EU has greatly altered competition in the German electricity market, which was formerly characterized by numerous strong competitors. Following liberalization, significant consolidation has taken place in the German market, resulting in three mergers of major interregional utilities in recent years: VEBA and VIAG forming E.ON, RWE and Vereinigte Elektrizitätswerke AG forming RWE (both in 2000) and Hamburgische Electricitäts-Werke AG/Bewag Berliner Kraft und Licht Aktiengesellschaft/VEAG/Lausitzer Braunkohle Aktiengesellschaft forming Vattenfall Europe in 2002. In 2006, E.ON, RWE, Vattenfall Europe and the other remaining major interregional utility, EnBW, supplied approximately two thirds of the total electricity production in Germany.

The interregional utilities own the high-voltage transmission lines in their traditional supply areas and are active in all phases of the electricity business. In addition to the interregional utilities, there are about 900 electric utilities in Germany at the state, regional and municipal level, many of which are partly or wholly owned by state or municipal governments. These utilities may be involved in various combinations of the generation, transmission, distribution and supply and trading functions. The liberalization of the electricity market in Germany has also led to new market

structures with new market participants. The market for electricity has become more liquid and more competitive, and currently has the highest number of participants in continental Europe. Approximately 200 new market participants have entered the German market since 1998, with more than half of them engaged in electricity trading. The volume of electricity trading rose in 2006 (1,133 TWh at the European Energy Exchange's Spot and Futures Market compared with 602 TWh in 2005). The European Energy Exchange has also become a benchmark for electricity prices in central Europe.

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Liberalization of the electricity market in Germany caused wholesale and consequently end customer electricity prices to decrease in 1998, with significant declines in some market segments. These declines were largely due to aggressive price setting by new competitors and suppliers, as well as other factors such as significant power plant overcapacity in Germany and Europe and relatively high and increasing price transparency. The rate of price declines began to slow in the second half of 2000, and prices have increased since 2001 but have developed differently in each of the customer segments. According to the German Electricity Association, VDEW, in 2006 prices paid by household customers were about 14 percent higher than in the liberalization year 1998, while prices (including electricity tax) paid by industrial customers were still about 8 percent lower than in 1998. In 2006, wholesale electricity prices in Germany stayed at a high level, but showed greater volatility, largely due to variations in CO<sub>2</sub> emission certificate prices. Some industrial customers were affected by the high wholesale prices, but others had already procured a lower price in 2004 or earlier. For this reason, the wholesale price increases did not affect the industrial customer segment to the same degree as household customers, who generally paid higher prices in 2006.

In addition to the effect of higher wholesale market prices, a significant factor in the overall price recovery are new or increased costs faced by electricity companies since the beginning of liberalization. Among these new or increased costs are the electricity tax (introduced in 1998 and subject to annual increases through 2003), duties and additional costs attributable to compliance with new legislation, including the Renewable Energy Law and Co-Generation Protection Law, as well as higher costs incurred in procuring balancing power to cover fluctuations in the availability of electricity from renewable resources such as wind. As most distributors have tried to pass these increases through to their customers, electricity prices have risen more rapidly than the associated margins for generators in recent years. Taxes and duties accounted for approximately 40 percent of German electricity prices for household customers in 2006, compared with about 25 percent before deregulation in 1998. Similarly, electricity taxes and duties increased from 2 percent of German electricity prices for industrial customers in 1998 to 19 percent in 2006. In view of recent developments in the commodity and fuel markets, E.ON Energie expects electricity prices in Germany to stabilize in 2007. E.ON Energie cannot exclude further price increases for end customers in 2007, which in most cases have to be approved by the relevant authorities. However, these price changes for end customers depend on the wholesale market prices for electricity. For information about court proceedings on price increases affecting some of E.ON Energie's majority-owned regional distribution companies, see Item 3. Key Information Risk Factors.

High environmental and nuclear safety standards, as well as high investments in new power plants, taxes on electricity, the requirements of the Co-Generation Protection Law and the Renewable Energy Law's requirement that regional utilities purchase electricity generated from renewable resources impose a considerable burden on German electricity prices for end customers. E.ON Energie still believes that it will be able to compete effectively in Germany. In addition, E.ON Energie believes that the liberalization of the gas and electricity markets may open new business opportunities. However, E.ON Energie may be unable to compete as effectively as other electricity companies due to the factors described above, as well as due to regulatory changes described in Regulatory Environment. Any of these or other factors could materially and adversely affect E.ON's financial condition and results of operations. See also Item 3. Key Information Risk Factors.

Outside Germany, the energy markets in which E.ON Energie operates are also subject to strong competition. In the countries of Eastern Europe where E.ON Energie has operations, full liberalization of the electricity and gas sales markets should be realized by July 1, 2007. This may alter competition in these electricity and gas markets, which could lead to decreasing end customer prices or to a loss of market shares. E.ON Energie cannot guarantee it will be able to compete successfully in electricity and gas markets where it already is present or in new electricity and gas markets it may enter.

**PAN-EUROPEAN GAS***Overview*

E.ON Ruhrgas is the lead company of the Pan-European Gas market unit and is responsible for all of E.ON's non-retail gas activities in continental Europe. In terms of sales, E.ON Ruhrgas is one of the leading non-state-owned gas companies in Europe and the largest gas company in Germany. E.ON Ruhrgas' principal business is the supply, transmission, storage and sale of natural gas. E.ON Ruhrgas also holds numerous stakes in German and other European gas transportation and distribution companies, as well as a small shareholding in Gazprom, Russia's

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main natural gas exploration, production, transportation and marketing company. In 2006, the Pan-European Gas market unit recorded revenues of 25.0 billion (which included 2.1 billion in natural gas and electricity taxes that were remitted, directly or indirectly, to the German tax authorities) and adjusted EBIT of 2.1 billion. 17.0 billion of the Pan-European Gas market unit's 2006 revenues were generated in Germany and 8.0 billion was generated abroad (measured by location of customer).

In 2006, E.ON Ruhrgas entered into the following significant transactions:

In March 2006, ERI completed the acquisition of 100 percent of the gas trading and gas storage businesses of the Hungarian oil and gas company MOL by acquiring ownership interests in MOL Földgázellátó Rt. and MOL Földgáztároló Rt. (which have since been renamed E.ON Földgaz Trade and E.ON Földgaz Storage). The acquisition of MOL's 50.0 percent interest in the gas importer Panrusgáz was completed at the end of October 2006.

In July 2006, E.ON Ruhrgas signed a framework agreement with OAO Gazprom memorializing the basic understanding of the parties regarding the swap of the following assets: E.ON Ruhrgas to receive 25.0 percent minus one share in the Severneftegazprom joint venture company, which holds the exploration and production license for the Yushno Russkoje gas field in Russia and Gazprom to receive 50.0 percent minus one share in each of E.ON Földgaz Trade and E.ON Földgaz Storage and 25.0 percent plus one share in E.ON Hungária. Any difference in the agreed value of the assets to be exchanged is to be settled, as applicable, by Gazprom through a cash payment and/or by E.ON through the payment of cash or E.ON Ordinary Shares (with Gazprom being able to select the method of payment). However, the timing of these transfers and the precise terms on which they are to be executed have yet to be determined.

In December 2006, Thüga Aktiengesellschaft (Thüga) agreed with EnBW to sell certain shareholdings to EnBW group companies. The transfer of the shareholdings is expected to take place in the first half of 2007.

***Operations***

Through E.ON Ruhrgas AG and its subsidiaries, E.ON Ruhrgas is primarily engaged in the following segments of the gas industry:

- Supply: The purchase of natural gas under long-term contracts with foreign and domestic producers, including the Russian gas company Gazprom, the world's largest gas producer in terms of volume, in which E.ON Ruhrgas holds a small shareholding. E.ON Ruhrgas also engages in gas exploration and production activities and, to supplement its supply as well as its sales business, in a limited amount of trading activities;
- Transmission: The transmission of gas within Germany via a network of approximately 11,400 km of pipelines in which E.ON Ruhrgas holds an interest;
- Storage: The storage of gas in a number of large underground natural gas storage facilities; and
- Sales: The sale of gas within Germany to supraregional and regional distributors, municipal utilities and industrial customers, as well as the delivery of gas to a number of customers in other European countries.

In addition to its natural gas supply, transmission, storage and sales businesses, E.ON Ruhrgas owns numerous shareholdings in integrated gas companies, gas distribution companies and municipal utilities through its subsidiaries ERI and Thüga. ERI holds both majority and minority shareholdings in German and European energy companies, while Thüga holds primarily minority shareholdings in 93 regional and municipal electricity and gas utilities in

Germany, as well as majority and minority shareholdings in a number of Italian gas distribution and sales companies.

For financial reporting purposes, the Pan-European Gas market unit is divided into three business units: Up-/Midstream, Downstream Shareholdings and Other/Consolidation. The Up-/Midstream business unit reflects the results of the supply, transmission, storage and sales businesses, with the midstream operations essentially including all of the supply and sales businesses other than exploration and production activities. The Downstream Shareholdings business unit reflects the results of ERI and Thüga. Other/Consolidation includes consolidation effects.

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The following table provides information about purchases and sales of natural gas and coke oven gas by E.ON Ruhrgas midstream operations for the years 2006 and 2005. The difference between gas supplies and gas sales in any given period is due to storage and metering differences and occurs routinely.

	<b>Total 2006 billion kWh</b>	<b>%</b>	<b>Total 2005 billion kWh</b>	<b>%</b>
<b>Purchases</b>				
Imports	609.9	84.4	580.0	84.5
German sources	113.3	15.6	106.1	15.5
Total	723.2	100.0	686.1	100.0
<b>Sales</b>				
Domestic distributors	318.7	44.9	323.7	46.9
Domestic municipal utilities	163.1	23.0	160.9	23.3
Domestic industrial customers	67.6	9.5	70.4	10.2
Sales abroad	160.3	22.6	135.2	19.6
Total	709.7	100.0	690.2	100.0

In the table above, as well as in the descriptions of E.ON Ruhrgas supply and sales businesses, purchase and sales volumes are presented for all periods excluding relatively small amounts of gas that E.ON Ruhrgas does not consider part of its primary business, including volumes handled for third parties. In addition, these gas volumes do not include gas volumes attributable to ERI or Thüga, which are part of the Downstream Shareholdings business unit.

The increase in total sales volume in 2006 is attributable to an increase in sales abroad, especially to customers in Sweden (including E.ON Sverige) and Denmark, short-term trading transactions in the United Kingdom and increased sales in France; the sales increase is primarily reflected in an increase in imports in 2006. For more information on E.ON Ruhrgas gas supply contract with E.ON Sverige, see Nordic Operations.

**Supply**

E.ON Ruhrgas purchases nearly all of its natural gas from producers in six countries: Russia, Norway, the Netherlands, Germany, the United Kingdom and Denmark. In 2006, E.ON Ruhrgas purchased a total of 723.2 billion kWh of gas, of which approximately 84.4 percent was imported and approximately 15.6 percent was purchased from German producers. E.ON Ruhrgas was the largest gas purchaser in Germany in 2006, acquiring more than half of the total volume of gas purchased for the German market. Of the 723.2 billion kWh of gas purchased in 2006, E.ON Ruhrgas bought approximately 27.2 percent from Norway and approximately 24.7 percent from Russia, its two largest suppliers. The following table provides information on the amount of gas purchased from each country and its percentage of the total volume of gas purchased by the midstream operations in the years 2006 and 2005:

	<b>Total 2006 billion kWh</b>	<b>%</b>	<b>Total 2005 billion kWh</b>	<b>%</b>
<b>Sources of Gas</b>				

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Germany	113.3	15.6	106.1	15.5
Russia	178.4	24.7	193.5	28.2
Norway	196.5	27.2	188.4	27.5
The Netherlands	137.5	19.0	139.0	20.2
United Kingdom	67.2	9.3	34.1	5.0
Denmark	22.9	3.2	23.7	3.4
Others(1)	7.4	1.0	1.3	0.2
Total	723.2	100.0	686.1	100.0

(1) Italy, France, Austria, Hungary and Slovakia.

In the table above, purchase volumes are presented for all periods excluding relatively small amounts of gas that E.ON Ruhrgas does not consider part of its primary supply business, including volumes handled for third parties. In addition, these gas volumes do not include gas volumes attributable to ERI or Thüga.



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As is typical in the gas industry, these purchases were primarily made under long-term supply contracts that E.ON Ruhrgas has with one or more gas producers in each country. Purchases under such contracts provided for nearly all of the gas bought by E.ON Ruhrgas in 2006; the remaining amounts were purchased on international spot markets or pursuant to short-term contracts. E.ON Ruhrgas' current long-term contracts with fixed terms (so-called "supply" type contracts) have termination dates ranging from 2007 to 2036 (subject in certain cases to automatic extensions unless either party gives notice of termination), while so-called "depletion" type contracts terminate upon the exhaustion of economic production from the relevant gas field. E.ON Ruhrgas believes that its existing contracts secure the supply of a total volume of approximately 13.5 trillion kWh of natural gas over the period to 2036. As is standard in the gas industry, the price E.ON Ruhrgas pays for gas under these contracts is calculated on the basis of complex formulas incorporating variables based upon current market prices for fuel oil, gas oil, coal and/or other competing fuels, with prices being automatically re-calculated periodically, usually monthly or quarterly. The contracts also generally provide for formal revisions and adjustments of the price or business terms to reflect changes in the market (in many cases expressly including changes in the retail market for natural gas and competing fuels), generally providing that such revisions may only be made once every few years unless the parties agree otherwise. Claims for revision are subject to binding arbitration in the event the parties cannot agree on the necessary adjustments. Certain contracts also provide E.ON Ruhrgas with the possibility of buying specified quantities of gas at prices linked to those on international spot markets. The contracts also require E.ON Ruhrgas to pay for specified minimum quantities of gas even if it does not take delivery of such quantities, a standard gas industry practice known as "take or pay." Take-or-pay quantities are generally set at approximately 80 percent of the firm contract quantities. To date, E.ON Ruhrgas has been able to avoid the application of these take-or-pay clauses in nearly all cases. The contracts also include quality and availability provisions (together with related discounts for non-compliance), *force majeure* provisions and other industry standard terms. E.ON Ruhrgas also has short-term arrangements with some of its suppliers, which provided less than 3 percent of E.ON Ruhrgas' gas supply in 2006. E.ON Ruhrgas generally takes delivery of the gas it imports at the point at which the relevant pipeline crosses the German border. For additional information on these contractual obligations, see Item 5. Operating and Financial Review and Prospects - Contractual Obligations.

In the medium and long term, rising demand for gas in Europe, combined with falling indigenous production in European countries, particularly in the United Kingdom, will lead to a greater reliance on imports by European gas wholesalers. Accordingly, in the near future, gas producers will have to invest, in some cases quite considerably, in expanding their production capacities. In addition, the natural decline in output from older fields will need to be made up by the development of new fields. E.ON Ruhrgas believes that long-term gas purchase contracts will remain crucial to European gas supplies, ensuring a fair balance of risks between producers and importers. E.ON Ruhrgas believes the price adjustment provisions in such contracts ensure sufficient supplies of gas at competitive prices, while the take or pay provisions give producers the necessary long-term security for investing. The economic significance of such contracts has been acknowledged by the German government and, in principle, by the European Commission, and E.ON Ruhrgas seeks to balance its purchase and sale obligations so as to minimize risk. For information about risks relating to long-term gas supply contracts, see Item 3. Key Information - Risk Factors.

E.ON Ruhrgas' supply sources are discussed below on a country-by-country basis.

*Russia.* In 2006, E.ON Ruhrgas purchased 178.4 billion kWh of gas, or 24.7 percent of its total gas purchased, from Russia. Russia is the largest supplier of natural gas to E.ON Ruhrgas, while E.ON Ruhrgas is the second-largest purchaser of gas from Russia. As with most of its gas imports, E.ON Ruhrgas takes ownership of its Russian gas when it reaches the German border.

All of E.ON Ruhrgas' purchases of Russian natural gas are made pursuant to long-term supply contracts with OOO Gazexport (now Gazprom export), the subsidiary of Gazprom responsible for exports. E.ON Ruhrgas holds a 3.5 percent direct interest in Gazprom; an additional stake of 2.9 percent in Gazprom is attributable to E.ON Ruhrgas on the basis of contractual arrangements relating to its minority interest in a Russian entity that holds these shares.

E.ON Ruhrgas considers its shareholding in Gazprom to be an important element supporting its long-term supply relationship with Gazprom, which is the world's largest gas producer, having produced approximately 5.7 trillion kWh of gas in 2006. E.ON Ruhrgas expects the importance of Russian gas exports for Europe to increase as the indigenous production of important European supply countries decreases. Gazprom has indicated it will flexibly cover about one third of E.ON Ruhrgas' gas requirements for the German market until 2030. In July 2004, E.ON and Gazprom signed a

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Memorandum of Understanding for a deepened strategic cooperation between the parties, pursuant to which E.ON, Gazprom and BASF AG ( *BASF* ) signed a basic agreement on the construction of the Nord Stream pipeline from Vyborg, Russia to Greifswald, Germany through the Baltic Sea in September 2005. In August 2006, the final shareholders agreement was signed. For details, see *Transmission and Storage Pipelines*.

In August 2006, E.ON and Gazprom finalized a series of agreements in Moscow. These agreements, which comprise extensions of existing contracts and a new supply contract, provide for the delivery of an aggregate of approximately 400 billion cubic meters ( *m<sup>3</sup>* ) of gas through 2036, and E.ON believes that these contracts represent an important contribution towards safeguarding long-term European gas supplies. The annual deliveries of approximately 24 billion *m<sup>3</sup>* are equivalent to one third of the gas volume currently purchased by E.ON Ruhrgas. The two companies signed 15-year extensions of the existing contracts with Waidhaus, Germany as delivery point through 2035, as well as a new supply contract for additional gas to be delivered via the Nord Stream pipeline from 2010/2011 onwards.

*Norway.* In 2006, E.ON Ruhrgas purchased 196.5 billion kWh, or 27.2 percent of its total gas purchased, from Norwegian sources. E.ON Ruhrgas has supply contracts with a number of major Norwegian and international energy companies that hold concessions for the exploitation of Norwegian gas fields. Some of the contracts are of the depletion -type while others are supply -type contracts. E.ON Ruhrgas takes delivery of its Norwegian supplies mainly at the gas import points near Emden along the German North Sea coast.

*The Netherlands.* In 2006, E.ON Ruhrgas purchased 137.5 billion kWh, or 19.0 percent of its total gas purchased, pursuant to a single long-term supply contract with GasTerra B.V. This contract provides E.ON Ruhrgas with a certain degree of flexibility in managing its supply portfolio. E.ON Ruhrgas believes such flexibility is particularly important in this case, as the Dutch gas fields are relatively close to the end consumers of E.ON Ruhrgas imports, making it more economically viable for E.ON Ruhrgas to react to changes in market demand by varying contract quantities. E.ON Ruhrgas takes delivery of Dutch gas at the German border.

*Germany.* In 2006, E.ON Ruhrgas purchased 113.3 billion kWh, or 15.6 percent of its total gas purchased, from domestic gas production companies. E.ON Ruhrgas has long-term supply contracts for German natural gas with ExxonMobil Gas Marketing Deutschland GmbH (formerly Mobil Erdgas-Erdöl GmbH), ExxonMobil Gas Marketing Deutschland GmbH & Co. KG (50 percent of former Britta Erdgas und Erdöl GmbH ( *BEB* )), Shell Erdgas Marketing GmbH & Co. KG (50 percent of former *BEB*), Gaz de France Produktion Exploration Deutschland GmbH (formerly Preussag Energie GmbH) and RWE Dea AG. A number of the contracts provide E.ON Ruhrgas with significant additional flexibility by providing for the supply of minimum and maximum quantities of gas, rather than a single fixed amount. E.ON Ruhrgas expects the volume of gas it purchases from domestic sources to decline over the coming years due to the depletion of German gas fields.

*United Kingdom.* In 2006, E.ON Ruhrgas purchased 67.2 billion kWh, or 9.3 percent of its total gas purchased, from U.K. sources. These quantities were partly purchased from BP Gas Marketing Ltd under a long-term supply contract, partly purchased on the spot short-term market and partly received as equity gas through E.ON Ruhrgas subsidiary E.ON Ruhrgas UK Exploration and Production Limited ( *E.ON Ruhrgas UK* ), which has interests in U.K. gas fields and infrastructure. See *Exploration and Production* below for more information on E.ON Ruhrgas UK.

In contrast to much of its other imported gas, which E.ON Ruhrgas generally takes ownership of at the German border, E.ON Ruhrgas takes delivery of its purchased U.K. gas supplies partly at Bacton and Easington terminals in the United Kingdom and partly at Zeebrugge terminal in Belgium. Gas from the U.K. gas fields is transported to Belgium through the undersea gas pipeline run by the project company Interconnector (U.K.) Limited ( *Interconnector* ).

*Denmark.* In 2006, E.ON Ruhrgas purchased 22.9 billion kWh, or 3.2 percent of its total gas purchased, from the Danish supplier DONG Energy A/S ( DONG ), with which E.ON Ruhrgas has long-term supply contracts. E.ON Ruhrgas takes delivery of Danish gas at the German-Danish and Swedish-Danish border.

*Trading*

In order to optimize and manage price risks of its long-term gas portfolio, E.ON Ruhrgas engages in gas, oil and coal trading. The gas trading activities are concentrated at the national balancing point in the United Kingdom,

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at the Zeebrugge hub in Belgium and at the Title Transfer Facility in the Netherlands (and, since October 2006, at the Virtuelle Handlungspunkte in Germany), and are mainly handled via brokers participating in open markets. Financial, oil and coal trading activities are undertaken mainly for hedging purposes. Proprietary trading is marginal compared to asset-based trading.

E.ON Ruhrgas' total traded gas volume for 2006 was 10.1 percent of total E.ON Ruhrgas sales, as compared with 5.9 percent in 2005, with the increase being attributable to increased hedging activities reflecting the expansion of the arbitrage business in the markets in the United Kingdom, Belgium and the Netherlands.

All of E.ON Ruhrgas' energy trading operations, including its limited proprietary trading, are subject to E.ON's risk management policies for energy trading. For additional information on these policies and related exposures, see Item 11. Quantitative and Qualitative Disclosures about Market Risk.

*Exploration and Production*

E.ON Ruhrgas participates in the exploration and production segment of the gas industry through its gas production companies in the United Kingdom and in Norway.

*United Kingdom.* In the United Kingdom, E.ON Ruhrgas operates through its subsidiary E.ON Ruhrgas UK, which directly holds mainly minority interests in a number of gas production fields, exploration blocks and pipelines in the British North Sea. In addition, E.ON Ruhrgas UK is the sole shareholder of E.ON Ruhrgas UK North Sea Limited ( E.ON Ruhrgas North Sea ) and its subsidiaries, which own interests in 16 gas fields and two pipeline systems as well as a trading business.

In 2006, the E.ON Ruhrgas UK group produced 7.7 billion kWh (725 million m<sup>3</sup>) of gas, compared with 5.3 billion kWh (479 million m<sup>3</sup>) of gas in 2005. The 45 percent increase reflects the first full year of production from the assets in which E.ON Ruhrgas North Sea holds an interest, which were acquired in November 2005. In addition, the E.ON Ruhrgas UK group produced 2.7 million barrels of liquids (oil and condensate) in 2006, compared with 2.5 million barrels in 2005. The Hunter and Glenelg fields started production in January and March 2006, respectively. At the end of 2006, the Merganser gas and condensate field also commenced production. In summer 2006, E.ON Ruhrgas North Sea successfully drilled and tested the Babbage appraisal well, its first well under own operatorship (its interest in the Babbage field is 47.0 percent).

The following table shows the name of each producing field in which the E.ON Ruhrgas UK group holds an interest, E.ON's ownership interest in the field, and the date each field commenced production:

**E.ON Ruhrgas UK Group**

<b>Name of Producing Field</b>	<b>E.ON Share in %</b>	<b>Start-up Date</b>
Ravenspurn North	28.75	July 1990
Caister	40.0	October 1993
Johnston	50.107	September 1994
Schooner	4.83	September 1996
Elgin/Franklin	5.2	April 2001
Scoter	12.0	December 2003
Hunter	79.0	January 2006

Glenelg	18.57	April 2006
Merganser	7.9185	December 2006

The E.ON Ruhrgas UK group received its share of production from all of the producing fields in which it owned an interest in 2006.

*Norway.* E.ON Ruhrgas operates in Norway through its subsidiary E.ON Ruhrgas Norge AS ( E.ON Ruhrgas Norge ). E.ON Ruhrgas Norge owns 30.0 percent of the Njord oil and gas field. Currently, gas from this field is being re-injected to increase the rate of oil recovery. E.ON Ruhrgas Norge obtained 2.6 million barrels of oil

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as a result of its stake in 2006 which were sold on the market. The field is currently expected to begin producing gas for sale later in 2007. To expand its business further, E.ON Ruhrgas Norge has applied for and received operator qualification on the Norwegian Shelf.

*Russia.* As noted above, in July 2006 E.ON Ruhrgas and Gazprom signed a framework agreement on the exchange of assets in the sectors of gas exploration and production as well as gas sales and trading and power. As part of this agreement, E.ON Ruhrgas will acquire a stake of 25.0 percent minus one share in the company Severneftegazprom, which holds the exploration and production license for the Yushno Russkoje gas field in Siberia.

*Liquefied Natural Gas*

LNG, which is liquefied in the gas producing country, transported by tanker and then converted back into gas at the receiving terminal, is an alternative to gas deliveries by pipeline. E.ON Ruhrgas is currently conducting a study on the construction of an LNG unloading and regasification terminal in Wilhelmshaven which would be Germany's first such facility. E.ON Ruhrgas has a majority shareholding in Deutsche Flüssigerdgas Terminal Gesellschaft mbH, which owns property to build the terminal in Wilhelmshaven, which, if built, could handle upon completion as much as 5 billion m<sup>3</sup> of natural gas per year and would have the flexibility to handle another 5 billion m<sup>3</sup> if required. According to initial calculations, the investments required would total approximately 695 million. No decision to build the terminal has yet been made, though its construction would be in line with E.ON's strategy of expanding its sources of natural gas with the goal of enhancing the security of its supply.

E.ON Ruhrgas and ADRIA LNG Study Company (whose current shareholders are OMV, TOTAL, RWE Transgas, INA and Geoplin) have agreed to prepare joint feasibility studies for the construction of an LNG regasification terminal in Croatia by signing a cooperation agreement. The studies are to be based on investigations already started in 1995 and will lay the foundations for a decision on what would be a major infrastructure project.

*Transmission and Storage*

E.ON Ruhrgas AG's technical infrastructure in Germany is comprised of pipelines and transport compressor stations (together, the transmission system), as well as underground gas storage facilities (including storage compressor stations) owned by E.ON Ruhrgas AG, those co-owned directly by E.ON Ruhrgas AG and other gas companies, and those owned by project companies in which E.ON Ruhrgas AG holds an interest.

Project companies are entities E.ON Ruhrgas AG has set up with German or European gas companies for a special purpose, such as establishing a pipeline connection between two countries or building and operating underground gas storage facilities. The following table provides more information on the E.ON Ruhrgas AG share in each of its German project companies as of December 31, 2006:

<b>Project Company</b>	<b>E.ON Ruhrgas Share %</b>
DEUDAN (DEUDAN – Deutsch/Dänische Erdgastransport-Gesellschaft mbH & Co. KG)	25.0
EGL (Etzel Gas-Lager GmbH & Co.)	74.8
GHG (GHG-Gasspeicher Hannover Gesellschaft mbH)	13.2
MEGAL (MEGAL Mittel-Europäische-Gasleitungsgesellschaft mbH & Co. KG)	51.0
METG (Mittelrheinische Erdgastransportleitungsgesellschaft mbH)	100.0
NETG (Nordrheinische Erdgastransportleitungsgesellschaft mbH & Co. KG)	50.0

NETRA (NETRA GmbH Norddeutsche Erdgas Transversale & Co. KG)	40.6
TENP (Trans Europa Naturgas Pipeline GmbH & Co. KG)	51.0

The E.ON Ruhrgas AG underground storage facilities are operated by E.ON Ruhrgas AG as storage system operator. The E.ON Ruhrgas AG transmission system is operated by E.ON Gastransport, a wholly-owned subsidiary of E.ON Ruhrgas AG, as transmission system operator. The underground storage facilities and the transmission system, based on service contracts, are monitored and maintained largely by E.ON Ruhrgas AG. The



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transmission system is used to transport the gas that E.ON Ruhrgas and third party customers receive from suppliers at gas import points on the German border or at other supply points within Germany to customers or to storage facilities for later use.

In accordance with Germany's energy law, the transmission system has been leased out to E.ON Gastransport together with all transmission rights and rights of beneficial use that E.ON Ruhrgas AG possesses in respect of third party transmission systems in Germany. For more information on Germany's new energy law, see Regulatory Environment EU/Germany: General Aspects (Electricity and Gas). For more information on E.ON Gastransport, see E.ON Gastransport below.

The following map shows the pipelines as well as the location of compressor stations, gas storage facilities and field stations belonging to E.ON Ruhrgas AG's technical infrastructure:

**E.ON Ruhrgas AG's Technical Infrastructure**

As shown in the map above, E.ON Ruhrgas AG's transmission system and its underground storage facilities are located primarily in western Germany, the historical center of E.ON Ruhrgas' operations.

*Pipelines.* As of the end of 2006, E.ON Ruhrgas AG owned gas pipelines totaling 6,556 km and co-owned gas pipelines totaling 1,543 km with other companies. In addition, German project companies in which E.ON Ruhrgas AG holds an interest owned gas pipelines totaling 3,306 km at the end of 2006.

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The following table provides more information on E.ON Ruhrgas AG's pipelines in Germany as of December 31, 2006:

<b>Pipelines</b>	<b>Total km</b>	<b>Maintained by E.ON Ruhrgas AG km</b>
Owned by E.ON Ruhrgas AG	6,556	6,234
Co-owned pipelines	1,543	604
DEUDAN (PC)	110	0
EGL (PC)	67	67
MEGAL (PC)	1,080	1,080
METG (PC)	425	425
NETG (PC)	285	144
NETRA (PC)	341	106
TENP (PC)	998	998
Companies in which E.ON Ruhrgas AG holds a stake through its subsidiaries ERI and Thüga		2,032
Owned by third parties		1,034
<b>Total in Germany</b>	<b>11,405</b>	<b>12,724</b>

(PC) project company

E.ON Ruhrgas AG's share in the use of any particular pipeline it does not wholly own is determined by contract and is not necessarily related to E.ON Ruhrgas AG's interest in the pipeline. E.ON Ruhrgas AG's pipeline network is comprised of pipeline sections of varying diameters originally built according to the estimated capacity needed for the relevant section of the system. Currently, the pipeline network comprises 2,012 km of pipelines with a diameter of less than or equal to 300 millimeters, 3,054 km of pipelines with a diameter of more than 300 and less than or equal to 600 millimeters, 3,002 km of pipelines with a diameter of more than 600 and less than or equal to 900 millimeters, and 3,337 km of pipelines with a diameter of more than 900 and less than or equal to 1,200 millimeters.

In 2006, E.ON Ruhrgas AG maintained 6,234 km of its own pipelines, 604 km of co-owned pipelines, 1,034 km of pipelines owned by third parties and 2,032 km of pipelines owned by companies in which E.ON Ruhrgas AG holds a stake through its subsidiaries ERI and Thüga, as well as 2,820 km of pipelines owned by project companies in which E.ON Ruhrgas AG holds an interest. In total, E.ON Ruhrgas AG maintained (including providing local monitoring) 12,724 km of pipelines in 2006. For information on pipeline monitoring and maintenance, see [Monitoring and Maintenance](#) below.

In addition to E.ON Ruhrgas AG's German transmission system, E.ON Ruhrgas has a 23.59 percent interest in Interconnector, a U.K. project company that owns the Interconnector transmission system, comprising a 235 km undersea gas pipeline from the United Kingdom to Belgium, a transport compressor station at Bacton (four units with a total installed capacity of approximately 116 MW) and a compressor station at Zeebrugge (four units with a total installed capacity of approximately 140 MW).

In July 2004, E.ON Ruhrgas acquired a 20.0 percent interest in BBL Company V.O.F., a Dutch project company founded in July 2004, which built a second undersea transmission system between continental Europe and the United Kingdom. This transmission system (comprising a 235 km undersea pipeline and a compressor station at Balgzand three units with a total installed capacity of approximately 69 MW), which links Balgzand in the Netherlands to Bacton in the United Kingdom, started operation in December 2006.

E.ON Ruhrgas also owns a 3.0 percent interest in the Swiss project company Transitgas AG, which owns the Transitgas transmission system, running through Switzerland from Wallbach on the Swiss-German border and Rodersdorf on the French-Swiss border to Griespass on the Swiss-Italian border. The Transitgas system comprises

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pipelines totaling 293 km and one transport compressor station at Ruswil (four units with a total installed capacity of approximately 60 MW).

In Romania, E.ON Ruhrgas has a 51.0 percent stake in the Romanian gas supplier E.ON Gaz România S.A. ( E.ON Gaz România ), the former S.C. Distrigaz Nord S.A. ( Distrigaz Nord ). E.ON Gaz România is active in gas distribution and supply in northern Romania; it owns gas pipelines totaling approximately 10,000 km and operates gas pipelines totaling 18,065 km.

In August 2006, Gazprom, E.ON Ruhrgas and Wintershall Aktiengesellschaft ( Wintershall ) signed the Final Shareholders Agreement providing for the construction of the Nord Stream pipeline (formerly the North European Gas Pipeline), which is planned to connect Vyborg on Russia's Baltic coast with Greifswald on the German Baltic coast, thereby providing an additional undersea route for the supply of Russian natural gas to Germany, as compared with the current land routes through Ukraine and Poland. The three joint venture partners have formed the Swiss company Nord Stream AG, in which Gazprom holds a 51.0 percent interest and E.ON Ruhrgas and Wintershall each hold 24.5 percent stakes. For a limited period of time, Gazprom has the option to request that Wintershall and E.ON Ruhrgas each assign up to a 4.5 percent interest in the company to an entity designated by Gazprom, which would therefore become the fourth joint venture partner. The Final Shareholders Agreement has not become formally effective yet. It is not expected that the first pipeline could be completed before 2010 at the earliest. The current estimates of E.ON Ruhrgas share of the expected cost of the complete project are in the range of approximately 1.8 billion (assuming that E.ON Ruhrgas retains a 24.5 percent stake in Nord Stream).

*Compressor Stations.* Compressor stations are used to produce the pressure necessary to transport gas through pipelines and to inject gas into underground storage facilities. E.ON Ruhrgas AG owns or co-owns 15 compressor stations, nine operating for gas transportation purposes (with a total installed capacity of 305 MW), and six for gas storage purposes (with a total installed capacity of 79 MW). German project companies in which E.ON Ruhrgas AG holds an interest own an additional 17 transport compressor stations with a total installed capacity of 591 MW and two storage compressor stations with a total installed capacity of 17 MW. In 2006, E.ON Ruhrgas AG provided monitoring and maintenance services under service contracts for the nine transport compressor stations leased out to E.ON Gastransport and 13 transport compressor stations of the project companies. E.ON Ruhrgas AG also operated, monitored and maintained its six compressor stations operating for gas storage purposes. The current installed capacity of the compressor stations monitored and maintained by E.ON Ruhrgas AG totals 907 MW.

The following table provides more information about E.ON Ruhrgas AG's and its project companies' gas compressor stations in Germany as of December 31, 2006:

Owned or Co-owned by	Compressor Stations	Compressor Units	Total Installed Capacity MW	Compressor Units	Installed Capacity of Compressor Units
				Monitored and Maintained by E.ON Ruhrgas AG	Monitored and Maintained by E.ON Ruhrgas AG
				Monitored and Maintained by E.ON Ruhrgas AG	MW

E.ON Ruhrgas AG (transportation and storage)	15	44	384	44	384
DEUDAN (PC) (transportation)	2	4	16	0	0
EGL (PC) (storage)	1	2	13	0	0
GHG Hannover (PC) (storage)	1	3	4	0	0
MEGAL (PC) (transportation)	5	19	201	19	201
METG (PC) (transportation)	2	11	131	11	131
NETG (PC) (transportation)	2	5	50	2	20
NETRA (PC) (transportation)	2	5	42	3	20
TENP (PC) (transportation)	4	15	151	15	151
Total in Germany	34	108	992	94	907

(PC) project company

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Due to the complexity of the transmission system, together with transmission rights and rights of beneficial use, as well as the number and complexity of factors influencing pipeline utilization, such as temperature, the volume of gas transported and the availability of compressor units, no meaningful data on the utilization of the transmission system is available. E.ON Ruhrgas AG had sufficient pipeline capacity in prior years and booked sufficient pipeline capacity in 2006. E.ON Ruhrgas AG believes that a shortage of pipeline capacity is not a material risk in the foreseeable future.

*Storage.* Underground gas storage facilities are generally used to balance gas supplies and heavily fluctuating demand patterns. For example, the gas sent out by E.ON Ruhrgas AG on a cold winter day is roughly four times as high as that on a hot summer day, while the flow of gas produced and purchased is much more constant. For this reason, E.ON Ruhrgas AG injects gas into storage facilities during warm weather periods and withdraws it in cold weather periods to cope with peak demand. E.ON Ruhrgas AG stores gas in large underground gas storage facilities, which are located in porous rock formations (depleted gas fields or aquifer horizons) or in salt caverns. Underground gas storage facilities consist of an underground section (cavity or porous rock and wells) and an above-ground part, namely the storage compressor station. As of the end of 2006, E.ON Ruhrgas AG owned five storage facilities, co-owned another two storage facilities and leased capacity in two storage facilities in order to meet its gas storage requirements. In addition, E.ON Ruhrgas AG had storage capacity available through two project companies in which it is a shareholder. Through these owned, co-owned, leased and project company storage facilities, a working gas storage capacity of approximately 5.2 billion m<sup>3</sup> was available to E.ON Ruhrgas AG in 2006. Due to the number and complexity of factors influencing storage utilization, particularly temperature and the terms of supply and delivery contracts, E.ON Ruhrgas does not consider data on the utilization of gas storage capacity to be meaningful. E.ON Ruhrgas AG had sufficient storage capacity available both in 2006 and in prior years and does not consider a shortage of gas storage capacity to be a material risk in the foreseeable future. However, depending on a number of factors such as future gas sent out, E.ON Ruhrgas AG's gas supply and delivery situation and further gas sales potential in European countries other than Germany, E.ON Ruhrgas AG intends to increase working gas capacity by enlarging existing storage facilities, building new facilities and by leasing additional gas storage capacity in the future. For information about risks related to the reliability of gas supplies, see also Item 3. Key Information Risk Factors. The following table provides more information about E.ON Ruhrgas AG's underground gas storage facilities, all of which are situated in Germany, as of December 31, 2006:

Underground Storage Facilities	E.ON Ruhrgas AG's Share in	E.ON Ruhrgas AG's Share in	Owned by	E.ON Ruhrgas AG's Share in	Operated by
	Working Capacity	Withdrawal Rate		or in the Project Company	
	(million m <sup>3</sup> )	(thousand m <sup>3</sup> /hour)		%	E.ON Ruhrgas AG
Bierwang(P)	1,360	1,200	E.ON Ruhrgas AG	100.0	Yes
Empelde(C)	18	47	GHG-Gasspeicher Hannover Gesellschaft mbH(PC)	13.2	
Epe(C)	1,641	2,450	E.ON Ruhrgas AG	100.0	Yes
Eschenfelden(P)	48	87	E.ON Ruhrgas AG/N-ERGIE AG	66.7	Yes

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Etzel(C)	375	987	Etzel Gas-Lager GmbH & Co. (PC)	74.8	
Hähnlein(P)	80	100	E.ON Ruhrgas AG	100.0	Yes
Krummhörn(C)(1)	0	0	E.ON Ruhrgas AG	100.0	Yes
Sandhausen(P)	15	23	E.ON Ruhrgas AG/Gasversorgung Süddeutschland GmbH	50.0	Yes
Stockstadt(P)	135	135	E.ON Ruhrgas AG	100.0	Yes
Breitbrunn(P)	992(2)	520	RWE Dea AG/ExxonMobil Gasspeicher Deutschland GmbH(3)/ E.ON Ruhrgas AG(4)	Leased(3)	Yes(4)
Inzenham-West(P)	500	300	RWE Dea AG	Leased	
Total	5,164	5,849			

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(C) salt cavern

(P) porous rock

(PC) project company

- (1) Currently out of service for repairs/adjustments.
- (2) 970 million m<sup>3</sup> was contractually guaranteed in 2005/06; 992 million m<sup>3</sup> is the current working gas capacity available to E.ON Ruhrgas AG.
- (3) Underground section.
- (4) Above ground part, particularly the storage compressor station.

In addition, the Hungarian company E.ON Földgáz Storage owns five underground gas storage facilities in Hungary with a total working gas storage capacity of about 3,500 million m<sup>3</sup>.

*Monitoring and Maintenance.* In 2006, E.ON Ruhrgas AG carried out for itself and under service contracts for E.ON Gastransport and some of the project companies E.ON Ruhrgas AG holds an interest in, monitoring and maintenance services for almost all of E.ON Ruhrgas AG's transmission system and its underground storage facilities.

Transmission system and underground storage monitoring operations are centered at E.ON Ruhrgas AG's and E.ON Gastransport's dispatching facilities in Essen. Among other tasks, the center keeps the technical infrastructure under continual surveillance, handles all reports of disturbances in the system and arranges for the necessary response to any disturbance report. In 2006, E.ON Ruhrgas AG performed this kind of system monitoring for about 12,700 km of pipelines, 23 transport compressor stations, one storage compressor station and seven underground storage facilities. Management of operations, general maintenance (including local monitoring) and troubleshooting are handled by the E.ON Ruhrgas AG field stations and facilities located along the network. E.ON Ruhrgas AG also deploys mobile units from these stations and facilities to carry out maintenance and repair work. For certain sections of pipelines, primarily those where no field station or facility is located nearby, maintenance (including local monitoring) is performed by third parties under service contracts. E.ON Ruhrgas AG's dispatching, monitoring and maintenance processes are regularly certified under International Standards Organization (ISO) 9001:2000 (quality management), ISO 14001 (environmental management), OHSAS 18001, an Occupational Health and Safety Assessment Series for health and safety management systems (work safety management), and TSM, the Technical Safety Management rules of DVGW (The German Technical and Scientific Association for Gas and Water). DVGW is a self-regulatory body for the gas and water industries, its technical rules serving as a basis for ensuring safety and reliability of German gas and water supplies.

*E.ON Gastransport.* On January 1, 2004, E.ON Ruhrgas transferred its gas transmission business to a new subsidiary, E.ON Ruhrgas Transport, which in mid-2006 was rebranded as E.ON Gastransport. E.ON Gastransport has sole responsibility for the gas transmission business and functions independently of E.ON Ruhrgas's sales business, which is a customer of E.ON Gastransport. As the transmission system operator, E.ON Gastransport operates, maintains and develops the E.ON Ruhrgas AG transmission system. It handles all major functions needed for an independent gas transmission business: transmission management (including commercial transport and hub operations), transportation contracts (including access fees), shipper relations, capacity planning and allocation, controlling and billing. E.ON Gastransport obtains certain support services from E.ON Ruhrgas AG under service agreements. On November 1, 2004, E.ON Ruhrgas Transport introduced an entry/exit system called ENTRIX for access to the E.ON Ruhrgas AG



gas transmission system as a result of an agreement reached with the Competition Directorate-General of the European Commission with respect to a matter that had been pending before the Competition Directorate. ENTRIX enables customers to book entry and exit capacities for the transmission of gas separately, in different amounts and at different times. Booked capacities can be transferred at short notice and combined with capacities of other customers of E.ON Gastransport. The fee structure is simple and applies to four market areas into which the transmission system of E.ON Ruhrgas AG has been divided. The level of transmission fees is determined by reference to European markets and pipeline and transport competition in Germany. Customers also benefit from the introduction of local exit zones within which they can use capacities flexibly.

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In order to comply with requirements of the Energy Law of 2005 (described in *Regulatory Environment*), further improvements of the E.ON Gastransport entry/exit system (now called ENTRIX 2) were launched in February 2006, giving customers more flexible services and making it possible to book freely allocable capacities online. The refined, web-based user interface of ENTRIX 2 contains all customer-relevant information on network access. Screen-based communication has been extended and simplified, serving as a user-friendly interface for all requests. A major refinement of ENTRIX 2 is the possibility to freely allocate entry and exit capacities to each other within the four market areas of the E.ON Ruhrgas AG transmission network, so that capacities that are separately booked can be interlinked without any further case-by-case examination. An additional significant improvement is the replacement of cubic meters per hour as booking unit with kWh per hour, which makes transmission handling easier for customers.

In order to comply with the new gas network access requirements of Germany's Energy Law of 2005, the gas industry negotiated and signed an agreement regarding cooperation between operators of gas supply networks located in Germany which contains principles for the cooperation of the network operators and standard terms and conditions for access to networks. The agreement uses one network access model with different market areas. Within each market area, which each include a number of network subsections, shippers are entitled to choose the following contractual alternatives for gas transportation: 1) transmission over different networks from an entry point to an exit point at the end consumer or 2) transmission from an entry point to an exit point within a network subsection (the so-called *city gate* alternative). E.ON Gastransport adjusted its entry/exit system in view of the cooperation agreement in October 2006, the date that the new network access model took effect.

Following the development of the gas industry cooperation agreement, a single gas trader and a German energy association filed claims against three network operators (including E.ON Hanse) which challenged the use of the city gate alternative. In November 2006, the German energy regulator decided that this contractual alternative does not comply with the Energy Law of 2005, thus necessitating changes to the existing gas network operators' cooperation agreement as well as amendments of E.ON Gastransport's existing transmission contracts. E.ON Gastransport has already implemented all necessary changes ahead of the October 1, 2007 deadline. For more information, see *Regulatory Environment - Germany: Gas*.

From October 2007, E.ON Gastransport will only have two market areas: one for high-calorific gas (H-gas) and one for low-calorific gas (L-gas). By taking this step, E.ON Gastransport is seeking to improve its competitive position on the gas market by trying to create a nationwide market area uniting large quantities of gas from all of Germany's major international sources. E.ON Gastransport expects its nationwide market area to be highly liquid and particularly attractive for shippers and gas traders.

In September 2005, E.ON Ruhrgas Transport received certification for all of its operations under ISO 9001:2000, ISO 14001 and OHSAS 18001, and in December 2005 received certification under TSM, all of which were confirmed by a reaudit in 2006.

***Sales***

*Germany.* E.ON Ruhrgas was the largest distributor of natural gas in Germany in 2006, selling a total volume of 549 billion kWh of gas. E.ON Ruhrgas also sold 160.3 billion kWh of gas outside of Germany in 2006.

E.ON Ruhrgas sells gas to supraregional and regional distributors, municipal utilities and industrial customers. Customers are concentrated in the western and southern parts of Germany and the areas around Berlin and Bremen, although E.ON Ruhrgas potentially serves customers throughout Germany. The following table sets forth information on the sale of gas by E.ON Ruhrgas' sales business in Germany for the periods presented:

<b>Sale of Gas to:</b>	<b>Total 2006 billion kWh</b>	<b>%</b>	<b>Total 2005 billion kWh</b>	<b>%</b>
Distributors	318.7	58.0	323.7	58.3
Municipal utilities	163.1	29.7	160.9	29.0
Industrial customers	67.6	12.3	70.4	12.7
Total	549.4	100.0	555.0	100.0

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In the table above, sales volumes are presented for all periods excluding relatively minimal amounts of gas that E.ON Ruhrgas does not consider part of its primary sales business, including volumes handled for third parties. In addition, these gas volumes do not include gas volumes attributable to ERI or Thüga.

In January 2006, the German Federal Cartel Office issued a decision prohibiting E.ON Ruhrgas from enforcing its existing long-term gas sales contracts with municipal utilities after October 1, 2006 and from entering into new sales contracts with those customers that are identical or similar in nature. In justifying its decision, the Federal Cartel Office contended that the longer-term sales contracts violate German and European competition law and lead to market foreclosure as they involve long-term customer commitment and typically account for a large share of municipal utilities' gas requirements. Accordingly, the Federal Cartel Office ruled that sales contracts that account for more than 80 percent of any such customer's requirements may have a maximum duration of two years, contracts that account for more than 50 percent and up to 80 percent of any such customer's requirements may have a maximum duration of four years and contracts that account for up to 50 percent of any such customer's requirements may have longer durations. In addition, the so-called ban on participation in competition is to apply: if it already meets part of any such customer's requirements, E.ON Ruhrgas is excluded from supplying any additional volume if it would exceed the percentage and duration criteria described above, even temporarily.

E.ON Ruhrgas unsuccessfully sought temporary relief in a summary proceeding in order to prevent the decision from taking immediate effect. Consequently, E.ON Ruhrgas has had to terminate, as of September 30, 2006, the contracts with municipal utilities that are covered by the Federal Cartel Office decision. E.ON Ruhrgas is currently challenging the Federal Cartel Office's decision in a full proceeding before the State Superior Court in Düsseldorf, which is expected to last through 2007. In the mean time, E.ON Ruhrgas has concluded new contracts having a duration of only 1 or 2 years with virtually all of the municipal utilities whose prior contracts it has been required to cancel. See also Item 3. Key Information Risk Factors.

As described in E.ON Gastransport above, Germany's energy regulator has decided that a form of gas network access contract widely used by the gas industry does not comply with Germany's Energy Law of 2005, and E.ON Gastransport has therefore amended its existing gas transmission contracts accordingly. This decision also requires that E.ON Ruhrgas amend its gas sales contracts, and E.ON Ruhrgas has also made all necessary changes ahead of the October 1, 2007 deadline.

Price terms in all types of sales contracts are generally pegged to the price of competing fuels, primarily gas oil or heavy fuel oil, and provide for automatic quarterly price adjustments based on fluctuations in underlying fuel prices. In addition, medium- and long-term contracts, with terms of over two years, usually contain clauses which enable the parties to review prices and price formulas at regular intervals (usually every one to four years) and to negotiate adjustments in accordance with changed market conditions. Contracts for industrial customers generally provide for some form of take or pay obligation, usually in an amount of 50 to 90 percent of the overall annual contract volume. Contracts with distributors and municipal utilities generally do not include fixed take or pay provisions.

In 2006, the selling prices of E.ON Ruhrgas generally tracked the higher level of heating oil prices with a time lag. In the course of the year, heating oil prices initially rose, but then dropped from September onwards. Due to the time lag, those decreases will not be reflected in the selling prices of E.ON Ruhrgas until 2007.

Gas prices in Germany are also affected by applicable taxes on fossil fuels. In Germany, customers in the commercial/residential sector pay gas prices that include at least 0.67 cent/kWh in duties and taxes, while industrial customers pay up to 0.47 cent/kWh in duties and taxes.

*International.* In 2006, E.ON Ruhrgas delivered 160.3 billion kWh of gas to customers in other European countries, or 22.6 percent of the total volume of gas sold by E.ON Ruhrgas, compared with 135.2 billion kWh or 19.6 percent in

2005. The destinations for E.ON Ruhrgas' external sales are the United Kingdom, Switzerland, the Benelux countries, Austria, France, Hungary, Italy, Sweden, Denmark, Poland and Liechtenstein. The 18.6 percent increase in international sales in 2006 was largely attributable to short-term trading transactions in the United Kingdom, increased sales in France and Denmark and a long-term supply contract with E.ON Sverige (which started in October 2005). Limitations on available gas transportation capacity due to the obligation imposed on E.ON Ruhrgas by Germany's energy regulator to keep transport and export capacity available at all times for

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customers of E.ON Ruhrgas gas release program (described in History and Development of the Company Ruhrgas Acquisition ) restricted E.ON Ruhrgas ability to expand its international sales business to certain countries in 2006.

***Downstream Shareholdings***

E.ON Ruhrgas owns numerous shareholdings in integrated gas companies, gas distribution companies and municipal utilities through its subsidiaries ERI and Thüga.

ERI holds both majority and minority shareholdings in European and German energy companies, while Thüga holds primarily minority shareholdings in 93 regional and municipal utilities in Germany. In addition, Thüga s main international shareholdings, most of which are held through its wholly-owned Italian subsidiary Thüga Italia S.r.l. ( Thüga Italia ), consist of interests in a number of Italian energy companies.

**ERI:** As of December 31, 2006, ERI s portfolio of shareholdings included stakes in three domestic and 22 foreign companies. In 2006, ERI (including its fully consolidated shareholdings) contributed sales of 3.7 billion (approximately 16.1 percent of E.ON Ruhrgas total sales, excluding natural gas and electricity taxes) and had sales volumes of 152.0 billion kWh in 2006 (2005: 46.5 billion kWh).

In March 2006, ERI acquired 100 percent of the gas trading and gas storage businesses of the Hungarian oil and gas company MOL. In June, the gas trading company was renamed E.ON Földgáz Trade and the storage company was renamed E.ON Földgáz Storage. At the end of October, ERI acquired MOL s 50.0 percent interest in the gas importer Panrusgáz. For details, see Overview.

*Germany.* As of December 31, 2006, ERI held interests in the following regional gas distribution companies in Germany:

<b>Shareholding</b>	<b>Share held by ERI %</b>
Ferngas Nordbayern GmbH(1)	53.10
Gas-Union GmbH(1)	25.93
Saar Ferngas AG(1)	20.00

(1) Interest held via ERI s wholly-owned subsidiary RGE Holding GmbH.

These companies are also customers of E.ON Ruhrgas. Other German gas companies also hold interests in certain of these companies.

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*International.* As of December 31, 2006, ERI held interests in the following companies in countries outside of Germany, primarily in central Europe and the Nordic region:

<b>Shareholding</b>	<b>Share held by ERI %</b>
Gasnor AS, Norway	14.00
Nova Naturgas AB, Sweden	29.59
Gasum Oy, Finland	20.00
AS Eesti Gaas, Estonia	33.66
JSC Latvijas Gaze, Latvia	47.23
AB Lietuvos Dujos, Lithuania	38.91
Rytu Skirstomieje Tinklai, Lithuania	20.28
Mazeikiu Elektrine, Lithuania	10.90
Inwestycyjna Spółka Energetyczna Sp.z o.o. (IRB), Poland	50.00
Szczecińska Energetyka Ciepła Sp.z o.o. (SECS), Poland(1)	32.92
EUROPGAS a.s., Czech Republic(2)	50.00
E.ON Földgáz Trade ZRT, Hungary	100.00
E.ON Földgáz Storage ZRT, Hungary	100.00
Panrusgáz Zrt., Hungary	50.00
Colonia-Cluj-Napoca-Energie S.R.L. (CCNE), Romania	33.33
E.ON Ruhrgas Mittel- und Osteuropa GmbH(3)	100.00
Nafta a.s., Slovakia	40.45
S.C. Congaz S.A., Romania	28.59
E.ON Servicii Romania S.R.L., Romania	50.00
Ekopur d.o.o., Slovenia(4)	100.00
SOTEG Société de Transport de Gaz S.A., Luxembourg	20.00
Holdigaz SA, Switzerland	2.21

(1) The shareholding in this company is expected to be transferred to E.DIS energia sp.z o.o. of the Central Europe market unit in 2007.

(2) EUROPGAS a.s. holds 50.0 percent of SPP Bohemia a.s. and 48.18 percent of Moravské naftové doly a.s. (MND) in the Czech Republic.

(3) E.ON Ruhrgas Mittel- und Osteuropa GmbH has an indirect interest of 24.50 percent in SPP, Slovakia.

(4) Ekopur d.o.o. holds 6.52 percent of Geoplin d.o.o. in Slovenia.

As with its German shareholdings, ERI holds some stakes in companies which are customers of E.ON Ruhrgas.

**Thüga:** Thüga holds primarily minority shareholdings in 93 regional and municipal utilities in Germany. In addition, Thüga's main international shareholdings, most of which are held through its wholly-owned Italian subsidiary Thüga Italia, consist of interests in a number of Italian energy companies. In 2006, Thüga Italia acquired through its subsidiaries mainly majority interests in seven additional Italian energy companies that are primarily active in gas sales. Through its majority and minority shareholdings in Italian gas distribution and sales companies, Thüga supplied natural gas to approximately 880,000 end customers in Italy by the end of 2006, primarily in the regions of Lombardy,

Emilia Romagna, Veneto, Friuli-Venezia Giulia and Piedmont.

With respect to its minority shareholdings, Thüga is an active shareholder, offering operational competence as well as other services. In 2006, Thüga contributed sales of 1.1 billion (approximately 4.7 percent of E.ON Ruhrgas' total sales, excluding natural gas and electricity taxes). Thüga increased its gas sales volumes by



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2.3 percent to 23.1 billion kWh in 2006 from 22.5 billion kWh in 2005, primarily as a result of first consolidation effects by Thüga Italia.

In December 2006, Thüga agreed with EnBW to sell its 76.5 percent shareholding in GSW Gasversorgung Sachsen Ost Wärmeservice GmbH & Co. KG ( GSW Wärmeservice ), its 76.5 percent shareholding in GSW Gasversorgung Sachsen Ost Wärmeservice Verwaltungsgesellschaft mbH ( GSW Verwaltungsgesellschaft ), its 14.5 percent shareholding in EnSO Energie Sachsen Ost GmbH ( EnSO ) and its 28.0 percent shareholding in Erdgas Südwest GmbH ( Erdgas Südwest ) to EnBW group companies. The transfer of the shareholdings is expected to take place in the first half of 2007.

As of December 31, 2006, E.ON Ruhrgas Thüga Holding GmbH held 81.1 percent of Thüga and E.ON Energie, through its subsidiary CONTIGAS Deutsche Energie-Aktiengesellschaft ( Contigas ), held the remaining 18.9 percent. In January 2007, E.ON Energie transferred the remaining 18.9 percent to E.ON Ruhrgas Thüga Holding GmbH.

*Germany.* As of December 31, 2006, Thüga held interests in operating companies which are primarily municipal utilities. The top ten shareholdings in terms of total sales in 2005 are as follows:

<b>Shareholding</b>	<b>Share held by Thüga %</b>
Stadtwerke Hannover Aktiengesellschaft	24.00
N-ERGIE Aktiengesellschaft	39.80
Mainova Aktiengesellschaft	24.44
Gasag Berliner Gaswerke Aktiengesellschaft	36.85
badenova AG & Co. KG	47.30
HEAG Südhessische Energie AG (HSE)	40.01
DREWAG-Stadtwerke Dresden GmbH	10.00
Erdgas Südbayern GmbH	50.00
Stadtwerke Duisburg AG	20.00
Stadtwerke Karlsruhe GmbH	10.00

*International.* As of December 31, 2006, Thüga held, through its subsidiary Thüga Italia, mainly the following shareholdings in privately owned gas distribution and sales companies as well as in one municipal utility in Italy:

<b>Shareholding</b>	<b>Share held by Thüga %</b>
E.ON Vendita S.r.l	100.00
Thüga Laghi S.r.l	100.00
Thüga Mediterranea S.r.l	100.00
Thüga Orobica S.r.l	100.00
Thüga Padana S.r.l	100.00
Thüga Triveneto S.r.l	100.00
G.E.I. S.p.A.	48.94
AMGA Azienda Multiservizi S.p.A	21.60

***Competitive Environment***

Along with oil and lignite/hard coal, natural gas is one of the three primary sources of energy used in Germany. Gas is currently used for a little more than 23 percent of Germany's energy consumption, and satisfies about a third of the energy demand of the German industrial and commercial/residential sectors. Competing sources of energy include electricity and coal in all sectors, gas oil and district heating in the commercial/residential sector and gas oil and heavy fuel oil in the industrial sector. Natural gas is also used, but on a limited basis, as an energy source for

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power stations. Since the 1970s, natural gas has made particular gains in the residential space heating market, where it is marketed as a modern and environmentally-friendly energy source for heating homes. At year-end 2006, approximately 48 percent of German homes were heated using gas, making gas the leading energy source for this market. In 2006, gas was chosen as the heating method for approximately 67 percent of new homes under construction. Although renewable energies are increasingly popular, natural gas was able to defend its leading position in the heating market.

Within the German gas market, E.ON Ruhrgas competes with domestic and foreign gas companies, the gas subsidiaries of oil producers and pure trading companies. Major domestic competitors include RWE Energy, Verbundnetz Gas AG ( VNG ) and Wingas. Foreign competitors include Gaz de France, Econgaz, Essent and Nuon. E.ON Ruhrgas currently enjoys a strong market position, supplying approximately 49 percent of all gas consumed in Germany in 2006. Nevertheless, E.ON Ruhrgas considers competition in the German gas market to be vigorous, with both new and established competitors vying for the business of E.ON Ruhrgas direct and indirect customers. E.ON Ruhrgas believes it was able to successfully compete in 2006 by remaining flexible in its contract and price negotiations and by offering attractive terms and services to its established and potential customers. In the future it is expected that the new network access model described above in Transmission and Storage E.ON Gastransport will lead to further intensification of competition.

For information about the debate on long-term gas sales contracts, which the Federal Cartel Office considers to be an obstacle to competition, as well as information about gas price trends in 2006, see Sales above. For information about regulatory developments which are affecting or may affect competition in the German gas market, see Regulatory Environment and Item 3. Key Information Risk Factors, which also includes information on investigations of gas prices charged by some German utilities, including utilities in which E.ON Ruhrgas and E.ON Energie hold interests.

Outside Germany, the gas markets in which E.ON Ruhrgas operates are also subject to strong competition. The Company cannot guarantee it will be able to compete successfully in the gas markets in which it is already present or in new gas markets E.ON Ruhrgas may enter.

**U.K.*****Overview***

E.ON UK is one of the leading integrated electricity and gas companies in the United Kingdom. It was formed as one of the four successor companies to the former Central Electricity Generating Board as part of the privatization of the electricity industry in the United Kingdom in 1989. E.ON UK and its associated companies are actively involved in electricity generation, distribution, retail and trading. As of December 31, 2006, E.ON UK owned or through joint ventures had an attributable interest in 10,547 MW of generation capacity, including 359 MW of CHP plants and 233 MW of operational wind and hydroelectric generation capacity. E.ON UK served approximately 8.4 million electricity and gas customer accounts at December 31, 2006 and its Central Networks business served 4.9 million customer connections. The U.K. market unit recorded sales of 12.6 billion in 2006 and adjusted EBIT of 1.2 billion.

***Operations***

In the United Kingdom, electricity generated at power stations is delivered to consumers through an integrated transmission and distribution system. For information about the principal segments of the electricity industry, see Central Europe Operations. All electricity transmission in Great Britain is operated by National Grid Transco plc ( National Grid ).

E.ON UK operates significant wholesale and retail gas and electricity businesses and engages in gas and electricity trading. The company served approximately 8.4 million customer accounts at December 31, 2006, including approximately 5.5 million electricity customer accounts and 2.8 million gas customer accounts. With effect from March 2007, E.ON UK plans to exit the telecommunications business, which currently has 0.1 million fixed line telephone customer accounts. E.ON UK's Central Networks distribution business served 4.9 million customer connections as of the end of 2006.

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The U.K. market unit comprises the non-regulated business, including energy wholesale (generation and energy trading), retail and energy services, the regulated distribution business, and other activities, such as certain non-distribution assets and the E.ON UK corporate center. In 2006, electricity accounted for approximately 64 percent of E.ON UK's sales, gas revenues accounted for approximately 36 percent and other activities accounted for less than 1 percent.

The following table sets forth the sources and sales channels of electric power in E.ON UK's operations during each of 2006 and 2005:

<b>Sources of Power</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>	<b>% Change</b>
Own production(1)	35,866	37,255	-3.7
Purchased power from power stations in which E.ON UK has an interest of 50 percent or less	731	627	+16.6
Power purchased from other suppliers(2)	38,131	39,224	-2.8
Power used for operating purposes, network losses and pump storage	(971)	(2,114)	-54.1
Net power supplied(3)	73,757	74,992	-1.6
<b>Sales of Power</b>			
Mass market sales (residential customers and small and medium sized enterprises)	37,893	37,314	+1.6
Industrial and commercial sales(4)	18,371	22,301	-17.6
Market sales(2)	17,493	15,377	+13.8
Net power sold(3)	73,757	74,992	-1.6

(1) The decrease in own production in 2006 was primarily attributable to an unplanned outage at Ratcliffe power station following an industrial accident.

(2) The decline in power purchased from other suppliers and increase in market sales in 2006 compared with 2005 primarily reflected lower sales to industrial and commercial customers.

(3) Excluding proprietary trading volumes. For information on proprietary trading volumes, see Non-regulated Business Energy Wholesale Energy Trading.

(4) During 2006, the industrial and commercial sales business continued to focus on securing profitable customers, which resulted in lower sales volumes compared with 2005.

The following table sets forth the sources and sales channels of gas in E.ON UK's operations during each of the periods presented:

<b>Sources of Gas</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>	<b>% Change</b>
Long-term gas supply contracts(1)	42,918	48,431	-11.4
Market purchases(2)	151,064	134,041	+12.7
<b>Total gas supplied(3)</b>	<b>193,982</b>	<b>182,472</b>	<b>+6.3</b>
<b>Sales and Use of Gas</b>			
Gas used for own generation(4)	38,632	40,318	-4.2
Sales to industrial and commercial customers(5)	28,663	32,590	-12.0
Sales to retail mass market customers(6)	63,888	67,671	-5.6
Market sales(7)	62,799	41,893	+49.9
<b>Total gas used and sold(3)</b>	<b>193,982</b>	<b>182,472</b>	<b>+6.3</b>

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- (1) The reduction in the volume of gas purchased under long-term gas supply contracts in 2006 was primarily the result of the unavailability of gas due to be delivered under certain contracts.
- (2) The increase in the volume of market gas purchases was attributable to the decline in supply contract volumes as well as an increase in activities to optimize E.ON UK's gas position.
- (3) Excluding proprietary trading volumes. For information on proprietary trading volumes, see Non-regulated Business Energy Wholesale Energy Trading.
- (4) Differences in relative margins made gas-fired generation less attractive compared to coal-fired generation, with a resulting reduction in gas used for own generation.
- (5) During 2006, the industrial and commercial sales business continued to focus on securing profitable customers, which resulted in lower sales volume in 2006 compared with 2005.
- (6) Mass market sales were lower in 2006 due to slightly warmer weather and changes in consumer behaviour.
- (7) Market sales in 2006 were higher than in 2005, reflecting both the decline in demand by retail customers (which freed volumes for market sales) and increased product optimization.

***Market Environment***

E.ON UK primarily operates in the electricity generation, electricity and gas trading and the electricity and gas retail energy markets in Great Britain (England, Wales and Scotland) and in the market for electricity distribution in England.

*Electricity.* Demand for electricity in the United Kingdom has been relatively stable in recent years. In the near term, E.ON UK expects electricity demand in the United Kingdom to grow by an average of approximately 1 percent per annum under normal weather conditions.

The principal commercial features of the electricity industry in the United Kingdom in recent years have been increasing competition in supply through a principle of open access to the transmission and distribution systems. Suppliers are free to compete with each other in supplying electricity to consumers anywhere within England, Wales and Scotland. All electricity supply (retail) and distribution activities were separated in Great Britain in 2001, splitting the market into a liberalized supply sector and a regulated network distribution sector.

On April 1, 2005, a new set of rules known as the British Electricity Trading and Transmission Arrangements (BETTA) was introduced in England, Wales and Scotland. This extended the existing NETA arrangements in force in England and Wales to Scotland, providing a market-based framework for electricity trading and wholesale sales, as well as a method of settling trading imbalances and a mechanism for maintaining the stability of the network. Trading activities are characterized by bilateral contracts for the purchase and sale of bulk power and are carried out both on exchanges and over the counter. The Office of Gas and Electricity Markets ( Ofgem ) is responsible for regulatory oversight of BETTA.

E.ON UK believes that it is able to compete more effectively in Scotland following BETTA's introduction which represents approximately 10 percent of the electricity market in Great Britain as a whole.

The combined pressure of overcapacity, an increasingly fragmented generation market and the introduction of NETA led to significant downward pressure on wholesale electricity prices in the period from 1999 through 2002, creating difficult trading conditions for many companies. The largest electricity generator in the United Kingdom, British Energy, required a government loan to continue operating and a number of generators were placed into administration.

Since April 2003, increasing generation fuel costs, security of supply concerns and expected future environmental costs (including the introduction of CO<sub>2</sub> emission certificates) have combined to push up wholesale electricity prices for forward delivery substantially. In response to these increases in wholesale prices, U.K. suppliers, including E.ON UK, increased their retail electricity prices a number of times during 2006, as explained in more detail in Retail below. However, the fourth quarter of 2006 was marked by significant declines in wholesale power prices on the back of falling gas prices. Baseload prices on forward markets for 2007 delivery decreased from approximately GBP53 per MWh in January 2006 to GBP35 per MWh in December 2006. Short-term electricity prices again exhibited significant volatility during 2006 due mainly to volatile fuel input prices.



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*Natural Gas.* Wholesale gas prices in the United Kingdom continued to be volatile during 2006, driven by higher oil prices and supply and demand imbalances in the United Kingdom and continental Europe. Within day prices spiked up to 255 pence per therm in March 2006. However, prices in the fourth quarter of 2006 decreased significantly, mainly due to warm weather and the successful commissioning of two new gas pipelines, Langed and BBL pipeline. Annual prices on forward markets for 2007 delivery decreased from approximately 62 pence per therm in January 2006 to 33 pence per therm in December 2006. Although E.ON UK purchases gas on both U.K. and international trading markets, management partially mitigated these price increases by secured forward purchases to cover most of its requirements in 2006, switched fuel sources used by certain of its generating assets and increased retail prices. As noted above, E.ON UK and all of its main competitors increased retail customer prices during 2006.

*Competition.* E.ON UK's exposure to wholesale electricity prices in the United Kingdom is partially hedged by the balance provided by its retail business. The retail energy market in the United Kingdom has consolidated over the last few years into six major competitors. Based on data from Datamonitor, Centrica, previously the monopoly gas supplier branded as British Gas, is currently the market leader in terms of size in both gas and electricity with approximately 16.7 million customer accounts. E.ON UK is the second largest energy retailer with approximately 8.4 million accounts, followed by Scottish and Southern Electricity with approximately 7.5 million accounts. The market is characterized by substantial levels of customers switching suppliers in any given year; approximately half of the customers in Great Britain have now switched either their gas or electricity supplier since market liberalization. Churn levels, which measure the percentage of customers switching suppliers, fell generally from 2002 through 2005 as the market matured, before increasing in 2006 in the context of significant price increases. This resulted in E.ON UK's annual churn rate increasing from 14.7 percent in 2005 to 15.4 percent in 2006.

In February 2007, E.ON UK announced that retail energy prices would be reduced as a result of decreasing wholesale energy prices, confirming E.ON UK's stated intent to provide value to its customers.

*Impact of Environmental Measures.* The ongoing implementation of environmental legislation is expected to have a significant impact on the energy market in the United Kingdom in coming years. In response, E.ON UK is increasing its production of electricity from renewable sources, as described in more detail below. Environmental measures of particular importance include:

The U.K.'s renewables obligation required electricity retailers to source an increasing amount of the electricity they supply to retail customers from renewable sources. Under the current regime, for the period from April 1, 2006 until March 31, 2007, the renewables obligation is equal to 6.7 percent, rising to a figure of 15.4 percent by 2015/2016. The U.K. government is currently consulting on options to potentially extend targets to a maximum of 20 percent by 2020. The requirement applies to all retail sales over a twelve-month period beginning on April 1 of each year, and Renewables Obligation Certificates ( ROCs ) are issued to generators as evidence of qualified sourcing. ROCs are tradeable, and retailers who fail to present Ofgem with ROCs representing the full amount of their renewables obligation are required to make a balancing payment in the amount of any shortfall into a buy-out fund. Receipts from the buy-out fund are re-distributed to holders of ROCs.

The United Kingdom implemented the EU Emissions Trading Directive at the beginning of 2005. The scheme requires companies to have CO<sub>2</sub> emission certificates in an amount equal to the CO<sub>2</sub> emissions made by their fossil fuel-fired power plants with a thermal input of more than 20 MW. During 2005, the U.K. government made an initial allocation of certificates for the first phase of the scheme (2005 to 2007) to owners of generating facilities, with the total number of certificates being issued equal to less than 90 percent of emissions levels in recent years. As a result, E.ON UK bought 9.7 million tons of additional CO<sub>2</sub> emission certificates in 2006, of which 4.7 million tons were utilized in 2006.

The application in the United Kingdom of the EU Large Combustion Plant Directive prevents coal- and oil-powered generation facilities that have not been fitted with specified sulphur oxide and oxides of nitrogen and particulate matter reduction measures from operating for more than a total of 20,000 hours starting in 2008.

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Further information on the emissions allowance trading scheme and the Large Combustion Plant Directive is given in Regulatory Environment and Environmental Matters.

**Non-regulated Business*****Energy Wholesale***

During 2004, E.ON UK's power generation and energy trading businesses were merged into a single business called Energy Wholesale. This change was designed to provide a greater strategic focus in the management of E.ON UK's generation and trading activities and reinforce the close operational ties between the two businesses. For example, the energy trading business is responsible for purchasing the fuel burned in power stations that are managed by the generation business. The energy trading business also decides whether E.ON UK should generate or purchase electricity to cover its retail obligations, depending upon the prevailing market price of electricity. However, for the purpose of describing the business activities of E.ON UK the two businesses are described separately since they each cover distinct areas of activity.

***Power Generation***

E.ON UK focuses on maintaining a low cost, efficient and flexible electricity generation business in order to compete effectively in the wholesale electricity market. As of December 31, 2006, E.ON UK owned either wholly, or through joint ventures, power stations in the United Kingdom with an attributable registered generating capacity of 10,547 MW, including 359 MW of CHP plants and 50 MW of hydroelectric plant, while its attributable portfolio of operational wind capacity stood at 183 MW. E.ON UK's share of the generation market in Great Britain remained relatively stable in 2006, at approximately 10 percent.

E.ON UK generates electricity from a diverse portfolio of fuel sources. In 2006, approximately 61 percent of E.ON UK's electricity output was fuelled by coal and approximately 37 percent by gas, of which approximately two percent was from CHP schemes, with the remaining two percent being generated from hydroelectric, wind and oil-fired plants. E.ON UK is continuing its effort to secure a balanced and diverse portfolio of fuel sources, giving it the flexibility to respond to market conditions and to minimize costs. E.ON UK also regularly monitors the economic status of its plant in order to respond to changes in market conditions.

The following table sets forth details about E.ON UK's electric power generation facilities in the United Kingdom, including their total capacity, the stake held by E.ON UK and the capacity attributable to E.ON UK for each facility as of December 31, 2006, as well as their start-up dates:

**E.ON UK ELECTRIC POWER STATIONS**

<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>E.ON UK's Share Attributable Capacity %</b>	<b>Start-up Date</b>
<b>Hard Coal</b>			
Ironbridge U1(1)	485	100.0	1970
Ironbridge U2(1)	485	100.0	1970
Kingsnorth U1(1)	485	100.0	1970

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Kingsnorth U2(1)	485	100.0	485	1971
Kingsnorth U3(1)	485	100.0	485	1972
Kingsnorth U4(1)	485	100.0	485	1973
Ratcliffe U1(1)(2)	500	100.0	500	1968
Ratcliffe U2(1)(2)	500	100.0	500	1969
Ratcliffe U3(1)(2)	500	100.0	500	1969
Ratcliffe U4(1)(2)	500	100.0	500	1970
Total	4,910		4,910	

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<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>E.ON UK's Share %</b>	<b>Attributable Capacity MW</b>	<b>Start-up Date</b>
<b>Natural Gas</b>				
Cottam Development Centre (CDC) Module	400	100.0	400	1999
Connahs Quay U1	345	100.0	345	1996
Connahs Quay U2	345	100.0	345	1996
Connahs Quay U3	345	100.0	345	1996
Connahs Quay U4	345	100.0	345	1996
Corby Module	401	50.0	200	1993
Enfield	392	100.0	392	2002
Killingholme Mod 1	450	100.0	450	1992
Killingholme Mod 2	450	100.0	450	1993
Merchant CHP(3)	218	100.0	218	various
<b>Total</b>	<b>3,691</b>		<b>3,490</b>	
<b>Oil</b>				
Grain U1	650	100.0	650	1982
Grain U4	650	100.0	650	1984
<b>Total</b>	<b>1,300</b>		<b>1,300</b>	
<b>Other (including hydroelectric and wind farms)</b>				
Grain Aux GT1	28	100.0	28	1979
Grain Aux GT4	27	100.0	27	1980
Kingsnorth Aux GT1	17	100.0	17	1967
Kingsnorth Aux GT4	17	100.0	17	1968
Ratcliffe Aux GT2	17	100.0	17	1967
Ratcliffe Aux GT4	17	100.0	17	1968
Taylor's Lane GT2	68	100.0	68	1981
Taylor's Lane GT3	64	100.0	64	1979
Hydroelectric	50	100.0	50	1962
Wind farms	197	various	183	various
<b>Total</b>	<b>502</b>		<b>488</b>	
<b>CHP schemes(3)</b>	<b>359</b>	<b>100.0</b>	<b>359</b>	<b>various</b>
<b>Total Capacity</b>	<b>10,762</b>		<b>10,547</b>	

(1) Biomass material co-fired during 2006.

(2)

In May 2006, after a successful 18-month trial, Ratcliffe-on-Soar power station was granted the necessary authorization to allow the co-firing of petroleum coke with coal at all four units.

- (3) The decrease in CHP capacity from 577 MW in 2005 to 359 MW in 2006 reflects the reclassification of merchant CHP plants as natural gas plants, as merchant CHP plants have no agreements with associated clients whereby the client agrees to take the power and steam.

E.ON UK divested Edenderry Power Limited and Edenderry Power Operations Ltd. (together, Edenderry ), which operates a 120 MW peat-fired plant in the Republic of Ireland, to Bord na Mona plc in December 2006. E.ON UK also owns a minority interest in a company that operates a gas-fired power plant in Turkey (see Midlands Electricity Non-Distribution Assets below).

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E.ON UK is planning significant investments to improve its generation capacity. This is partly to replace capacity which will be taken out of production in coming years due to applicable environmental regulations. In particular, in 2007 E.ON UK plans to commence construction of a 1,200 MW gas-fired station at its Isle of Grain site in Kent. The existing oil-fired station will be retained, while the new technology is expected to create one of the most efficient power stations in the United Kingdom. A planning application has also been submitted for the construction of two new highly efficient coal units at the Kingsnorth power station site in Kent, with the commencement of construction targeted for 2008 and production by 2013.

*Nuclear.* E.ON UK does not operate any nuclear power plants.

*Renewable Energy.* E.ON UK plans to grow its renewable electricity generation business in response to the U.K. regulatory initiatives summarized above. E.ON UK's wind generation projects are developed by E.ON UK Renewables Holdings Limited. E.ON UK is already one of the leading developers and owner/operators of wind farms in the United Kingdom, with interests in 20 operational onshore and offshore wind farms with total capacity of 197 MW, of which 183 MW is attributable to E.ON UK.

During 2004, E.ON UK completed construction of a large offshore wind farm site with a capacity of approximately 60 MW at Scroby Sands off the coast of East Anglia. The Scroby Sands project builds on E.ON UK's success in commissioning the U.K.'s first offshore wind farm at Blyth during 2001. Potential onshore and offshore projects with an aggregate capacity of approximately 1,139 MW are now in the development phase (compared with 1,100 MW in the development phase in 2005). E.ON UK started construction in the fourth quarter of 2006 of an 18 MW onshore wind farm in Cambridgeshire called Stags Holt, which is expected to become operational by the third quarter of 2007.

In December 2006, E.ON UK received final approval for the construction of the Robin Rigg offshore wind farm in the Solway Firth on the northeast coast of England. Due for completion in spring 2009, the 180 MW wind farm is expected to be the United Kingdom's largest offshore wind farm to date, with plans for 60 turbines, each with a capacity of 3 MW. In terms of generating capacity, Robin Rigg is expected to be twice the size of the United Kingdom's current largest offshore wind power scheme, and three times the size of E.ON UK's existing Scroby Sands wind farm.

In addition to the planned expansion of its wind farm portfolio, E.ON UK increased its generation from biomass in 2006 by co-firing with coal at the Kingsnorth, Ironbridge and Ratcliffe power stations, generating a total of 286 GWh of renewable energy by this method during the year. During 2006 work also continued on the construction of a 44 MW wood-burning plant at Steven's Croft, near Lockerbie in southwest Scotland, which when built is expected to be the United Kingdom's largest dedicated biomass plant. Commercial operation of the plant is scheduled to commence in December 2007.

During 2007, E.ON UK expects to continue to develop its capability in marine generation (using tidal power) to position itself to capture future opportunities in this area.

As a part of its balanced approach, E.ON UK seeks to fulfill its renewables obligation through a combination of its own generation, renewable energy purchased from other generators under tradeable ROC contracts, and direct payment of any residual obligation into the buy-out fund. For the period from April 1, 2005 to March 31, 2006, E.ON UK achieved 95 percent of its renewables obligation through own generation and purchases.

*CHP.* E.ON UK also operates large scale CHP schemes. CHP is an energy efficient technology which recovers heat from the power generation process and uses it for industrial processes such as steam generation, product drying, fermentation, sterilizing and heating. E.ON UK's total operational CHP electricity capacity at December 31, 2006 was 359 MW. Clients range across a number of sectors, including pharmaceuticals, chemicals, paper and oil refining.

*Energy Trading*

E.ON UK's energy trading unit engages in asset-based energy trading in gas and electricity markets to assist E.ON UK in commercial risk management and the optimization of its U.K. gross margin. The energy trading unit plays a key role in E.ON UK's integrated electricity and gas business in the United Kingdom by acting as the



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commercial hub for all energy transactions. It manages price and volume risks and seeks to maximize the integrated value from E.ON UK's generation and customer assets.

Energy trading activities include:

Purchasing of coal, gas and oil for power stations;

Dispatching generation and selling the electrical output and ancillary services provided by E.ON UK's power stations;

Purchasing gas and electricity as required for E.ON UK's retail portfolio;

Managing the net position and risks of E.ON UK's generation and retail portfolio;

Managing renewable obligations for the retail portfolio through long-term purchases and trading of ROCs;

Purchasing and/or trading of CO<sub>2</sub> emission certificates and other environmental products, including Levy Exempt Certificates (issued in relation to the U.K. Climate Change Levy); and

Achieving portfolio optimization and risk management.

E.ON UK also engages in a controlled amount of proprietary trading in gas, power, coal, oil and CO<sub>2</sub> emission certificates markets in order to take advantage of market opportunities and maintain the highest levels of market understanding required to support its optimization and risk management activities. The following table sets forth E.ON UK's electricity and gas proprietary trading volumes for 2006 and 2005:

<b>Proprietary Trading Volumes</b>	<b>2006 Electricity billion kWh(1)</b>	<b>2005 Electricity billion kWh</b>	<b>2006 Gas billion kWh(1)</b>	<b>2005 Gas billion kWh</b>
Energy bought	14.0	10.4	57.7	36.2
Energy sold	14.0	10.4	57.7	36.2
Gross volume	28.0	20.8	115.4	72.4

(1) The increase in traded gas and electricity volumes in 2006 was primarily attributable to higher volatility in market prices and the greater market opportunities this provided.

In its energy trading operations, E.ON UK uses a combination of bilateral contracts, forwards, futures, options contracts and swaps traded over-the-counter or on commodity exchanges. E.ON UK also undertakes relatively low levels of trading in other commodities, including ROCs, environmental products and weather derivatives. All of E.ON UK's energy trading operations, including its limited proprietary trading, are subject to E.ON's risk management policies for energy trading. For additional information on these policies and related exposures, see Item 11. Quantitative and Qualitative Disclosures about Market Risk.

E.ON UK has in place a portfolio of fuel contracts of varying volume, duration and price, reflecting market conditions at the time of commitment. Coal contracts with a variety of suppliers within the United Kingdom and overseas ensure that supplies are secured for E.ON UK's coal-fired plants, while maintaining enough flexibility to minimize the cost of generation across the total generation portfolio. E.ON UK's coal import facilities at Kingsnorth power station and Gladstone Dock, Liverpool, provide secure access to international coal supplies.

The supply of gas for E.ON UK's CCGT and CHP plants is sourced through non-interruptible long-term gas supply contracts with gas producers (certain of which contain take or pay provisions), and through purchases on the forward and spot markets. Since October 2004, E.ON Ruhrgas has been a significant supplier of natural gas to E.ON UK pursuant to a long-term supply contract between the parties. The agreed framework for the E.ON Ruhrgas contract is essentially that of a take or pay arrangement. Risk management arrangements in respect of the volume and price risks associated with E.ON UK's gas supply contracts are conducted through trading on the spot, over-the-counter and bilateral markets. For additional details on these contractual commitments, see Item 5. Operating and Financial Review and Prospects Contractual Obligations and Notes 24 and 25 of the Notes to Consolidated Financial Statements.

**Table of Contents*****Retail***

E.ON UK sells electricity, gas and other energy-related products to residential, business and industrial customers throughout Great Britain. As of December 31, 2006, E.ON UK supplied approximately 8.4 million customer accounts, of which 7.7 million were residential customer accounts and 0.7 million were small and medium-sized business and industrial customer accounts. During the year, there was a net decrease in the total number of customer accounts of approximately 0.2 million as some customers switched suppliers in the wake of retail price increases described below. E.ON UK continues to focus on reducing the costs of its retail business, through efficiency improvements, more economical procurement of services and the utilization of lower cost sales channels.

*Residential Customers.* The residential business had approximately 7.7 million customer accounts as of December 31, 2006. Approximately 65 percent of E.ON UK's residential customer accounts are electricity customers and 35 percent are gas customers. Individual retail customers who buy more than one product (*i.e.*, electricity, gas or other energy-related products) are counted as having a separate account for each product, although they may choose to receive a single bill for all E.ON UK-provided services. In the residential customers sector, E.ON UK sold 26.5 TWh of electricity and 52.4 TWh of gas in 2006, as compared with 28.4 TWh of electricity and 54.1 TWh of gas in 2005.

E.ON UK targets residential customers through national marketing activities such as media advertising (including print, television and radio), targeted direct mail, public relations and online campaigns under its Powergen (a company of E.ON) brand. E.ON UK also seeks to create significant national brand awareness through high profile sponsorships under its E.ON brand. This includes the sponsorship of the FA Cup, England's most historic soccer competition, which commenced in August 2006. E.ON UK is also the main sponsor for Ipswich Town, a soccer team playing in the English Championship league.

In an environment of rising wholesale energy prices and increasing environmental costs, E.ON UK, like other suppliers, implemented a number of electricity and gas price increases affecting residential users in 2006, though the precise level of increases varied by supplier. E.ON UK's increases in 2006 amounted to 30 percent for electricity and 47 percent for gas at national average prices for an Ofgem average consuming customer. E.ON UK has also implemented a package of measures to limit the effects of rising wholesale costs by offering subsidized energy efficient products including cavity wall and loft insulation to a significant proportion of its customers. These initiatives contribute to the requirements placed on suppliers in relation to the Energy Efficiency Commitment, which is described in Regulatory Environment U.K.

*Small and Medium-Sized Business and Industrial and Commercial Customers.* The number of accounts in this sector totaled approximately 0.7 million at year-end 2006. In this sector, E.ON UK sold 29.7 TWh of electricity and 40.1 TWh of gas in 2006, as compared with 31.3 TWh of electricity and 46.1 TWh of gas in 2005. E.ON UK's focus in this area remains on acquiring and retaining the most profitable contracts available.

***E.ON Energy Services***

The E.ON Energy Services business was created in July 2005, bringing together the new connections and metering businesses from Central Networks and the home installation activities from Retail with the vision of providing E.ON UK customers with all the services they need to get connected to energy supplies, heat their homes and understand their energy use. As well as establishing a profitable growth business, E.ON Energy Services has three further aims in the medium term: (1) to deliver products and services for the Retail and Central Networks businesses; (2) to improve the level of customer service E.ON UK provides; and (3) to demonstrate the E.ON brand values of Performance and Expertise through an E.ON-branded workforce. E.ON Energy Services employs more than 3,500 people and staff is expected to undertake more than 50 million meter readings and carry out work in around 400,000 homes per year, playing a key part in E.ON UK's low carbon agenda by delivering energy efficiency measures such as loft and cavity

wall insulation services. The results of this business have been reported within the non-regulated business unit since 2006.

**Table of Contents****Regulated Business*****Distribution***

The electricity distribution business in the United Kingdom is effectively a natural monopoly within the area covered by the existing network due to the cost of providing an alternative distribution network. Accordingly, it is highly regulated. However, new distribution licenses are available for network developments, including for those areas already covered by an existing distribution license, and electricity distribution could also face indirect competition from alternative energy sources such as gas. For details on the license system, see Regulatory Environment U.K.

E.ON UK's Central Networks business manages the distribution businesses formerly operated by East Midlands Electricity Distribution plc ( EME ) and Midlands Electricity plc ( Midlands Electricity ). The combined service area covers approximately 11,312 square miles extending from the Welsh border in the West to the Lincolnshire coast in the East and from Chesterfield in the North to the northern outskirts of Bristol in the South and contains a resident population of about 10 million people. The networks distribute electricity to approximately 4.9 million homes and businesses in the combined service area and transport virtually all electricity supplied to consumers in the service area (whether by E.ON UK's retail business or by other suppliers). Separate distribution licenses are issued for the operation of the two networks but the combined business is managed by a centralized management team and uses the same methodology and staff to operate both networks.

The following table sets forth the total distribution of electric power by E.ON U.K.'s Central Networks business for each of the periods presented:

<b>Distribution of Power to</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>	<b>% Change</b>
Large non-domestic customers	25,915	26,129	-0.8
Domestic and small non-domestic customers	31,238	31,287	-0.2
Total	57,153	57,416	-0.5

Distribution charges are billed on the basis of published tariffs, which are set by the company and adhere to Ofgem's price control formulas. New price controls that run from April 2005 until March 2010 were agreed with Ofgem in December 2004. The price controls incorporate an allowed rate of return for investing in and operating the network, as well as a five year performance target.

**Other*****Midlands Electricity Non-Distribution Assets***

E.ON UK also acquired a number of non-distribution businesses in the Midlands Electricity transaction, including an electrical contracting operation and an electricity and gas metering business in the United Kingdom, as well as minority equity stakes in companies operating electricity generation plants in England, Pakistan and Turkey. Following disposals in 2004 and 2005, the only remaining generation stake is a 31.0 percent interest in Trakya Electric Uretim ve Ticaret A.S., which owns and operates a 478 MW CCGT plant in Turkey. E.ON UK has decided to retain the electricity and gas metering services business and core parts of the contracting business (including street

lighting) within the newly-formed E.ON Energy Services business, but has closed or sold the non-core parts of the contracting business.

## **NORDIC**

### *Overview*

E.ON Nordic's principal business, carried out mainly through E.ON Sverige, is the generation, distribution, marketing, sale and trading of electricity, gas and heat, mainly in Sweden. E.ON Sverige is the second-largest Swedish utility (on the basis of electricity sales and production capacity). E.ON Nordic is the largest shareholder in E.ON Sverige, currently holding 55.3 percent of the share capital and a 56.6 percent voting interest. Statkraft (Statkraft refers to Statkraft SF and its consolidated subsidiaries), the other shareholder in E.ON Sverige, has a put

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option allowing it to sell any or all of its 44.6 percent interest in E.ON Sverige's share capital to E.ON Energie at any time through December 15, 2007.

For the first half of 2006, E.ON Nordic also held a majority shareholding in E.ON Finland. On June 26, 2006, E.ON Nordic and Fortum finalized the transfer of this interest pursuant to an agreement signed on February 2, 2006. In total, 10,246,565 shares, equivalent to 65.56 percent of the share capital and voting interest of E.ON Finland, were transferred to Fortum for total consideration of approximately 390 million. For additional information, see Discontinued Operations.

E.ON Nordic and its associated companies are actively involved in the ownership and operation of power generation facilities. As of December 31, 2006, E.ON Nordic owned, through E.ON Sverige, interests in power stations with a total installed capacity of approximately 14,800 MW, of which its attributable share was approximately 7,300 MW (not including mothballed and shutdown power plants).

In 2006, about 56 percent of the electric power generated by E.ON Nordic through E.ON Sverige was generated at nuclear facilities and about 37 percent at hydroelectric plants. The remaining approximately 7 percent was generated using fuel oil, biomass, natural gas, wind power and waste. E.ON Nordic also supplies gas, is active in the heat and waste business and conducts electricity trading activities. In 2006, E.ON Nordic had sales of 3.2 billion (including 377 million of energy taxes) and adjusted EBIT of 619 million. Electricity contributed approximately 68 percent, heat 15 percent, gas 8 percent and other 9 percent of 2006 sales, net of energy taxes. Other sales are mainly attributable to the waste business, as well as contracting activities. E.ON Nordic traded a total of approximately 56.6 TWh of electricity in 2006 (including both purchases and sales). E.ON Nordic is primarily active in Sweden, but also operates to a minor degree in Finland, Denmark and Poland. In 2006, E.ON Nordic estimates that it supplied about 20 percent of the electricity consumed by end users in Sweden.

In 2003, E.ON Sverige acquired a majority stake in the Swedish utility Gräninge AB (Gräninge). The stake was gradually increased to a 100 percent shareholding in the first half of 2004. As of the end of 2005, all of Gräninge's Swedish activities had been fully integrated into E.ON Nordic's operations and are now carried out under the E.ON brand. In September 2004, E.ON agreed further details regarding its agreement in principle with the Norwegian energy company Statkraft to sell a portion (1.6 TWh) of the generation capacity that E.ON Sverige had acquired as part of the Gräninge acquisition to its minority shareholder Statkraft. This corresponds to approximately 5 percent of E.ON Nordic's annual electricity production, and approximately 50 percent of the capacity it acquired with the majority stake in Gräninge. In July 2005, E.ON Sverige and Statkraft signed the corresponding agreement, whereby Statkraft would acquire a total of 24 hydroelectric power plants. In accordance with the agreement, Statkraft took ownership of the plants in October 2005.

On January 8 and 9, 2005, a severe storm hit Sweden and devastated large areas of forest in southern Sweden. This had a serious effect on the distribution grid, which in some areas was destroyed. Approximately 420,000 households in Sweden, including approximately 250,000 E.ON Nordic customers, were affected by power outages, some of which lasted several weeks. E.ON Nordic recorded related costs for rebuilding its distribution grid and compensating customers of approximately 140 million in 2005. Another severe storm hit Sweden in January 2007, cutting power to approximately 300,000 households, including approximately 170,000 E.ON Nordic customers. Preliminary estimates of the costs to be incurred by E.ON Nordic for providing mandatory compensation to affected customers in accordance with newly-enacted Swedish legislation, as well as rebuilding infrastructure, are in the range of 95 million.

2006 was characterized by highly volatile spot prices for electricity in the Nordic region, especially during the summer and early autumn. This was mainly a consequence of substantially less precipitation than normal during the summer and early autumn (which had a negative impact on hydroelectric generation, as described in more detail below), as well as unplanned outages at E.ON Nordic's nuclear reactors following an incident at the Forsmark power

plant. For additional information, see [Market Environment](#) and [Power Generation](#) below.

***Operations***

In the Nordic region, electricity generated at power stations is delivered to consumers through an integrated transmission and distribution system. For information about the principal segments of the electricity industry, see



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Central Europe Operations. E.ON Nordic and its associated companies are actively involved in electricity generation, distribution, retail and trading.

As a consequence of the disposal of all of its interest in E.ON Finland on June 26, 2006, the business segmentation of E.ON Nordic has changed. The previous geographical segmentation (Sweden and Finland) has been replaced by a segmentation based on the different lines of business (Regulated, Non-Regulated, Other/Consolidation). E.ON Nordic has separated its Regulated operations comprising electricity distribution and gas distribution, both of which are seen as natural monopolies, from the Non-Regulated operations comprising generation, trading, retail and other competitive parts of the business. Other/Consolidation includes consolidation effects, as well as results of the parent companies (E.ON Nordic and E.ON Sverige) and of the two Finnish distribution network operators (described in Electricity Distribution ).

The following table sets forth the sources and sales channels of electric power in E.ON Nordic's operations during each of 2006 and 2005:

<b>Sources of Power</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>	<b>% Change</b>
Own generation	27,901	33,272	-16.1
Purchased power from jointly owned power stations	10,173	10,398	-2.2
Power purchased from outside sources	4,646	4,153	+11.9
Total power procured	14,819	14,551	+1.8
Power used for operating purposes and network losses	(2,154)	(1,905)	+13.1
Total	40,566	45,918	-11.7
<b>Sales of Power</b>			
Residential customers	6,618	6,999	-5.4
Commercial customers	12,845	12,678	+1.3
Sales partners(1)/Nord Pool	21,103	26,241	-19.6
Total	40,566	45,918	-11.7

(1) Sales partners are co-owners in E.ON Nordic's majority-owned power plants, primarily nuclear power plants, to which E.ON Nordic sells electricity at prices equal to the cost of production.

In 2006, E.ON Nordic procured a total of 40.6 billion kWh of electricity, including 2.2 billion kWh used for operating purposes and network losses. E.ON Nordic purchased a total of 10.2 billion kWh of power from power stations in which it has an interest of 50 percent or less. In addition, E.ON Nordic purchased 4.6 billion kWh of electricity from other sources, mainly from the Nord Pool power exchange. In 2006, E.ON Nordic's own generation volumes decreased by approximately 5.4 billion kWh, primarily as a result of the lower levels of rainfall during the year and the sale of generation assets to Statkraft in late 2005. Nuclear power production declined by approximately 0.8 billion kWh due to the fact that several Swedish nuclear units were taken offline as a consequence of an incident at Vattenfall AB's (Vattenfall) Forsmark nuclear power station in late July 2006. As a result of lower power production volumes from its

own sources, E.ON Nordic purchased slightly more power from outside sources (0.5 billion kWh). Sales to residential and commercial customers decreased by approximately 0.1 billion kWh in 2006, mainly due to the unseasonably warm weather in the fourth quarter. Sales to sales partners and Nord Pool decreased by approximately 5.1 billion kWh in 2006, primarily reflecting lower own generation. See Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31, 2006 Compared with Year Ended December 31, 2005 Nordic.

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E.ON Nordic also operates wholesale and retail gas businesses in Sweden, Denmark and Finland. The following table sets forth the sources and sales channels of gas in E.ON Nordic's operations during each of 2006 and 2005:

<b>Sources of Gas</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>	<b>% Change</b>
Long-term gas supply contracts	7,156	7,901	-9.4
Market purchases	400	256	+56.3
<b>Total gas supplied</b>	<b>7,556</b>	<b>8,157</b>	<b>-7.4</b>
<b>Sale and Use of Gas</b>			
Gas used for own generation	1,775	1,235	+43.7
Sales to industrial and distribution customers	5,006	6,684	-25.1
Sales to residential customers	257	238	+8.0
Market sales	518	0	
<b>Total gas used and sold</b>	<b>7,556</b>	<b>8,157</b>	<b>-7.4</b>

Since September 2005, E.ON Ruhrgas has been the sole supplier of natural gas to E.ON Nordic pursuant to a long-term supply contract between the parties. The agreed framework for the E.ON Ruhrgas contract is essentially that of a take or pay arrangement, though it will provide E.ON Nordic with a certain amount of flexibility in relation to the purchase of additional quantities and the deferral of quantities not taken.

**Market Environment**

*Electricity.* The electricity market in the Nordic countries has undergone major and far-reaching changes since the mid-1990s. Electricity market reforms have been instituted with the goal of increasing efficiency. Market integration and increased competition were seen as means to attain this objective. Privatization has not been an objective, and consequently the degree of public ownership in the electricity supply industry is essentially unaffected by the electricity market reforms.

The first major step in Swedish market reform was taken in 1991, with the decision to separate transmission from generation. Svenska Kraftnät, established to manage the main Swedish 200-400 kV transmission network, started operating in 1992. The networks were opened to new participants, and legislation providing for competition became effective January 1, 1996.

Today, the key feature of the Nordic electricity market is that there is a strict separation between the natural monopoly and the competitive parts of the industry. Thus, transmission and distribution, which are seen as natural monopolies, are separated from generation, retail sales and trading. The transmission network is therefore owned and managed by Svenska Kraftnät, a state agency controlled by the Swedish state, while distribution activities must be carried out by a legal entity separate from those engaged in retail sales (though common ownership is allowed). In order to make competition in generation and retail sales possible in the Nordic area, third party access to transmission and distribution networks is guaranteed. The prices and quality of transmission and distribution services are subject to regulation by a sector-specific regulator in each country. Moreover, in each country a central transmission system operator is responsible for the stability of the system. Thus, although there is a common spot market and free trade

across the national borders, system control remains a national responsibility.

Following deregulation, the electricity trading market in the Nordic countries is a liquid and transparent commodity market with trading taking place through the Nordic electricity exchange Nord Pool. The market participants at Nord Pool include power generators, retail companies, end users, traders and portfolio managers. The electricity exchange markets consist of a physical market (day-ahead for delivery in the next 24-hour period and an intra-day market) and a financial market (contracts of up to six years for hedging and trading). Nord Pool also has clearing operations where all financial contracts traded at Nord Pool and most OTC contracts for Nordic power, contracts for differences between price areas, and emissions allowances are cleared. The current volume of electricity traded at the Nord Pool spot market exchange is equal to more than 60 percent of underlying consumption in the Nordic countries and the volume traded at the financial market is about 6 times the underlying physical

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consumption in the Nordic countries. The pricing in the Nordic market is therefore efficient, with low transaction costs and high transparency. In addition, the exchange price is used as a reference price for a large part of bilateral trading contracts. The prices on the spot and forward markets are generally used as the price basis in sales contracts with end customers.

The electricity supply system in the Nordic countries is highly dependent on the hydroelectric power systems in Norway and Sweden. In a normal year, total hydroelectric power generation in the Nordic countries amounts to approximately 190-200 TWh. Hydroelectric power has low variable costs and is highly flexible due to the possibility to regulate the flow of water from the reservoirs. Weak hydrologic balance, meaning less hydroelectric power being produced, entails that more thermal production units with considerable higher marginal costs will have to be put into operation, implying increasing wholesale prices. Although long-term precipitation is relatively stable in the region, wide variations occur in the short term both within individual years and between years. As a result, the price on the Nord Pool electricity spot market can vary widely both within a given year and between years.

Since the introduction of the EU emissions trading scheme on January 1, 2005, CO<sub>2</sub> emission certificates have had a significant impact on electricity prices in the Nordic countries. The price of CO<sub>2</sub> emission certificates is set on the European emissions market, through trading on marketplaces such as ECX and Nord Pool and on the European OTC market for CO<sub>2</sub> emission certificates. The price of CO<sub>2</sub> emission certificates for 2006 was very volatile, varying between 6.5 and 32 /ton during 2006. This has increased the volatility of electricity prices since it affects the marginal costs of thermal power plants.

In 2004, the total volume of electrical energy generated by hydroelectric power was 184 TWh, slightly below normal volumes. In the beginning of 2004, electricity prices in the Nordic market remained at levels between 29 and 35 /MWh. Prices on the spot market as well as on the forward markets had a peak during summer and early autumn, with the spot price reaching levels of about 48 /MWh. By the fourth quarter, more normal levels of rainfall during the course of the year allowed reservoir levels to recover and at year-end reservoirs were near normal levels. At year-end, electricity spot prices were traded at levels of 25 /MWh.

In 2005, which was a wet year, the total volume of electrical energy generated by hydroelectric power in the Nordic countries was 222 TWh. The year started with warm weather in January and February and after a cold March the rest of the year was a bit warmer than normal. The hydrological balance started at a level above normal and reached a peak of 16 TWh above normal in the beginning of the year. Reservoir levels decreased to normal at the end of the year. The introduction of the EU emissions trading scheme in January resulted in generally higher prices for electricity. The average electricity spot price in 2005 amounted to 29 /MWh.

In 2006, which had a dry start of the year and a wet autumn, the total volume of electrical energy generated by hydroelectric power in the Nordic countries was 191 TWh. The hydrological balance started at a level slightly below normal and reached its lowest level at more than 30 TWh below normal at the end of the summer before increasing to levels near normal at the end of the year. The development of the hydrological situation and the impact of the EU emissions trading scheme resulted in generally high and volatile prices for electricity. The daily average Nordic spot price peaked in August above 80 /MWh when four nuclear reactors had to be shut down due to the Forsmark incident described below. The monthly average spot price was 40 /MWh in January, reached its highest value of 66 /MWh in August and ended up with its lowest value, 33 /MWh, in December. The volatile spot prices during the year caused an increase in the average electricity spot price in 2006, which reached 49 /MWh compared with only 29 /MWh in 2005.

Since 2001, electricity consumption in the Nordic countries has been relatively stable with a slight increase from 393 TWh in 2001 to 397 TWh in 2006. A temporary decrease occurred during 2002 and 2003, mainly due to an extremely dry autumn 2002 followed by high electricity prices and weaker economies in the Nordic area.

In 2006, the Swedish parliament decided to prolong the electricity certificate system until 2030 in order to support renewable electrical energy. This system, which was introduced in 2003, is a market-based support system in which the price of electricity certificates is the result of the relation between supply and demand on the electricity certificate market. The aim of the system is to increase the volume of electricity produced from renewable sources by 17 TWh by 2016 as compared with the 2002 level. Electricity certificates are granted by the Swedish government to generators of electricity from certain types of renewable sources. For every MWh of electricity produced from

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such sources the generator is given one certificate that it can sell in addition to the electricity generated. In order to create a demand for electricity certificates, it is mandatory for most electricity end users (including residential end users) to purchase a certain number of certificates in proportion to their consumption. This is known as the quota obligation. During 2004, the quota obligation amounted to 8.1 percent of electricity consumed. In 2005, the quota obligation amounted to 10.4 percent and in 2006 12.6 percent. The quota obligation is scheduled to peak at 17.9 percent in 2010-2012 and thereafter decline to 8.9 percent in 2013 due to the phase out of some production units from the system. Any applicable end user who fails to meet this quota obligation must instead pay a quota obligation charge to the Swedish government. E.ON Nordic generally has earned a sufficient number of electricity certificates through its own wind power and biomass production, and also has purchasing agreements with a number of small renewable electricity producers.

E.ON Nordic's main competitors in the Nordic wholesale market are the Swedish energy company Vattenfall, the Finnish utility Fortum and the Norwegian energy company Statkraft. Vattenfall and Fortum are also the main competitors of E.ON Nordic in the Swedish retail market, which is completely deregulated.

*Natural Gas.* The Swedish gas pipeline system is constructed along the western coast of Sweden, starting in Dragör, Denmark and ending in Gothenburg, Sweden. Gas represents 20 percent of the total energy supply in this region, while at the national level, it comprises somewhat less than 2 percent of Sweden's total energy supply. In 2006, gas consumption in Sweden amounted to approximately 10 TWh. The Swedish gas market is characterized by a small number of companies and a high degree of vertical integration. There are currently about five competitors active in the Swedish market, with E.ON Nordic accounting for the distribution and sale of approximately half of all gas distributed and sold in Sweden in 2006. The major competitor in the end customer market is the Danish gas company DONG and to a smaller extent municipally owned companies with customers mainly in the geographic area of their municipality.

*District Heating.* District heating supplies residential buildings, commercial premises and industries with heat for space heating and residential hot water production.

In Sweden, most district heating companies are still owned by municipalities, although the current trend is for large energy groups to acquire municipal companies. E.ON Nordic is actively participating in this privatization process. District heating is not price-controlled. The price of competing alternatives serves, however, as a ceiling for the prices that district heating companies can charge. E.ON Nordic also conducts some heating operations in Denmark.

**Non-regulated Business*****Power Generation***

*General.* E.ON Nordic owns interests in electric power generation facilities, mainly in Sweden, with a total installed capacity of approximately 14,800 MW, of which its attributable share is approximately 7,300 MW (not including mothballed, shutdown or reduced power plants).

E.ON Nordic generates electricity primarily at nuclear and hydroelectric power plants, with a small percentage generated at other types of power plants. In 2006, approximately 56 percent of E.ON Nordic's electric output was generated by nuclear, 37 percent by hydroelectric, and the remaining 7 percent by other fuels including oil, hard coal, biomass, natural gas, wind and waste.

Based on the consolidation principles under U.S. GAAP, E.ON Nordic reports 100 percent of revenues and expenses from majority-owned power plants in its consolidated accounts without any deduction for minority interests. Conversely, 50 percent and minority-owned power plants are accounted for by the equity method. Power generation in jointly owned plants is generally reported based on E.ON's ownership percentage.





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The following table sets forth E.ON Nordic's major electric power generation facilities (including cogeneration plants), the total capacity, the stake held by E.ON Nordic and the capacity attributable to E.ON Nordic for each facility as of December 31, 2006, and their start-up dates.

**E.ON NORDIC ELECTRIC POWER STATIONS**

<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>E.ON Nordic's Share</b>		<b>Start-up Date</b>
		<b>%</b>	<b>Attributable Capacity MW</b>	
<b>Nuclear</b>				
Forsmark 1	996	9.3	93	1980
Forsmark 2	1,006	9.3	94	1981
Forsmark 3	1,190	10.8	128	1985
Oskarshamn I	467	54.5	255	1972
Oskarshamn II	602	54.5	328	1974
Oskarshamn III	1,153	54.5	628	1985
Ringhals 1	843	29.6	249	1976
Ringhals 2	867	29.6	256	1975
Ringhals 3	957	29.6	283	1981
Ringhals 4	908	29.6	268	1983
Total	8,989		2,582	
<b>Hydroelectric</b>				
Bålforsen	88	100.0	88	1958
Bergeforsen	160	44.0	70	1955
Bjurfors nedre	78	100.0	78	1959
Blåsjön	60	50.0	30	1957
Degerforsen	63	100.0	63	1965
Edensforsen	67	96.5	65	1956
Edsele	60	100.0	60	1965
Forsse	52	100.0	52	1968
Gulsele	64	65.0	42	1955
Hällby	84	65.0	55	1970
Hammarforsen	79	100.0	79	1928
Harrsele	223	50.6	113	1957
Hjälta	178	100.0	178	1949
Järnvägsforsen	100	94.9	95	1975
Korselbränna	130	100.0	130	1961
Moforsen	135	100.0	135	1968
Olden (Langan)	112	100.0	112	1974
Pengfors	52	65.0	34	1954
Ramsele	157	100.0	157	1958
Rätan	60	100.0	60	1968
Sollefteåforsen	61	50.0	31	1966
Stensjön (Hårkan)	95	50.0	48	1968



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<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>E.ON Nordic's Share Attributable</b>		<b>Start-up Date</b>
		<b>%</b>	<b>Capacity MW</b>	
<b>Hydroelectric (continued)</b>				
Storfinnforsen	112	100.0	112	1953
Trångfors	73	100.0	73	1975
Other (<50 MW installed capacity)	835	n/a	778	n/a
<b>Total</b>	<b>3,178</b>		<b>2,738</b>	
<b>Fuel Oil</b>				
Barsebäck GT	84	100.0	84	1974
Bråvalla	240	100.0	240	1972
Halmstad G11	78	100.0	78	1973
Halmstad G12	172	100.0	172	1993
Karlshamn G1	332	70.0	232	1971
Karlshamn G2	332	70.0	232	1971
Karlshamn G3	326	70.0	228	1973
Karskär G4	125	50.0	63	1968
Öresundsverket GT	126	100.0	126	1971
Oskarshamn GT	80	54.5	44	1973
Other (<50 MW installed capacity)	77	n/a	41	n/a
<b>Total</b>	<b>1,972</b>		<b>1,540</b>	
<b>Natural Gas</b>				
Heleneholm G11, G12(CHP)	130	100.0	130	1966+1970
<b>Wind Power</b>				
Sweden	18	n/a	18	n/a
Denmark	165	n/a	33	n/a
<b>Total</b>	<b>184</b>		<b>51</b>	
<b>Other Power Plants</b>				
Abyverket G1, G2, G3(CHP)	151	100.0	151	1962-1974
Händelö (Norrköping)(CHP)	100	100.0	100	1983
Karskär G3	48	50.0	24	1968
<b>Total</b>	<b>299</b>		<b>275</b>	
<b>Shutdown</b>				
Barsebäck 1(Nuclear)		25.8		1975
Barsebäck 2(Nuclear)		25.8		1977
<b>Total</b>	<b>14,751</b>		<b>7,316</b>	

(CHP) Combined Heat and Power Generation.

E.ON Nordic's total attributable capacity decreased by 58 MW compared with 2005 mostly due to the disposal of some minor hydroelectric power plants.

The construction of a new gas-fired CHP facility in the Swedish city of Malmö was initiated by E.ON Nordic during 2006. The new plant is expected to be fully operational in late 2008 or early 2009 and to contribute a total capacity of 440 MW of electricity and 250 MW of heat. In addition, efficiency improvements, which are aimed at

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increasing generation capacity, are planned for the nuclear reactors in Forsmark, Ringhals and Oskarshamn. The implementation of these efficiency measures was started in 2005. Pending receipt of the necessary approvals, E.ON Nordic expects that all major efficiency improvements will be completed by 2011.

*Nuclear Power.* E.ON Nordic operates three Swedish nuclear power plants (Oskarshamn I – III), which provided 56 percent of E.ON Nordic’s total power output in 2006. In addition, E.ON Nordic holds minority participations in all other Swedish nuclear power reactors. E.ON Nordic receives a share of the electrical power produced at these plants according to its respective shareholding. The purchase price for this electricity is determined on the basis of the total costs for each facility and is paid according to the shareholding in each reactor.

In 2006, production at Oskarshamn was negatively affected following a country-wide review of nuclear power plants following a transmission-related incident at the Forsmark plant in late July that resulted in an emergency shutdown of the plant and subsequent modifications to the plant’s transmission infrastructure. Notably, the Forsmark incident (in which a power surge resulted in the failure of two out of four emergency power supply systems) did not result in any nuclear accident, release of radioactivity or equipment damage. Reviews of similar infrastructure at other reactors following the Forsmark incident took a number of Swedish reactors out of service for a period of several weeks and revealed the need for a significant overhaul at the Oskarshamn I reactor operated by E.ON Nordic, which was only restarted in January 2007. Although investigations into responsibility for the Forsmark incident are ongoing, it is expected that primary responsibility for the Forsmark incident will primarily be vested with Forsmark Kraft AB, the company owning the reactors at Forsmark. Vattenfall is the majority shareholder of Forsmark Kraft AB and operates the reactor, though E.ON Nordic has a minority stake in the company in line with Swedish national policy. The Swedish nuclear power plants in which E.ON Nordic holds an interest operated at approximately 84 percent of available capacity in 2006.

E.ON Nordic’s nuclear power plants are required to meet applicable Swedish safety standards, which are described in Environmental Matters – Nordic. In Sweden, nuclear waste is handled by Svensk Kärnbränslehantering AB (SKB), which is owned by the domestic nuclear power producers and supervised by various state institutions. Sweden’s low and intermediate-level nuclear waste is deposited in the Repository for Radioactive Operational Waste, located at the Forsmark nuclear power plants. Spent nuclear fuel and other high-level nuclear waste are placed in temporary storage at the Central Interim Storage Facility for Spent Nuclear Fuel, situated near the Oskarshamn nuclear power plants. No long-term repository has yet been constructed for spent nuclear fuel, but SKB is planning to build a deep repository for the long-term storage of all spent nuclear fuel. E.ON Nordic expects that a decision will be taken on where the deep repository is to be built at the earliest by 2012, with the first nuclear waste expected to be stored there after 2020.

In 1997, a law concerning the phase out of nuclear power was passed pursuant to which the government can decide to revoke a license to conduct nuclear operations, but must compensate the owner of the nuclear plants that are phased out. E.ON Nordic’s Barsebäck 1 reactor was closed under this law in 1999, while Barsebäck 2 was closed in 2005, with E.ON Nordic receiving compensation in each case. During 2006, the compensation agreement concerning the closure of Barsebäck 2 was fully and finally implemented, with E.ON Sverige’s interest in Ringhals AB being increased to 29.56 percent at no cost to E.ON Nordic.

E.ON Nordic currently has no other nuclear power plants that have been explicitly targeted for early phase-out by the Swedish government. However, it is unclear if and to what extent such shutdowns may be required in the future.

In Sweden, the financing system for the handling of high-level nuclear waste as well as the dismantling of nuclear facilities is currently based on a fee charged per generated kWh of electricity. The exact amount is regularly calculated based on assumptions about the expected period of operation for each reactor by the Swedish Nuclear Power Inspectorate and ultimately determined by the Swedish government. Nuclear power operators include this fee in the price of electricity and transfer it to the national Nuclear Waste Fund. The purpose of this fund is to cover all expenses

incurred for the safe handling and final disposal of spent nuclear fuel, as well as for dismantling nuclear facilities and disposing of decommissioning waste. For changes to this financing system, see Environmental Matters Nordic. Expenses for other low and intermediate-level operational nuclear waste have to be directly covered by the nuclear operators. For this purpose, E.ON Nordic has made provisions totaling 8.3 million as of December 31, 2006.

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In Sweden, taxes are levied on the production of nuclear power based on the installed nuclear power capacity. This tax amounted to approximately 7,230 per MW of thermal power in 2005. In December 2005, the Swedish parliament approved an 85 percent increase in the nuclear tax effective as of January 2006, at which time the tax increased to approximately 13,400 per MW of thermal power. As a consequence, E.ON Nordic's related tax expense increased by 36 million in 2006. No further changes of the nuclear tax are expected during 2007.

E.ON Nordic purchases fuel elements for nuclear power plants from international suppliers. E.ON Nordic considers the supply of uranium and fuel elements on the world market to be adequate.

*Hydroelectric.* E.ON Nordic operates 115 Swedish hydroelectric power plants, which provided 37 percent of E.ON Nordic's total power output in 2006. Due to the presence of mountains and rivers, hydroelectric plants are generally located in northern Sweden. Due to natural variances in annual water inflow to the hydro reservoirs, hydroelectric plants can be subject to reduced operations during periods of low precipitation. Notably, during periods of low precipitation market prices for electricity increase, while during periods with high precipitation market prices decrease. Thus, variances in rainfall in the region can have a significant positive or negative effect on the Nordic market unit's financial and operating results. See also Item 3. Key Information Risk Factors. In 2006, the inflow to E.ON Nordic's hydro reservoirs was about 93 percent of normal inflow and therefore production from hydroelectric assets was lower. However, since autumn 2006 was warm in Sweden, rain and snow have contributed to reservoir levels above normal at year-end.

Hydroelectric power plants in Sweden are subject to real estate taxes. In 2006, the Swedish parliament approved an increase of the real estate tax rate from 0.5 percent to 1.7 percent. As a consequence, E.ON Nordic's real estate tax expense increased by 27 million in 2006. Further increases in real estate tax expenses are expected during 2007 due to an anticipated revaluation of E.ON Nordic's tax base.

*Other Power Plants.* Power plants fuelled by fuel oil, hard coal, biomass, natural gas, wind power and waste provided the remaining 7 percent of E.ON Nordic's total power output in 2006. Hard coal and wind power plants are usually used for electricity base load operations. Oil- and gas-fired plants are only used for peak load operations, when market prices cover the operational cost. The production planning of CHP plants is to a large degree dependent on temperature conditions. Fuel oil, natural gas, hard coal and biomass are generally available from multiple sources, though prices are determined on international commodities markets and are therefore subject to fluctuations. Waste is purchased under supply contracts with local providers.

Demand for power tends to be seasonal, rising in the winter months and typically resulting in additional electricity sales by E.ON Nordic in the first and fourth quarters.

Although E.ON Nordic's power plants are maintained on a regular basis, there is a certain risk of failure for power plants of every fuel type. Depending on the associated generation capacity, the length of the outage and the cost of the required repair measures, the economic damage due to such failure can vary significantly. Thus, as with water shortages, power plant outages can negatively affect the market unit's financial and operating results. No significant unplanned outage occurred in 2004 or 2005, while a number of Swedish nuclear plants suffered unplanned outages in the second half of 2006 following the incident at Forsmark described above.

Nuclear generated electricity in the Nordic market decreased significantly in 2006 compared with 2005 as a consequence of the Forsmark incident and the related unplanned outages at other reactors, including the Oskarshamn I reactor operated by E.ON Sverige. The impact of lost production for E.ON Nordic as compared with 2005 was, however, limited to 0.5 TWh, as there was high availability of the plants in the first half of the year.

***Retail***

E.ON Nordic and its associated companies sell electricity, gas and district heating, as well as other energy-related services, to residential and commercial customers, mainly in the southern parts of Sweden. In addition, E.ON Nordic sells minor amounts of electricity, gas and district heating to end customers in Denmark, Finland and Poland.

*Electricity.* As of December 31, 2006, E.ON Nordic supplied electricity to approximately 840,000 electricity customer accounts in Sweden and to a minor degree in Denmark. Through its subsidiaries Kainuun Energia Oy and



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Karhu Voima Oy, E.ON Nordic supplied approximately 70,000 customers in Finland. Although the majority of E.ON Nordic's customer accounts are with residential customers, the majority of its sales volumes are made to commercial customers. E.ON Nordic sold a total of 19.5 TWh of electricity in 2006, of which 6.6 TWh was delivered to residential customers and 12.9 TWh was delivered to commercial customers (including municipal distributors). E.ON Nordic's electricity customers are concentrated in the south of Sweden, the areas of Stockholm, Örebro and Norrköping, the Mid-Norrland region, as well as in the eastern parts of Finland, although E.ON Nordic potentially serves customers throughout the Nordic region.

*Gas.* In the Swedish gas market, E.ON Nordic supplied approximately 14,000 customers with gas in 2006. 3.3 TWh were delivered to large industrial and (mostly municipal) distribution customers, and 0.3 TWh were delivered to residential customers. E.ON Nordic also supplied a small amount of gas in Denmark (0.5 TWh) and Finland (0.6 TWh) in 2006.

*Heat & Waste.* E.ON Nordic sells heating, primarily district heating, to approximately 30,000 customers in Sweden and Denmark. In 2006, sales of district heating amounted to 5.3 TWh in Sweden and 0.1 TWh in Denmark. In addition, in 2006 E.ON Nordic sold a *de minimis* amount of heat in Poland.

E.ON Nordic is also active in the Swedish waste business, mainly through E.ON Sverige SAKAB AB (E.ON Sverige SAKAB). E.ON Sverige SAKAB's operations focus on recycling and destroying hazardous waste. In addition, E.ON Sverige SAKAB treats a small portion of household waste and industrial refuse for heat-recovery purposes. In 2006, E.ON Nordic's waste activities had combined sales of 49 million. Waste volumes handled amounted to approximately 444,000 tons.

*Other Activities.* E.ON Nordic provides services for distribution networks and other services primarily in Sweden through E.ON Sverige's subsidiary ElektroSandberg AB. In August 2006, E.ON Sverige sold a 75.1 percent interest in the broadband communication business E.ON Sverige Bredband AB (E.ON Sverige Bredband) to Tele2 Sverige AB (Tele2). In addition, E.ON Sverige has a put option allowing it to sell the remaining shares within 24 months and Tele2 has a call option to acquire E.ON Sverige's remaining shares in E.ON Sverige Bredband in the event that E.ON Sverige does not exercise the put option.

**Trading**

E.ON Nordic's energy trading activities focus on electricity trading on the Nord Pool exchange, but also to a lesser extent include other commodities such as oil, natural gas, CO<sub>2</sub> emission certificates and propane.

E.ON Nordic uses energy trading to optimize the value of and manage risks associated with its energy portfolio. E.ON Nordic also performs a limited amount of proprietary trading, as well as providing portfolio management services for external clients, including access to energy exchanges, advice and risk management for their portfolios. Since 1999, E.ON Trading Nordic AB has been fully authorized by the Swedish Financial Supervisory Authority to advise and conduct trading on behalf of portfolio management clients.

All of E.ON Nordic's energy trading operations, including its limited proprietary trading, are subject to E.ON's risk management policies for energy trading. For additional information on these policies and related exposures, see Item 11. Quantitative and Qualitative Disclosures about Market Risk.

The following table sets forth the total volume of E.ON Nordic's traded electric power in 2006 and 2005.

**2006****2005**

<b>Trading of Power</b>	<b>million kWh</b>	<b>million kWh</b>	<b>% Change</b>
Power sold	28,281	36,580	-22.7
Power purchased	28,304	36,842	-23.2
Total	56,585	73,422	-22.9

The major part of realized trading volumes is usually contracted in the year prior to realization. Trading volumes decreased in 2006 compared with 2005 due to a lower volume of trades made during the 4-5 year period preceding the settlement year.

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### **Regulated Business**

#### ***Electricity Distribution***

E.ON Nordic and its associated companies are actively involved in electricity distribution activities in both Sweden and Finland.

In Sweden, the 200-400 kV electricity grid is owned and managed by Svenska Kraftnät, a state agency controlled by the Swedish state. 30-130 kV electricity is transmitted through a regional distribution network with a length of around 40,000 km, of which E.ON Nordic owns and manages 8,000 km, located in southern Sweden and around Sundsvall in the north of Sweden. The local distribution networks are managed by about 180 different grid companies, including E.ON Nordic. The length of the total local network for Sweden is about 550,000 km, of which E.ON Nordic owns 117,000 km. Balance control for the whole system is managed by Svenska Kraftnät.

In January 2005, a severe storm hit Sweden and devastated large areas of forest in southern Sweden. This had a serious effect on parts of E.ON Nordic's distribution grid, which in some areas was destroyed. Following this storm, E.ON Nordic has launched a major reinvestment program in order to secure and increase the reliability of its local and regional distribution grids. The focus of reinvestment activity is on cabling insulated overhead lines in the local networks and securing broader right of way corridors in the regional networks.

As a result of the storm in 2005, the Swedish government passed new legislation concerning electricity distribution in December 2005. Under the new law, which came into force on January 1, 2006, a customer shall be compensated for power outages that last more than 12 hours, with the compensation payment being equal to at least 12.5 percent and up to 300 percent of the customer's annual network charges, with compensation being based on the length of the outage. With effect of new legislation from January 1, 2011, the maximum allowable period of time for a power outage will be 24 hours. Following this new legislation, E.ON Nordic has set the timetable for a major part of the ongoing reinvestments in the electricity network to be completed by 2010. E.ON Nordic expects that this will to a large extent reduce its exposure to weather-related damage in the future.

On January 14, 2007, another severe storm hit southern Sweden, with serious effect on the distribution grid. Approximately 300,000 households in Sweden, including approximately 170,000 of E.ON Sverige's customers, were affected by power outages. Some customers, including E.ON Sverige customers, were left without electricity for up to ten days. Estimated costs to be incurred by E.ON Nordic for rebuilding its distribution grid and compensating customers are in the range of 95 million. Due to the ongoing reinvestment activities described above, the number of affected customers was reduced and the restoration of power distribution has been efficient.

The electricity grid in Sweden is linked to the power transmission grids in Norway, Finland and Denmark. In addition, the Baltic Cable links the Swedish transmission grid to the grid of E.ON Netz in Germany. The Baltic Cable is one of the longest (250 km) direct current submarine cables in the world, with a capacity of 600 MW. E.ON Nordic owns one-third of the cable through E.ON Sverige, with the remaining two-thirds owned by the Norwegian company Statkraft.

In 2006, E.ON Nordic's distribution network served approximately one million customers, including approximately 590,000 customers in southern Sweden, 325,000 customers in the metropolitan areas of Stockholm/Örebro/Norrköping and 85,000 customers in the Mid-Norrland region. The areas around the cities of Malmö (in southern Sweden), Stockholm, Örebro and Norrköping belong to the more densely populated areas of Sweden, but parts of southern Sweden and Norrland are more rural areas with a lower density.

E.ON Nordic also owns and operates local power distribution grids in Finland through Kainuun Energia Oy (approximately 54,800 customers in eastern Finland), with a length of 12,663 km, and Karhu Voima Oy (16 industrial customers in southwest Finland), with a length of 68 km.

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The following map shows E.ON Nordic's current distribution areas.

In Sweden and Finland, electricity customers have separate contracts with a retail supplier and an electricity distributor. For this reason, distribution customers of E.ON Nordic may choose other retail suppliers and E.ON Nordic may sell electricity to customers not covered by its own distribution grids. For information on grid access, see Regulatory Environment - Nordic.

### ***Gas Transmission, Distribution and Storage***

The Swedish gas pipeline system is constructed along the western coast of Sweden, starting in Dragör, Denmark and ending in Gothenburg, Sweden. Gas represents approximately 20 percent of total energy supply in the Nordic region, while at the national level, it comprises somewhat less than 2 percent of Sweden's total energy supply. The 320 km national gas transmission pipeline is owned by Nova Naturgas AB, a consortium in which E.ON Ruhrgas International AG holds a 29.6 percent interest. E.ON Nordic owns, operates and maintains a regional high-pressure gas pipeline with a length of 202 km and a low-pressure gas distribution pipeline with a length of 1,700 km. In addition, E.ON Nordic has an underground gas storage facility in Getinge with a working capacity of 8.5 million m<sup>3</sup> and a maximum withdrawal rate of 40 thousand m<sup>3</sup>/hour. In 2006, E.ON Nordic transported a total of 6.5 TWh of gas through its gas pipeline system.

The Swedish natural gas market is currently connected to the Danish natural gas market through one supply route. Sweden's strategic location between two of the largest producers, Russia and Norway, has led to the initiation of several studies and projects with the aim of increasing supplies to or via Sweden.

## **U.S. MIDWEST**

### ***Overview***

E.ON U.S. is a diversified energy services company with businesses in power generation, retail gas and electric utility services, as well as asset-based energy marketing. Asset-based energy marketing involves the off-system sale of excess power generated by physical assets owned or controlled by E.ON U.S. and its affiliates. E.ON U.S.'s power generation and retail electricity and gas services are located principally in Kentucky, with a small customer base in Virginia and Tennessee. As of December 31, 2006, E.ON U.S. owned or controlled aggregate generating capacity of approximately 7,500 MW. In 2006, E.ON U.S. served more than one million customers. The U.S. Midwest market unit recorded sales of \$1,947 million in 2006 and adjusted EBIT of \$391 million.

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### ***Operations***

In the areas of the United States in which E.ON U.S. operates, electricity generated at power stations is delivered to consumers through an integrated transmission and distribution system. For information about the principal segments of the electricity industry, see *Central Europe Operations*. In 2006, E.ON U.S. was actively involved in generation, transmission, distribution, retail and trading in the states in which it had utility operations.

E.ON U.S. divides its operations into regulated utility and non-regulated businesses. Utility operations are subject to state regulation that sets rates charged to retail customers.

In the regulated utility business, which accounted for approximately 97 percent of E.ON U.S.'s revenues in 2006 (83 percent electricity, 17 percent gas), E.ON U.S. operates two wholly-owned utility subsidiaries: Louisville Gas and Electric Company ( LG&E ), an electricity and natural gas utility based in Louisville, Kentucky, which serves customers in Louisville and 17 surrounding counties, and Kentucky Utilities Company ( KU ), an electric utility based in Lexington, Kentucky, which serves customers in 77 Kentucky counties, five counties in Virginia and one county in Tennessee.

E.ON U.S.'s non-regulated business, which accounted for approximately 3 percent of E.ON U.S.'s sales in 2006, is comprised of the operations of E.ON U.S. Capital Corp. ( ECC ).

### ***Market Environment***

In the United States, the market environment for electricity companies varies from state to state, depending on the level of deregulation enacted in each jurisdiction.

The electric power industry remains highly regulated at the retail level in much of the U.S., including Kentucky, although in some parts of the country, including Virginia, it has become more competitive as a result of price and supply deregulation and other regulatory changes. In approximately one-third of the United States, retail electricity customers can now choose their electricity supplier; however, some states have taken steps to halt deregulation or consider re-regulation, including Virginia. To better support a competitive industry, federal regulators are transforming the manner in which the electric transmission grid is operated. Transmission owning entities are generally encouraged by federal regulators to transfer individual control over the operation of their transmission systems to regional transmission organizations ( RTOs ). These RTOs are intended to ensure non-discriminatory and open access to the nation's electric transmission system. Depending on the specifics of deregulation in the states in which they operate, U.S. electric utilities have adopted different strategies and structures, sometimes divesting one or more of the generation, transmission, distribution or supply components of their businesses.

E.ON U.S.'s electric service territories are located in Kentucky, Virginia and Tennessee. At present, due to the absence of customer choice or competitive market requirements in Kentucky and Tennessee and the passage of legislation in Virginia exempting KU from the provisions of that state's liberalization measures, none of E.ON U.S.'s retail utility operations are subject to customer choice or competitive market conditions. E.ON U.S.'s customers are therefore generally required to purchase their electric service from E.ON U.S.'s utility subsidiaries at prices approved by state governmental regulators.

E.ON U.S.'s primary retail electric service territories are located in Kentucky, which accounted for approximately 68 percent of E.ON U.S.'s total revenues in 2006. To date, neither the Kentucky General Assembly nor the Kentucky Public Service Commission ( KPSC ) have adopted or announced a plan or timetable for retail electric industry competition in Kentucky. However, the nature or timing of any new legislative or regulatory actions regarding industry restructuring or the introduction of competition and their impact on LG&E and KU cannot currently be

predicted.

Although retail choice became available for many customers in Virginia in January 2002 pursuant to the Virginia Electric Restructuring Act (the Restructuring Act ), KU remains exempt from the provisions of the Restructuring Act until such time as KU provides competitive electric service to retail customers in any other state. During 2006, KU's Virginia operations accounted for approximately 5 percent of KU's total revenues and

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approximately 2 percent of E.ON U.S.'s total revenues. E.ON U.S.'s very limited Tennessee operations accounted for less than 1 percent of its total revenues in each of 2006 and 2005.

Over the past decade, E.ON U.S. has taken steps to maintain efficient rate structures while achieving high levels of customer satisfaction, including a reduction in the number of employees; aggressive cost reduction activities; an increase in focus on commercial, industrial and residential customers; an increase in employee involvement and training; and continuous modifications of its organizational structure. E.ON U.S. also strives to control costs through competitive bidding and process improvements. The company's performance in national customer satisfaction surveys continues to be high.

Seasonal variations in U.S. demand for electricity reflect the summer cooling period as the time of peak load requirements, with a lesser peak during the winter heating period, the latter primarily in regions which do not have extensive gas distribution networks. The peak period of retail gas demand is the winter heating period.

***Regulated Business***

**LG&E.** LG&E is a regulated public utility that generates and distributes electricity to approximately 398,000 customers and supplies natural gas to approximately 324,000 customers in Louisville and adjacent areas of Kentucky. LG&E's service area covers approximately 700 square miles in 17 counties. LG&E's coal-fired electric generating plants, most of which are equipped with systems to reduce SO<sub>2</sub> emissions, produce a significant amount (97 percent) of LG&E's electricity; the remainder is generated by gas-fired combustion turbines (approximately 2 percent) and by a hydroelectric power plant. Underground natural gas storage fields assist LG&E in providing economical and reliable gas service to customers. As of December 31, 2006, LG&E owned steam and combustion turbine generating facilities with an attributable capacity of 3,060 MW and a 48 MW hydroelectric facility on the Ohio River.

**KU.** KU is a regulated public utility engaged in producing, transmitting, distributing and selling electric energy. KU provides electric service to approximately 501,000 customers in 77 counties in central, southeastern and western Kentucky and approximately 30,000 customers in five counties in southwestern Virginia. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities and five customers in Tennessee. KU's coal-fired electric generating plants produce a significant amount (97 percent) of KU's electricity; the remainder is generated by gas-fired combustion turbines (approximately 3 percent) and a hydroelectric facility. As of December 31, 2006, KU owned steam and combustion turbine generating facilities with an attributable capacity of 4,375 MW and a 24 MW hydroelectric facility.

***Power Generation***

The following table sets forth details of LG&E's and KU's electric power generation facilities, including their total capacity, the stake held by E.ON U.S. and the capacity attributable to E.ON U.S. for each facility as of December 31, 2006, and their start-up dates.

**LG&E'S AND KU'S ELECTRIC POWER STATIONS**

<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>E.ON U.S.'s Share Attributable Capacity %</b>	<b>Start-up Date</b>
<b>Hard Coal</b>			



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Cane Run 4(1)	155	100.0	155	1962
Cane Run 5(1)	168	100.0	168	1966
Cane Run 6(1)	240	100.0	240	1969
E.W. Brown 1(2)	101	100.0	101	1957
E.W. Brown 2(2)	167	100.0	167	1963
E.W. Brown 3(2)	429	100.0	429	1971
Ghent 1(2)	475	100.0	475	1974

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<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>E.ON U.S. s Share % Attributable Capacity MW</b>	<b>Start-up Date</b>
<b>Hard Coal (continued)</b>			
Ghent 2(2)	484	100.0	484
Ghent 3(2)	493	100.0	493
Ghent 4(2)	493	100.0	493
Green River 3(2)	68	100.0	68
Green River 4(2)	95	100.0	95
Mill Creek 1(1)	303	100.0	303
Mill Creek 2(1)	301	100.0	301
Mill Creek 3(1)	391	100.0	391
Mill Creek 4(1)	477	100.0	477
Trimble County 1(1)	511	75.0	383
Tyrone 3(2)	71	100.0	71
Total	5,422		5,294
<b>Natural Gas</b>			
Cane Run 11(1)	14	100.0	14
E.W. Brown 5(3)	117	100.0	117
E.W. Brown 6(3)	154	100.0	154
E.W. Brown 7(3)	154	100.0	154
E.W. Brown 8(2)	106	100.0	106
E.W. Brown 9(2)	106	100.0	106
E.W. Brown 10(2)	106	100.0	106
E.W. Brown 11(2)	106	100.0	106
E.W. Brown IAC(3)	98	100.0	98
Haefling 1(2)	12	100.0	12
Haefling 2(2)	12	100.0	12
Haefling 3(2)	12	100.0	12
Paddy s Run 11(1)	12	100.0	12
Paddy s Run 13(3)	158	100.0	158
Trimble County 5(3)	160	100.0	160
Trimble County 6(3)	160	100.0	160
Trimble County 7(3)	160	100.0	160
Trimble County 8(3)	160	100.0	160
Trimble County 9(3)	160	100.0	160
Trimble County 10(3)	160	100.0	160
Zorn 1(1)	14	100.0	14
Total	2,141		2,141
<b>Hydroelectric</b>			
Dix Dam(2)	24	100.0	24



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<b>Power Plants</b>	<b>Total Capacity Net MW</b>	<b>E.ON U.S. s Share %</b>	<b>E.ON U.S. s Share Attributable Capacity MW</b>	<b>Start-up Date</b>
<b>Hydroelectric (continued)</b>				
Ohio Falls(1)	48	100.0	48	1928
Total	72		72	
<b>Total</b>	<b>7,635</b>		<b>7,507</b>	
<b>Mothballed/Shutdown/Reduced</b>				
Green River 1(2)	22	100.0	22	1950
Green River 2(2)	22	100.0	22	1950
Paddy s Run 12(1)	23	100.0	23	1968
Tyrone Unit 1(2)	27	100.0	27	1947
Tyrone Unit 2(2)	31	100.0	31	1948
Waterside 7(1)	11	100.0	11	1964
Waterside 8(1)	11	100.0	11	1964
Total	147		147	

(1) Power stations owned by LG&E.

(2) Power stations owned by KU.

(3) Power stations jointly owned by LG&E and KU.

*Fuel.* Coal-fired steam and combustion turbine generating units provided approximately 97 percent of LG&E s and KU s net kWh generation for 2006. The remainder of 2006 net generation was produced by natural gas-fueled combustion turbine peaking units (approximately 2 percent) and hydroelectric plants. E.ON U.S. is currently building a second coal-fired (750 MW) unit at Trimble County which is expected to come on line in 2010. E.ON U.S. s interest will be 75.0 percent. E.ON U.S. has no nuclear generating units and coal will continue to be the predominant fuel used by E.ON U.S. s subsidiaries for the foreseeable future. LG&E and KU have entered into coal supply agreements with various suppliers for coal deliveries for 2007 and beyond and normally augment their coal supply agreements with spot market purchases. The companies have coal inventory policies which they believe provide adequate protection under most contingencies. Reliability of coal deliveries can be affected from time to time by a number of factors, including fluctuations in demand, coal mine labor issues and other supplier or transporter operating or contractual difficulties.

Each of LG&E and KU expect to continue purchasing much of their coal, which has varying sulphur content ranges, from western Kentucky, southern Indiana and West Virginia, with additional KU purchases from eastern Kentucky, Wyoming and Colorado. In general, the delivered cost of coal has been rising since late 2002.

LG&E purchases natural gas transportation services from both of the major, trans-continental natural gas transmission pipeline companies operating in the southern Midwest region. LG&E also has a portfolio of gas supply arrangements

with a number of suppliers in order to meet its firm sales obligations. These gas supply arrangements have various terms and include pricing provisions that are market-responsive. LG&E believes these firm supplies, in tandem with the pipeline transportation services, provide the reliability and flexibility necessary to serve LG&E's gas customers. LG&E operates five underground gas storage fields with a current working gas capacity of 15.1 billion cubic feet. Gas is purchased and injected into storage during the summer season and is then withdrawn to supplement pipeline supplies to meet the gas-system load requirements during the winter heating season. LG&E and KU primarily buy natural gas and oil fuel used for generation on the spot market.

LG&E and KU have limited exposure to market price volatility in prices of coal and natural gas, as long as cost pass-through mechanisms, including the fuel adjustment clause and gas supply clause, exist for retail customers. For a more detailed explanation of these mechanisms, see [Regulatory Environment U.S. Midwest](#).

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*Asset-Based Energy Marketing.* LG&E and KU conduct energy trading and risk management activities to maximize the value of power sales from physical assets they own, in addition to the wholesale sale of excess asset capacity. These off-system sales accounted for 2.7 TWh in 2006. Energy trading activities are principally forward financial transactions to hedge price risk and are accounted for on a mark-to-market basis in accordance with SFAS No. 133. Prior to MISO establishing its energy market in April 2005, wholesale sales of excess asset capacity were treated as normal sales under SFAS No. 133 and were not marked-to-market.

**Transmission**

E.ON U.S.'s utility subsidiaries LG&E and KU operate 4,925 miles of transmission line. In September 2006, these entities withdrew from the Midwest Independent Transmission System Operator, Inc. ( MISO ), in which they had participated as transmission owning members since 1998 and which commenced commercial operations in February 2002. In connection with their withdrawal from MISO, LG&E and KU paid an exit fee of approximately \$33 million, which remains subject to certain adjustments. Following exit from MISO, LG&E and KU have contractually engaged two independent third parties to perform certain of oversight and function control activities formerly performed by MISO relating to their transmission systems, in accordance with applicable Federal Energy Regulatory Commission ( FERC ) regulations. The Southeastern Power Pool ( SPP ) will now function as the transmission system operator and the Tennessee Valley Authority ( TVA ) will now function as the reliability coordinator, respectively, for LG&E and KU.

For additional information about transmission developments, see [Regulatory Environment](#) U.S. Midwest.

**Distribution/Retail**

The electric retail activities of LG&E and KU are limited to their respective service territories in Kentucky, with a small KU service region in Virginia and service to five customers in Tennessee. In 2006, LG&E's total electric retail sales to residential, commercial and industrial customers were 10.7 billion kWh and its total aggregate electric sales, including off-system sales, were 14.4 billion kWh. In 2006, KU's total electric retail sales to residential, commercial and industrial customers were 16.3 billion kWh and its total aggregate electric sales were 20.9 billion kWh.

The following table sets forth LG&E's and KU's sale of electric power for the periods presented:

<b>Sales of Electric Power to</b>	<b>Total 2006 million kWh</b>	<b>Total 2005 million kWh</b>
Residential	10,330	10,864
Commercial and industrial customers	16,628	16,684
Municipals	1,978	2,014
Other retail	3,703	3,720
Off-system sales	2,650	4,434
<b>Total</b>	<b>35,289</b>	<b>37,716</b>

The gas retail activities of LG&E are limited to its service territory in Kentucky. In 2006, LG&E's total retail gas sales were 8.7 billion kWh (2005: 10.8 billion kWh) and its total aggregate gas sales (including gas transportation volumes and wholesale sales) were 12.4 billion kWh (2005: 14.6 billion kWh).

***Non-regulated Businesses***

*ECC.* ECC is the primary holding company for E.ON U.S.'s non-regulated businesses, which now consist only of interests in Argentine gas distribution operations which provide natural gas to approximately two million customers in Argentina through three distributors (Gas Natural BAN S.A. ( Ban ), Distribuidora de Gas del Centro S.A. ( Centro ) and Distribuidora de Gas Cuyana S.A. ( Cuyana )). ECC owns 19.6 percent of Ban, 45.9 percent of Centro, and 14.4 percent of Cuyana. These operations continue to be subject to economic and political risks typical of emerging markets.

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LG&E Power Inc. ( LPI ), a wholly-owned subsidiary of ECC, and its affiliates, including LG&E Power Services LLC ( LPS ), formerly owned, operated and maintained interests in U.S. independent power generation facilities. Following management's decision in September 2003 to dispose of all of LPI's assets, LPI and ECC sold their interests in wind power generation facilities in Texas and Spain in 2004. In January 2005, LPI sold its 50 percent ownership interest in a 550 MW gas-fired power generation facility in Texas. In June 2006, LPI sold its 50 percent ownership interest in a 209 MW coal-fired facility in North Carolina and LPS sold its remaining operations and maintenance contracts relating to the North Carolina plant along with four independent power generation facilities.

**DISCONTINUED OPERATIONS**

In 2002 and 2001, the Company discontinued the operations of its former oil segment and its former aluminum segment, respectively. These former segments are accounted for as discontinued operations in accordance with U.S. GAAP. In addition, in 2003, E.ON discontinued and disposed of certain operations in the U.S. Midwest market unit, as well as certain activities of Viterra in the Other Activities business segment. In 2005, E.ON discontinued and either disposed of certain operations or classified certain businesses as held for sale in the Pan-European Gas and U.S. Midwest market units, as well as Viterra in the Other Activities business segment. E.ON therefore also considers these businesses to be discontinued operations. Finally, in 2006, the Nordic market unit disposed of its entire stake in E.ON Finland. Under U.S. GAAP, results of all such discontinued operations must be shown separately, net of taxes and minority interests, under Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income. For details, see Note 4 of the Notes to Consolidated Financial Statements.

***Oil***

In July 2001, E.ON and BP entered into an agreement pursuant to which BP agreed to acquire a 51.0 percent stake in VEBA Oel by way of a capital increase. VEBA Oel was then active in the oil and gas exploration and production, oil processing and marketing and petrochemicals businesses. The agreement also provided E.ON with a put option that allowed it to sell the remaining 49.0 percent interest in VEBA Oel to BP at any time from April 1, 2002 for 2.8 billion, subject to certain purchase price adjustments. In December 2001, the German Federal Cartel Office cleared the transaction. The capital increase took place in February 2002, giving BP majority control of VEBA Oel as of February 1, 2002. The aggregate consideration paid by BP for the capital increase was approximately 2.9 billion. In addition, 1.9 billion in shareholder loans from the E.ON Group to VEBA Oel were repaid. As of June 30, 2002, E.ON exercised the put option. E.ON has received 2.8 billion for its VEBA Oel shares plus the aforementioned repayment of the shareholder loans. In April 2003, E.ON and BP reached an agreement setting the final purchase price for VEBA Oel (without prejudice to the standard indemnities in the contract) at approximately 2.9 billion. E.ON recognized a loss on disposal of 35 million in 2003 related to the final purchase price settlement and a gain of 1.4 billion in 2002. In 2004, E.ON recognized a loss of 19 million resulting from claims under standard contractual indemnities. These effects were recorded under Income (Loss) from discontinued operations, net in the income statement for the relevant period.

***Aluminum***

In March 2002, E.ON sold VAW (then one of Europe's major aluminum companies) to the Norwegian company Norsk Hydro ASA for the aggregate price of 3.1 billion, including financial liabilities and pension provisions totaling 1.2 billion. E.ON realized a gain on disposal of 893 million, which does not include the reversal of VAW's negative goodwill of 191 million, as this amount was required to be recognized as income due to a change in accounting principles upon adoption of SFAS No. 142, Goodwill and Other Intangible Assets ( SFAS 142 ), on January 1, 2002. In 2005, E.ON recognized a gain of 10 million before income taxes resulting from the release of a related provision. This effect was recorded under Income (Loss) from discontinued operations, net in the Consolidated Statements of Income.



*Other Activities*

In June 2003, Viterro disposed of Viterro Energy Services AG ( Viterro Energy Services ), which then provided heat and water submetering services for administrators and owners of residential and commercial

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property, to CVC Capital Partners. In March 2003, Viterra sold its Viterra Contracting GmbH ( Viterra Contracting ) subsidiary, which then provided heat contracting services to apartment buildings, to Mabanaft GmbH ( Mabanaft ). The aggregate consideration for both transactions totaled 961 million, including approximately 112 million of assumed liabilities, with Viterra realizing a gain of 641 million. In 2004, the release of previously recorded provisions resulted in income in the amount of 10 million, which is recorded in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income.

On May 17, 2005, E.ON sold Viterra (then one of Germany's largest private owners of residential property) to Deutsche Annington GmbH ( Deutsche Annington ). The purchase price for 100 percent of Viterra's equity was approximately 4 billion. The transaction closed in August 2005. The company was classified as a discontinued operation in May 2005 and deconsolidated as of July 31, 2005. The portion of Viterra's 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to 2.6 billion and 294 million, respectively. In 2005, Viterra had revenues of 453 million. E.ON recorded a gain on disposal of 2.4 billion. In 2006, E.ON recognized gains of 52 million resulting from adjustments of the purchase price and the partial release of a related provision.

***Other***

As a part of the regulatory approval of the former Powergen's acquisition of LG&E Energy (now E.ON U.S.), the SEC had required that LG&E Energy sell CRC-Evans International Inc. ( CRC-Evans ), then a provider of specialized equipment and services used in the construction and rehabilitation of gas and oil transmission pipelines. Effective October 31, 2003, LG&E Energy sold CRC-Evans to an affiliate of Natural Gas Partners for 37 million. The portion of CRC-Evans' results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to approximately 1 million in 2005. E.ON realized no gain or loss on the disposal.

On June 15, 2005, E.ON Ruhrgas signed an agreement regarding the sale of Ruhrgas Industries (then an industrial business, which focused on metering and industrial furnaces) to CVC Capital Partners. The purchase price for 100 percent of Ruhrgas Industries' equity was approximately 1.2 billion, with the purchaser's assumption of Ruhrgas Industries' debt and provisions bringing the total value of the transaction to approximately 1.5 billion. The transaction received antitrust approval in July and early September and closed on September 12, 2005. The company was classified as a discontinued operation in June 2005 and deconsolidated as of August 31, 2005. The portion of Ruhrgas Industries' 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to 628 million and 29 million, respectively. In 2005, Ruhrgas Industries had revenues of 847 million. E.ON recorded a gain on disposal of 0.6 billion.

E.ON U.S.'s wholly-owned subsidiary, Western Kentucky Energy Corp. and affiliates ( WKE ) operates the generating facilities of Big Rivers Electric Corporation ( BREC ), a power generation cooperative in western Kentucky, and a coal-fired facility owned by the city of Henderson, Kentucky, under a 25-year lease. In November 2005, E.ON U.S. entered into a letter of intent with BREC regarding a proposed transaction to terminate the lease and operational agreements among the parties and other related matters. The parties are in the process of negotiating definitive agreements regarding the transaction, the closing of which would be subject to a number of conditions, including review and approval of various regulatory agencies and acquisition of certain consents by other interested parties. Subject to such contingencies, the parties are working on completing the proposed termination transaction during 2007. WKE was classified as discontinued operations at the end of December 2005. The portion of WKE's 2006, 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to income of 64 million and losses of 162 million and 2 million, respectively.

In February 2006, E.ON Nordic and Fortum signed an agreement providing for Fortum's acquisition of E.ON Nordic's entire 65.6 percent stake in E.ON Finland for a total of approximately 390 million. In June 2006, E.ON Nordic and

Fortum finalized the transfer of all of E.ON Nordic's shares in E.ON Finland to Fortum. The company was classified as a discontinued operation in mid-January 2006. The portion of E.ON Finland's 2006 and 2005 results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to 11 million and 24 million, respectively. In 2006, E.ON Finland had revenues of 131 million.

For further information, see Note 4 of the Notes to Consolidated Financial Statements.

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**REGULATORY ENVIRONMENT**

**EU/GERMANY: GENERAL ASPECTS (ELECTRICITY AND GAS)**

***Overview***

In order to promote competition in the EU energy market, the EU adopted electricity and gas directives (Directive 96/92/EC Concerning Common Rules for the Internal Market in Electricity, or the First Electricity Directive and Directive 98/30/EC Concerning Common Rules for the Internal Market in Natural Gas, or the First Gas Directive ).

The First Electricity Directive was adopted in December 1996 and was intended to open access to the internal electricity markets of EU member states. Germany implemented the First Electricity Directive by enacting an Energy Law (*Energiewirtschaftsgesetz*, or the Energy Law ) that entered into force on April 29, 1998. The Energy Law of 1998 modified the old Energy Law, the German legal framework governing utilities that sets forth the general obligations required of electricity and gas companies and defines which segments of the industry are subject to regulation.

The First Gas Directive was adopted in 1998 and was intended to open access to the internal gas markets of EU member states. The Energy Law of 1998 already included elements of the First Gas Directive, while an amendment to the Energy Law, which came into effect on May 24, 2003, completed the implementation of the First Gas Directive into German law.

In June 2003, the EU Energy Council amended the First Electricity Directive and replaced it with a new electricity directive (Directive 2003/54/EC Concerning Common Rules for the Internal Market in Electricity, or the Second Electricity Directive ), and also adopted a second gas directive (Directive 2003/55/EC Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 98/30/EC, or the Second Gas Directive ), which replaced the First Gas Directive. Germany implemented these directives by enacting the new Energy Law of 2005 (*Zweites Gesetz zur Neuregelung des Energiewirtschaftsrechts*, or the Energy Law of 2005 ), which came into force on July 13, 2005. Corresponding network access and network charges ordinances for electricity and gas came into force on July 29, 2005.

The following paragraphs outline relevant aspects of the First Electricity and Gas Directives, the Energy Law, the Second Electricity and Gas Directives, and amendments of the Energy Law, as well as other EU proposed and adopted directives and regulations that affect the German energy industry.

E.ON's operations outside of Germany are subject to the different national and local regulations in the relevant countries.

***The First Electricity and Gas Directives***

The First Electricity Directive established common rules for the internal EU electricity market. Under the First Electricity Directive, the EU electricity market was expected to be opened gradually to competition. Member states could choose to have either a so-called single-buyer system or a system permitting negotiated or regulated third party access to electricity networks ( nTPA or rTPA ). Member states that elected the nTPA system were required to publish frameworks for network charges. The Directive also required integrated utilities to keep separate accounts for their transmission and distribution activities, as well as for other activities not relating to transmission and distribution, in their internal accounting.

The First Gas Directive provided for a gradual opening of EU member states' natural gas markets to competition. It allowed each member state to opt for nTPA or rTPA systems, similar to the provisions of the First Electricity Directive. Under the First Gas Directive, natural gas companies were allowed to apply for a temporary derogation from the rules for third party access in case of serious economic and financial difficulties created by existing take-or-pay commitments. The First Gas Directive also required integrated utilities to keep separate accounts for their transmission and distribution activities, as well as for other activities not relating to transmission and distribution, in their internal accounting.

**Table of Contents*****The German Energy Law of 1998***

Germany's Energy Law of 1998 implemented the First Electricity Directive. The Energy Law abolished exclusive supply contracts, thereby introducing competition in the supply of electricity to all consumers, and provided (in addition to the so-called "single-buyer" system) for non-discriminatory nTPA for all utilities. The German market was opened for all customers in one step, going far beyond the requirements of the First Electricity Directive and also beyond the steps taken by Germany's neighboring countries. Specifically, in assessing a request for energy transmission, the Energy Law requires a transmission company to take into account the extent to which such transmission displaces electricity generated from CHP plants, renewable energy sources and, in eastern Germany, lignite-based power plants, and the extent to which it impedes the commercial operation of such power plants. Furthermore, the Energy Law introduced a provision for third party access into the Law Against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, or "GWB"). In 1998, the first electricity association agreement provided the main basis for an nTPA network access system for electricity in Germany. See "Germany: Electricity Network Access" below.

The Energy Law of 1998 also included "prior to the adoption of the First Gas Directive" certain parts of the First Gas Directive. The Energy Law of 1998 enhanced competition in gas supply to consumers and provided for non-discriminatory nTPA for all utilities. The German gas market was opened for all customers in one step in the year 1998, in this respect going far beyond the requirements of the First Gas Directive and also beyond the steps taken by Germany's neighboring countries. In 2000, the first gas association agreement provided the main basis for an nTPA network access system for gas in Germany. Technical access rules for household and small commercial customers were introduced in September 2002.

***The Second Electricity and Gas Directives***

*Completion of the Internal Electricity Market/The Second Electricity Directive.* On June 26, 2003, the EU Energy Council adopted the Second Electricity Directive, which replaced the First Electricity Directive. The Second Electricity Directive requires full market opening to competition in each member state by July 1, 2004 for commercial customers and by July 1, 2007 for household customers. The Directive also sets forth general rules for the organization of the EU electricity market, such as the option of the member states to impose certain public service obligations, customer protection measures and provisions for monitoring the security of the EU's electricity supply. The previous framework of negotiated third party access in Germany is no longer allowed under the Second Electricity Directive. Instead, the Directive requires that at least a methodology for calculating network charges be fixed by law or approved by an independent regulatory body which is required to be established. In addition, the Second Electricity Directive contains provisions requiring the organizational and legal unbundling of transmission and distribution system operators, as well as mandatory electricity labeling for fuel mix, emissions and waste data.

The following paragraphs provide more detail on the independent regulatory authority, legal unbundling, electricity labeling and certain of the public service requirements.

The Second Electricity Directive (as well as the Second Gas Directive, see below) requires the establishment of a regulatory body that is independent of the interests of the electricity and gas industries. According to the Directive, the independent regulator shall be responsible for ensuring non-discriminatory network access, monitoring effective competition and ensuring the efficient functioning of the market. Further, the regulator shall be responsible for fixing or approving the terms and conditions for connection and access to national transmission and distribution networks (or at least the methodologies to calculate such terms), including transmission and distribution charges, and for the provision of balancing services, and shall also have the authority to require transmission and distribution system operators, if necessary, to modify their terms and conditions in order to ensure that they are proportionate and applied in a non-discriminatory manner.

In addition, the Second Electricity Directive requires that each transmission and distribution system operator be independent, at least in terms of legal form, organization and decision-making, from other activities not relating to transmission or distribution ( legal unbundling ). This requirement does not imply or result in the requirement to separate the ownership of assets of the transmission network from the vertically integrated undertaking. The Second Electricity Directive enables member states to postpone the implementation of provisions for legal unbundling of distribution system operations until July 1, 2007 at the latest. Derogations from legal unbundling may also be

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granted to distribution companies serving less than 100,000 connected customers or small isolated networks. Member states can request an exemption from legal unbundling if they can prove that total and non-discriminatory access to the distribution networks can be achieved by other means.

The Second Electricity Directive requires electricity suppliers to specify in or with bills, as well as in promotional materials for end user customers, the following information:

The contribution of each energy source to the overall fuel mix of the supplier over the preceding year; and

A reference to where information is publicly available on the environmental impact of the supplier's activities, including the amount of CO<sub>2</sub> and radioactive waste produced.

Finally, the Second Electricity Directive requires that household customers and where member states deem it appropriate small companies must be provided with universal service, *i.e.*, the right to be supplied with electricity of a specified quality at reasonable prices.

*Completion of the Internal Gas Market/The Second Gas Directive.* On June 26, 2003, the EU also adopted the Second Gas Directive, which replaced the First Gas Directive. Similar to the Second Electricity Directive, the Second Gas Directive requires full opening of each member state's gas market to competition by July 1, 2004 for all non-household customers and by July 1, 2007 for all customers. The Directive also sets forth similar general rules for the organization of the EU gas market. The previous framework of negotiated third party gas network access in Germany is no longer allowed under the Second Gas Directive. Instead, as in the Second Electricity Directive, the Second Gas Directive requires that at least a methodology for calculating network charges be fixed by law or approved by an independent regulatory authority which is required to be established. The Directive also requires integrated gas companies to legally unbundle their transmission and distribution system operators from other operations.

The Second Electricity and Gas Directives were required to be implemented by each member state by July 1, 2004.

### ***Revisions of the German Energy Law***

Prior to the adoption of the Second Gas Directive, the German government amended the Energy Law in May 2003. The amended Energy Law (*Erstes Gesetz zur Änderung des Gesetzes zur Neuordnung des Energiewirtschaftsrechts*) fully completed the implementation of the First Gas Directive into national law. Apart from provisions to facilitate the opening of the gas market, a new section determined the legal basis for non-discriminatory access to gas networks. In addition, the amended Energy Law formally recognized the relevant electricity and gas association agreements (*Verbändevereinbarung Strom II+* and *Verbändevereinbarung Gas II*) as good commercial practice until December 31, 2003. Furthermore, this amendment modified the provisions of the GWB concerning the suspensive effect of appeals made against decisions of the Federal Cartel Office, so that decisions issued pursuant to the third party access provision of the GWB become immediately applicable.

In order to implement the Second Electricity and Gas Directives, the German legislature passed the Energy Law of 2005 (*Zweites Gesetz zur Neuordnung des Energiewirtschaftsrechts*), which came into force on July 13, 2005. Corresponding network access and network charge ordinances for electricity and gas came into force on July 29, 2005.

Under this new legal framework, the German legislature has authorized the Federal Network Agency (*Bundesnetzagentur*, or the BNetzA, previously called the Regulatory Authority of Telecommunications and Post) to act as the independent regulatory body required by the Second Electricity and Gas Directives, initially with ex-ante supervisory powers. The BNetzA is responsible for fixing or approving and controlling the terms and conditions for



connection and access to national transmission and distribution networks, including transmission and distribution charges. The BNetzA (and the state-level regulators) also have the authority to require transmission and distribution system operators, if necessary, to modify their conduct in order to ensure that they act in a non-discriminatory manner.

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The following paragraphs provide more detail on the most significant elements of the Energy Law of 2005 for German utilities:

*Network access and network charge regulation:* The Energy Law of 2005 contains two phases of regulation. In the starting phase of regulation, the BNetzA and the state level regulators have to approve the network charges which are calculated by the utilities using a cost-based rate-of-return model. Thus the BNetzA and the state level regulators effectively set the network charges for network operators ex-ante. The allowed capital costs for existing investments are derived from a regulated asset base that is partly valued at current cost. For new investments, the allowed capital costs are derived from a regulated asset base valued at historic cost. See also [Germany: Electricity Electricity Network Charges](#) and [Germany: Gas Gas Network Charges](#) below. A second phase of regulation envisages a new incentive-based regulation system which will replace the current cost-based rate-of-return model. According to law, the BNetzA presented a proposal in summer 2006 to the Ministry of Economics. The Ministry now has to draft a regulation containing the main points of an incentive-based regulation system. At this time it is expected that a second cost-based ex-ante approval of network charges will be used for 2008; the allowed network charges for 2008 are expected to be the starting point for the incentive regulation system in 2009. The energy industry is in favor of starting an incentive-based system in 2008. At this time, E.ON is unable to predict the detailed form of the forthcoming incentive regulation, or its effects on the Company and on the German energy industry generally.

The Energy Law of 2005 contains an exemption from cost calculations for gas transmission networks if actual or potential pipeline competition can be proved. The law also provides for the development of a special entry/exit system for gas network access, whereby network operators have to offer entry and exit capacities for the transmission of gas separately to system users in order to ensure that system users only need one contract for entry capacities and one contract for exit capacities. The gas network operators together with the Association of the German Gas Industry (*Bundesverband der deutschen Gas- und Wasserwirtschaft* or *BGW*) developed an entry/exit model in 2006, offering two variants for gas transportation. Following proceedings instituted by a gas trader and a German energy association, however, the BNetzA decided in November 2006 that one of the variants for gas transportation does not comply with the Energy Law of 2005 and that the gas network operators must change their contracts to comply by October 1, 2007. For more information, see [Germany: Gas Gas Network Access](#) below.

*Unbundling of network operators:* The Energy Law of 2005 requires legal as well as operational (organizational), information and accounting unbundling of each transmission and distribution system operator from the other activities of the utilities. Network operators serving less than 100,000 connected customers are exempt from the legal and operational unbundling obligations.

The Company's German transmission and distribution system operations already comply with the legal, operational (organizational), informational and accounting unbundling requirements contained in the Energy Law of 2005.

*New Ordinances.* The exact interpretation of some of the new regulatory rules is still pending. Therefore, the Company cannot predict all consequences of the new legal framework for its operations or the overall effect of the new law on its future earnings and financial condition. However, the BNetzA has already interpreted some of the new regulatory rules and ordinances to reach a conclusion that is different than that reached by, and in some cases less favorable to, the Company as well as other German network operators. For more information, see [Germany: Electricity Electricity Network Charges](#) and [Germany: Gas](#) below. In 2006, the following ordinance came into effect under the Energy Law of 2005:

*Network Connection Ordinance:* In November 2006 the network connection ordinance came into force. This ordinance increases potential liability for network operators for damages caused by energy supply disturbances by lowering the negligence threshold required for customers to collect damages. Under the ordinance, simple rather than gross negligence is the required threshold, while damages are capped at a maximum of 5,000 per customer.

In addition, the following ordinance has been discussed and may come into effect in 2007:

*Power Station Grid Connection Ordinance:* The German Ministry of Economics expects to issue a power station grid connection ordinance in the same package with its incentive regulation ordinance. The draft power

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station ordinance addresses regulatory aspects of power station connection to the electricity grid, and gives certain preferential treatment to the grid connection of new power stations with respect to capacity bottlenecks.

For the ordinance which has replaced the Federal Electricity Charge Regulation (*Bundestarifordnung Elektrizität*, or BTOElt ), see Germany: Electricity Electricity Rate Regulation below.

***Further German Legislation***

*Law on the Acceleration of Planning Procedures for Infrastructure.* The Law on the Acceleration of Planning Procedures for Infrastructure (*Infrastrukturplanungsbeschleunigungsgesetz*) came into force in December 2006. Pursuant to this law the costs for the connection of offshore wind power plants will not be paid by the plant operator, but will be borne by all grid users via an apportionment of indirect costs. The additional costs through 2020 are initially distributed among all four transmission system operators in Germany (including E.ON) and will lead to increased grid fees for all grid users.

*Energy Tax Act.* On August 1, 2006, the Energy Tax Act (*Energiesteuergesetz*) came into force. The Energy Tax Act, which is based on and incorporates the old Oil Taxation Law (*Mineralölsteuergesetz*), is the national implementation of the EU energy taxation directive from October 27, 2003 that requires certain minimal tax rates for different forms of energy. Furthermore, the former taxation of gas as an input in electricity generation has been abolished in order to comply with the EU directive, which stipulates that there be no taxation for inputs for electricity production. Since all proposed tax rates in the EU directive are below the actual German tax rates that apply to E.ON, there is currently no risk for the Company of a higher tax burden.

*Revisions of the German Competition Law.* In 2006 the German Ministry of Economics began an initiative to intensify its antitrust oversight of the country's electricity, natural gas and heating markets. In November 2006, a draft bill was introduced in Parliament to tighten the provisions of the Law Against Restraints of Competition (GWB) regarding the abuse of a dominant position in the energy markets. The draft bill stipulates that undertakings holding a dominant position in an energy market shall not charge or impose prices, price components or other commercial conditions that are less favorable than those of other undertakings in comparable markets (even if the deviation is slight) or charge prices that disproportionately exceed their costs. The Federal Cartel Office would have broad powers to penalize a market dominating electric utility for infractions by imposing sanctions under the GWB. E.ON believes that these changes would impede competition in Germany's energy markets, but is currently unable to quantify the effects that the implementation of the tightened provisions would have on E.ON. The bill is expected to be passed into law in the first half of 2007.

***European Regulation on Cross-Border Trading***

The Second Electricity Directive was accompanied by a new EU regulation on cross-border electricity trading (Regulation (EC) No. 1228/2003 on Conditions for Access to the Network for Cross-Border Exchanges in Electricity, or the Regulation on Cross-Border Electricity Trading ). This regulation required the establishment of a committee of national experts chaired by the European Commission. The committee will adopt guidelines on inter-transmission system operator compensation for electricity transit flows, on the harmonization of national transmission charges and on network congestion management. The applicable guidelines have already been drafted; the congestion management guidelines entered into force at the beginning of December 2006 and the other guidelines are expected to enter into force sometime in 2007.

At the EU level, a provisional charge system for cross-border electricity trading came into effect in March 2002. The system provides a fund mechanism to cover costs resulting from cross-border trades. Until 2003, money for the fund was raised from two sources: a charge on exports and socialized costs charged to all electricity customers. As of

January 1, 2004, a modified cross-border charge system has taken effect. Instead of charging export fees for international electricity flows, transmission system operators must now pay into a fund according to their net physical import and export flows. As before, the distribution of the funds depends on transit volume, so as a large transit country Germany continues to be a net receiver of funds. This transitional charge system will remain in effect until the guidelines outlined in the EU's Regulation on Cross-Border Electricity Trading are applicable, *i.e.* sometime in 2007.

**Table of Contents*****Greenhouse Gas Emissions Trading***

In order to reach the greenhouse gas emissions reduction targets set by the Kyoto Protocol to the United Nations Framework Convention on Climate Change (the Kyoto Protocol), the EU adopted a directive on emissions trading (Directive 2003/87/EC Establishing a Scheme for Greenhouse Gas Emission Allowance Trading Within the Community, or the Emissions Trading Directive) on October 13, 2003. The Emissions Trading Directive establishes a greenhouse gas emissions allowance trading scheme for member states which started in 2005. The trading scheme is currently limited to the trading of CO<sub>2</sub> emission certificates. The first obligatory commitment period under the Kyoto Protocol will follow from 2008 to 2012. Under the emissions allowance trading scheme, operators of identified types of industrial installations within the EU (including fossil fuel-fired combustion installations and gas turbines with a thermal input exceeding 20 MW) are obliged to acquire one or more CO<sub>2</sub> emission certificates that entitle the installation to emit a specified quantity of CO<sub>2</sub>. If an installation exceeds the level of emissions covered by its certificates (which were initially allocated free of charge), it is obliged to buy additional certificates on the market. If it fails to do so in the period 2005-2007, it must pay a penalty fee of 40 per ton of CO<sub>2</sub> emitted and the missing certificates additionally have to be bought on the market. For the period 2008-2012, the penalty is 100 per ton of CO<sub>2</sub>. If the emissions of an installation fall below the level of allocated emission certificates, the certificates can be sold on the market.

All EU member states have already transposed the Emissions Trading Directive into national law for 2005-2007. The two new member states Bulgaria and Romania are obliged to develop an allocation plan for the year 2007; these two drafts have so far not been approved by the EU. In Germany, in July 2004 the German Parliament passed the so-called Greenhouse Gas Emissions Trade Act (*Treibhausgas-Emissionshandelsgesetz* or TEHG) and in August 2004 the Allocation Act 2007 (*Zuteilungsgesetz 2007* or ZuG 2007), which consists of methods of permit allocation and application procedures, came into force. Most of E.ON Energie's gas-, oil- and coal-powered generating facilities are covered by the new legislation. In addition, E.ON Ruhrgas operates several compressor stations with a thermal capacity exceeding 20 MW which are covered by the legislation. Pursuant to ZuG 2007, E.ON Energie and E.ON Ruhrgas applied for the necessary CO<sub>2</sub> emission certificates by year-end 2004. The results of the allocation of CO<sub>2</sub> emission certificates for E.ON Energie's covered facilities by the competent authority (*Deutsche Emissionshandelsstelle* or DEHSt) are generally acceptable to E.ON. However, E.ON Energie has filed lawsuits against the DEHSt with respect to the allocation of CO<sub>2</sub> emission certificates at certain installations. The lawsuits are still pending subject to approval of the Federal Ministry of Environment. Most lawsuits concerning minor issues have been settled in favor of the DEHSt; a major lawsuit has been settled in favor of E.ON (pending approval of the Federal Ministry of Environment). Currently, the number of certificates granted to E.ON Energie's covered facilities nearly covers its emissions, with a slight shortfall. The actual shortfall at any time, however, depends on a number of influence parameters, e.g., availability of plants, weather conditions, electricity demand, electricity exports and fuel prices. E.ON considers the results of the allocation of CO<sub>2</sub> emission certificates for E.ON Ruhrgas covered facilities to be generally acceptable. Outside Germany, CO<sub>2</sub> emission certificates have also been allocated in all other EU member states where the Company has generation assets. Although the Company is generally satisfied with the allocations, E.ON Benelux has filed an objection for a single installation.

In 2006, the relevant German ministries developed a national allocation plan (NAP), which allocates CO<sub>2</sub> emission certificates to covered installations for the period 2008-2012, and submitted it to the European Commission. Certain other member states, such as the United Kingdom, Sweden and the Netherlands, have also submitted draft NAPs to the European Commission, which has already commented on some draft NAPs. For Germany, the proposed allocation amount was cut by the EU, and an agreement between Germany and the EU has been reached whereby Germany accepts the EU cut. The *Zuteilungsgesetz 2012* (ZuG 2012), which is the corresponding law, is expected to be finalized by the end of 2007.

The implementation of the Emissions Trading Directive took effect in 2005. Since the CO<sub>2</sub> emissions trading market is still a developing market, the Company cannot currently predict how the trading of CO<sub>2</sub> emission certificates will develop or what long-term impact, if any, the new regime may have on the Company's financial condition and results of operations. The market developed fairly well in 2005 and 2006 with increasing trading turnover, although the market for the period 2008-2012 is less developed than the market for 2005-2007 allowances. By the end of 2006, CO<sub>2</sub> emissions trading was possible in all EU member states. In general, prices have been rather volatile, and depend to a large extent on factors such as the gas to coal price differential, weather situation and plant

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outages. In April 2006, a massive one-day price drop took place when it became clear that the emissions market was better allocated than expected. One reason for this dramatic price drop was that the information was released to the market without any prior notice. The EU has since stated that further publications to the market will follow stricter rules similar to rules of the financial markets. Currently, the Company does not generally expect the emissions trading scheme to have a significant negative impact on its operations. However, in each of 2005 and 2006, companies of both the U.K. and Central Europe market units had to purchase additional CO<sub>2</sub> emission certificates on the market, with a resultant increase in operating costs. For more information, see Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31, 2005 Compared with Year Ended December 31, 2004. The German Federal Cartel Office has opened proceedings against E.ON Energie and RWE, alleging that these two companies are abusing their dominant position in the German energy market by including costs for CO<sub>2</sub> emission certificates in the calculation of energy prices for industrial customers. For more information, see Item 3. Key Information Risk Factors. For more information about the Company's trading operations, see Business Overview Central Europe Trading, U.K. Energy Wholesale Energy Trading and Nordic Trading.

***Energy Infrastructure and Security of Supply***

In December 2003, the European Commission proposed a legislative package on energy infrastructure and security of supply. In January 2006, the EU adopted Directive 2005/89/EC Concerning Measures to Safeguard Security of Electricity Supply and Infrastructure Investment (the Security of Supply Directive), which requires EU member states to ensure a high level of security of electricity supply by taking necessary measures to facilitate a stable investment climate. The Security of Supply Directive stipulates that transmission system operators set minimum operational rules and obligations for network security, which then may require approval by the relevant authority. Member states must also prepare, in close cooperation with the transmission system operators, a system adequacy report according to EU reporting requirements. Member states must transpose the Security of Supply Directive into national law by February 24, 2008.

In addition, in November 2005 the EU adopted a regulation on conditions for access to gas transmission networks, which covers access to all gas transmission networks in the EU and addresses a number of issues such as access charges (which must reflect the actual costs incurred), third party access services, capacity allocation mechanisms, congestion management, transparency requirements, balancing and imbalance charges, secondary markets (introducing a use-it-or-lose-it principle), and information and confidentiality provisions. The regulation also requires the establishment of a committee of national experts chaired by the European Commission, which has the authority to revise the rules annexed to the regulation. The regulation came into effect July 1, 2006, except for provisions concerning amendment of the rules in the regulation annex, which came into effect January 1, 2007. The regulation directly affects E.ON Gastransport, which has to comply with these binding rules in its function as transmission system operator.

The EU directive on energy end-use efficiency and energy services (Directive 2006/32/EC of the European Parliament and of the Council of April 5, 2006 on Energy End-Use Efficiency and Energy Services Repealing Council Directive 93/76/EEC) was adopted in February 2006 and must be implemented into national law by May 2008. It provides for indicative targets for member states to reduce overall end energy consumption by nine percent over a nine year period (ending in 2016), which would be achieved by boosting energy efficiency measures in the EU. Member states must propose national action plans on end user energy efficiency by July 2007, which have to be approved by the European Commission.

***Security of Energy Supply (Gas)***

On April 26, 2004, the EU adopted a directive establishing measures to safeguard the security of the EU's gas supply (Directive 2004/67/EC Concerning Measures to Safeguard Security of Natural Gas Supply, or the Gas Supply



Directive ). The Gas Supply Directive establishes a common framework within which member states must define general, transparent and non-discriminatory security of supply policies compatible with the requirements of a

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competitive internal gas market, and focuses on measures to be taken if severe difficulties arise in the supply of natural gas. The key elements of the Gas Supply Directive are:

Member states must adopt adequate minimum security of supply standards, and

A three step procedure will take effect in the event of a major supply disruption for a significant period of time. Under the three step procedure, the gas industry should take measures as a first response to such a disruption, followed by national measures taken by member states. In the event of inadequate measures at the national level, the Gas Coordination Group, consisting of representatives of member states, the gas industry and relevant consumers under the chairmanship of the European Commission, would then decide on necessary measures.

The Gas Supply Directive was required to be implemented by each member state by May 19, 2006. This directive has been implemented into German law through the Energy Law of 2005.

### ***Markets in Financial Instruments Directive***

The Markets in Financial Instruments Directive ( MiFID ), which substantially revises the existing Investment Services Directive, was adopted by the EU in April 2004. The original implementation deadline has been postponed and member states are now required to implement the directive to be effective by November 1, 2007.

MiFID establishes high level organizational and conduct of business standards that apply to all investment firms, including the application of EU capital adequacy standards. The extension of regulation to include commodity derivatives and investment advice are two notable features of the directive which could affect energy firms with energy trading activities. There are, however, a number of exemptions which could apply to energy firms, depending on how MiFID is eventually implemented in each of the EU member states. At this time the Company cannot predict precisely how the implementation of MiFID may affect its operations, but has set up an intra-Group implementation project in order to ensure that it can comply with any MiFID requirements that may apply to it on a timely basis.

### ***Regional Markets***

*Electricity.* In June 2005, the European Regulator Gas and Electricity Group ( ERGEG ) published a consultation paper on the creation of regional electricity markets and initiated a consultation procedure. The paper identified four action areas: availability of transmission capacity, availability in control of information, cooperation between network operators and incompatibility of wholesale market arrangements. In its conclusion paper dated February 8, 2006, ERGEG confirmed its intention to pursue the action areas and has therefore set up for each of seven identified European regions a regional coordination committee for each Mini Forum that was set up for the identified regions in September 2004. The MiniFora address congestion management in the EU electricity transmission network on a regional basis and aim to provide a plan and detailed timetable for the introduction of day-ahead coordinated market-based mechanisms, such as auctions of cross-border capacity. Participants in these MiniFora include regulators, transmission system operators, power exchanges and the European Commission.

In 2006, market integration was therefore pursued in regional market initiatives, thereby achieving considerable progress in consolidating the rules for the EU internal electricity market. The most prominent example of this is the adoption of the congestion management guidelines that were adopted by the European Commission in November 2006. According to Article 9 of EU Regulation 1228/03, these guidelines are mandatory and it is the responsibility of national regulators to ensure that they are applied fully.

*Gas.* After publishing a roadmap for the development of EU gas markets, the ERGEG drafted a detailed program in summer 2006 which will be discussed in a consultation process in 2007. The roadmap contains the following measures for the improvement of the current EU gas markets:

closer cooperation between national regulatory authorities;

strict control of unbundling fulfillment, especially in the case of activities in several member states;

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ad hoc and transparent publication of non-confidential information;

improvement of third party access at access points;

improved environment for cross-border trading; and

creation of regional gas markets.

### ***New European Energy Policy***

In the summer of 2005, the Competition Directorate-General of the European Commission launched a sector inquiry concerning the electricity and gas markets in the EU. This investigation, based on Article 17 of EU Regulation 1/2003, assessed the competitive conditions in EU electricity and gas markets. For more information, see Item 3. Key Information Risk Factors. As part of its final report issued on January 10, 2007, the European Commission tabled a package of measures to establish a new energy policy for the EU to combat climate change and boost the EU's energy security and competitiveness. The package of proposals includes a series of ambitious targets on:

*A true internal energy market:* The European Commission recommends a clearer separation of energy production from energy transmission and distribution, where the EU has a strong preference for ownership unbundling, *i.e.* the separation of ownership of the electricity and gas networks and the other commercial activities of the utilities. Another alternative that does not require ownership unbundling is the use of an independent system operator to operate the electricity and gas networks. The European Commission also calls for stronger independent regulatory control, in particular for cross border issues. To facilitate European-wide energy trading, the European Commission considers it necessary to establish a new single regulatory body at the EU level or, at a minimum, a European network of independent regulators that would take European interests into account and have the appropriate involvement of the Commission.

*Greenhouse gas emissions:* The European Commission believes that when international agreement on greenhouse gas emissions for the post-2012 timeframe is reached, the EU should aim to achieve a 20 percent cut in greenhouse gas emissions compared to 1990 levels by 2020 at the latest. Should other countries initiate similar plans to combat climate change, the European Commission has expressed the possibility of a 30 percent abatement target.

*Energy efficiency:* The European Commission's objective is to save 20 percent of total primary energy consumption by 2020 compared to 1990 levels. Potential methods include an efficient use of fuels in vehicles for transport, tougher standards and better labeling for appliances, improved energy performance of the EU's existing buildings, and improved efficiency of heat and electricity generation, transmission and distribution.

In February 2007, the Energy Council of the European Commission discussed this package, including the results of the sector inquiry report. The European Council is expected to discuss measures for an action plan at its March 2007 meeting. The German government has announced its intention not to support ownership unbundling, but to analyze all possible options for independent system operation.

### **GERMANY: ELECTRICITY**

#### ***The Electricity Feed-in Law and the Renewable Energy Law***

Under the amended German *Stromeinspeisungsgesetz* (law governing renewable electricity fed into the power network, or Electricity Feed-In Law ), which came into effect in 1991, all regional utilities with standard rate customers were required to pay for energy produced from renewable resources, including wind-generated electricity, fed into the network. The price paid by the regional utility to the generator of renewable energy, determined by the average electricity price to the end user nationwide, typically exceeded the regional utilities' procurement costs, thereby forcing regional utilities to pay part of the costs of renewable sources of energy. Regional utilities in whose supply area the feeding plants are located had to bear these costs.

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As this led to distortions in competition, the German Parliament passed another change in the Electricity Feed-in Law, which came into effect April 1, 2000. Important aspects of the changed law, which is called the Renewable Energy Law, include:

**Fixed charges for renewable energies:** Charges for renewable energies are fixed. For wind turbines coming online in 2006, the charge is fixed at 8.36 cent/kWh. This charge is limited in time, with a general term of five years that may be extended up to 20 years depending upon the actual production volume of the installation. After five years, the charge is reduced to 5.28 cent/kWh if 150 percent or more of a reference production, which is the potential production of the installed wind turbine operating with a constant wind speed of five meters per second over five years, has been produced. In addition, the fixed charge is reduced by two percent for new wind turbines every year. For wind turbines coming online in 2007, this means a reduction to 8.19 cent/kWh and 5.17 cent/kWh, respectively.

**National burden sharing:** The Renewable Energy Law assumes that the subsidy obligation would be passed on in full to the supplying companies. At the transmission company level, there is an equalization process covering the whole country. Each transmission company first determines how much electricity it takes up under the Renewable Energy Law and how much electricity in total flows in its region to end users. An equalization will then be effected among all transmission companies so that all transmission companies take on and subsidize proportionally equivalent amounts of renewable electricity under the statute. The transmission company will then pass these quantities of electricity and the corresponding costs on to the suppliers delivering electricity to end users in its region in proportion to their respective sales.

The Renewable Energy Law abolished regional differences in electricity costs for consumers and the related competitive disadvantages for E.ON Energie. However, the growing production of energy from wind turbines has led to growing costs for balancing power, network extensions and back-up power for power stations that have to be kept in reserve. This became a growing burden for E.ON Energie, since almost half of Germany's wind turbines are situated in the network control area of E.ON Energie AG, an area that meets approximately 30 percent of German electricity demand.

In August 2004, an amendment of the Renewable Energy Law came into force which partially addressed this burden by introducing an obligation for the transmission system operators to share the effort of balancing power by equally distributing the feed-in of electricity from wind power according to the electricity consumption in the area of each transmission system operator. As a result of this burden sharing mechanism, E.ON Energie is able to pass a certain amount of balancing costs on to other network operators. Other costs caused by renewable energy (network extension and back-up power) are, however, currently not part of the national burden sharing mechanism.

A further amendment in October 2006 reduces the additional payment for renewable energy support for companies with an electricity consumption higher than 10 GWh per year and with electricity costs higher than 15 percent of their total turnover to an amount of 0.05 cent/kWh. As a result, non-energy-intensive end consumers have to pay a higher share of the subsidies for renewable energy under the Renewable Energy Law. In 2006, the additional payment for renewable energy that non-energy-intensive customers made amounted to 0.76 cent/kWh.

E.ON Energie believes that the charges for renewable energies are still too high and that competition which would bring down the cost of renewable energy generation has not developed.

In two court rulings dated December 22, 2003, the German Federal Court of Justice found that contractual provisions used by E.ON's competitor RWE to impose taxes and levies upon the customer (so-called *Steuer- und Abgabeklauseln*) also apply to the additional burdens placed on electric power companies by the Renewable Energy Law, despite the fact that those burdens are neither taxes nor levies in a legal sense. Although E.ON was not a party to

the proceedings that resulted in these rulings, it believes these rulings could be a legal base for all German electric power companies to pass the costs imposed by the Renewable Energy Law on to their customers.

***Co-Generation Protection Law***

In order to protect existing CHP plants and give incentives to improve them, the German Parliament passed a new Co-Generation Protection Law (*Kraft-Wärme-Kopplung-Gesetz*) on March 1, 2002, which came into effect on April 1, 2002 and replaced the former Co-Generation Protection Law of May 2000. The law, which will expire at the

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end of 2010, requires local network operators to pay CHP plants the following bonus payments for electricity that is produced in combination with heat and fed into the public network:

CHP plants that were commissioned before 1990 received 1.53 cent/kWh in 2002 and 2003, 1.38 cent/kWh in 2004 and 2005, and 0.97 cent/kWh in 2006;

CHP plants that were commissioned after 1990 received 1.53 cent/kWh in 2002 and 2003, 1.38 cent/kWh in 2004 and 2005, and 1.23 cent/kWh in 2006, and will receive 1.23 cent/kWh in 2007, 0.82 cent/kWh in 2008, and 0.56 cent/kWh in 2009;

CHP plants that are modernized received 1.74 cent/kWh in 2002, 2003 and 2004, 1.69 cent/kWh in 2005, and 1.69 cent/kWh in 2006, and will receive 1.64 cent/kWh in 2007 and 2008 and 1.59 cent/kWh in 2009 and 2010; and

Small CHP plants with an installed capacity of less than two MW received 2.56 cent/kWh in 2002 and 2003, 2.4 cent/kWh in 2004 and 2005, and 2.25 cent/kWh in 2006, and will receive 2.25 cent/kWh in 2007, 2.1 cent/kWh in 2008 and 2009, and 1.94 cent/kWh in 2010.

The local network operators are in turn allowed to pass on the costs of the bonus payments to the network operators, which may pass on the costs of the bonus system to their customers. A nationwide equalization process among the utilities was implemented in order to ensure the equal distribution of the costs of the bonus system across utilities. In 2006, every consumer had to pay an additional approximately 0.341 cent/kWh (excluding VAT). Customers with an electricity consumption of more than 100,000 kWh had to pay only 0.05 cent/kWh for that portion of their electricity consumption exceeding 100,000 kWh per year. For those customers whose electricity costs are higher than 4 percent of their total turnover, this fee for electricity consumption exceeding 100,000 kWh per year is limited to 0.025 cent/kWh. In 2004, the government together with the utilities started a monitoring process to evaluate the extent to which CO<sub>2</sub> emissions have been reduced as a result of this law and whether the current bonus payments are adequate. While acknowledging that a substantial reduction in CO<sub>2</sub> emissions has been achieved, the German Federal Ministries of Environment and of Economics have recognized that the reduction targets for 2010 cannot be entirely reached. The German government is therefore expected to make a proposal for changes to the Co-Generation Protection Law, probably in 2007.

The European Union has passed a co-generation directive in order to promote the use of co-generation and thereby increase energy efficiency and reduce CO<sub>2</sub> emissions. The directive corresponds largely to the German national CHP legislation and will not require a change in current German law.

***Electricity Network Access***

The First Electricity Directive was implemented in Germany with a framework for negotiated third party access to high-, medium- and low-voltage networks agreed by the associations of all German utilities and of industrial customers (*Verbändevereinbarung*, amended as *Verbändevereinbarung II* and *Verbändevereinbarung II+*). *Verbändevereinbarung II+* was valid until December 2003 and subsequently utilities still acted according to its rules until the Energy Law of 2005 came into force. As of July 13, 2005, electricity network access is regulated according to the Energy Law of 2005, as described in Revisions of the German Energy Law above.

***Electricity Network Charges***

As described in Revisions of the German Energy Law above, the regulation of electricity network charges started in July 2005, with network charges calculated according to a cost-based rate-of-return model. To obtain approval for



network charges to be used starting sometime in 2006, network operators had to calculate their network charges using the cost-based rate-of-return model and submit the calculated charges to the BNetzA by the end of October 2005.

Approval of the network charges by the BNetzA was originally due by May 1, 2006. Due to the complex check of companies' cost calculations, approval was delayed by several months and received by E.ON Energie's network operators between July and October, 2006. Approved network charges averaged a 13.7 percent reduction from E.ON Energie's filed network charges. The approved network charges were applied by the network operators

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immediately after receipt of the relevant approval. The BNetzA has announced that it will require network operators to refund to network customers the difference between operators' actual network charges and their approved charges for the period between November 1, 2005 (the day after applications for network charges approval were due) and the relevant approval date. Several German utilities have challenged the BNetzA's decisions in third party legal proceedings; however, final decisions have not yet been made and E.ON intends to wait for the outcome of the pending legal proceedings before making any refunds to customers. Network charges will be valid until December 31, 2007.

***Electricity Rate Regulation***

In 2006, prices at which local and regional distributors sold electricity to standard-rate and smaller industrial customers were regulated by the economics ministries of each of the German states (as provided in the BTOElt). The rates were set at a level to assure an adequate return on investment on the basis of the costs and earnings of the electricity company. However, these governmentally-set ceiling rates do not completely represent the actual market situation, with numerous rates offered which are designed to meet different customers' special needs. The average price charged by utilities for an average standard-rate customer in Germany with an assumed annual consumption of 3,500 kWh was, according to the VDEW, 19.46 cent per kWh in 2006 (all taxes included), while E.ON Energie charged an average of 19.51 cent per kWh. The average price quoted by the German Association for Energy Consumption ( VEA ) for industrial customers was 10.51 cent per kWh, while the average price per kWh charged by E.ON Energie was 10.82 cent per kWh, as quoted by VEA as of July 1, 2006 (net of tax). Pursuant to the Energy Law of 2005, electricity rate regulation should be abandoned in mid-July 2007. A new ordinance with respect to the tariffs for household customers (including some transitional arrangements) largely replaced the BTOElt in November 2006. A general tariff is again provided, but not yet legally well defined.

Prices for sales of electricity by E.ON Energie to regional electricity companies, municipal utilities and large industrial customers are not regulated by the BTOElt; however, they are governed by the GWB, which requires that no patently unreasonable rates are set.

**GERMANY: GAS*****Gas Network Access***

Until the Energy Law of 2005 took effect, E.ON Ruhrgas used the framework for third party gas network access contained in an agreement between E.ON Ruhrgas and the Competition Directorate-General of the European Commission with respect to a matter that had been pending before the Competition Directorate. The agreement contained, among other commitments by E.ON Ruhrgas with respect to its transmission business such as greater transparency and improved congestion management, an agreement to use an entry/exit system for gas network access. The agreed entry/exit system was introduced by E.ON Gastransport on November 1, 2004. For more information, see

Business Overview Pan-European Gas Transmission and Storage. As of July 13, 2005, gas network access is regulated according to the Energy Law of 2005, as described in Revisions of the German Energy Law above. Under the Energy Law of 2005, gas network operators have to offer entry and exit capacities for the transmission of gas separately to system users (entry/exit system). Network access has to be granted without fixing transport routes, which are dependent on the specific transaction. All network operators are obliged to cooperate, in order to ensure that system users need only one contract for entry capacities and one contract for exit capacities, including when gas transportation is carried out via several conducted networks. In order to comply with this requirement, E.ON Gastransport adjusted its entry/exit system with the introduction of the ENTRIX 2 system on February 1, 2006.

In order to comply with this statutory obligation, the gas industry started to implement a network access model at the end of 2005 in consultation with the BNetzA. The Association of the German Gas Industry (BGW) and the

Association of the Municipalities (*Verband der Kommunalen Unternehmen*, or VKU ) drafted an agreement regarding cooperation between operators of gas supply networks located in Germany which contains principles for the cooperation of the network operators and standard terms and conditions for access to networks. The agreement uses one network access model with different market areas. Within each market area, which each include a number of network subsections, shippers are entitled to choose the following variants for gas transportation: 1) transmission

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over different networks from an entry point to an exit point at the end consumer or 2) transmission from an entry point to an exit point within a network subsection (*e.g.* to exit via a city gate). E.ON Gastransport adjusted its entry/exit system in view of the cooperation agreement in October 2006, the date that the new network access model took effect.

Following the development of the gas industry cooperation agreement, a single gas trader (Nuon) and a German energy association (*Bundesverband Neuer Energieanbieter*, or BNE) filed claims against three network operators (including E.ON Hanse) which challenged the use of the second variant for gas transportation. In November 2006, the BNetzA decided that this variant does not comply with the Energy Law of 2005, thus necessitating changes to the existing gas network operators' cooperation agreement. The E.ON Group decided to accept this decision after a detailed analysis of the regulator's decision and to implement the necessary changes into the existing cooperation agreement. BGW and VKU have prepared a revised draft of the cooperation agreement with the necessary changes, which is currently still under discussion with the BNetzA. E.ON Gastransport has already implemented all changes that are necessary in order to comply with the BNetzA's decision and the revised cooperation agreement.

***Gas Network Charges***

As described in Revisions of the German Energy Law above, the regulation of gas network charges started in July 2005, with network charges calculated according to a cost-based rate-of-return model. To obtain approval for network charges to be used in 2006, distribution network operators had to submit the calculated charges to the BNetzA by the end of January 2006, with approval to be granted by August 1, 2006. Since the BNetzA examined the application documents in detail, approval was delayed and granted to E.ON Energie's distribution network operators between September and November 2006. Approved network charges of E.ON Energie's regional distribution network operators were reduced by approximately ten percent on average, based on a different interpretation of the new law by the BNetzA. In addition, the filed network charges of Ferngas Nordbayern GmbH (Ferngas Nordbayern) and Thüga in the Pan-European Gas market unit were reduced by 19.0 and 17.2 percent, respectively. As in the case of electricity network charges described above, the BNetzA has announced that the lower charges should be economically effective from the day after applications were due, in this case February 1, 2006. A preliminary ruling of the competent court in a third party suit brought by Vattenfall Europe Transmission has denied the BNetzA's decisions to require refunds; a decision on the merits of the case is, however, still pending and E.ON will wait until the legality of the refunds is decided before refunding any network charges. Network charges will be valid until March 31, 2008.

The Energy Law of 2005 provides an exemption from cost calculations for gas transmission networks if actual or potential pipeline competition can be proved. In January 2006, E.ON Gastransport gave notice to the BNetzA that it would calculate its network costs on a market-oriented basis (rather than submitting the charges for BNetzA approval). As the BNetzA has not yet determined whether actual or potential pipeline competition exists, E.ON Gastransport is not yet required to submit calculated gas network transmission charges to the BNetzA as described above.

***Gas Rates***

Gas and heat rates are not regulated in Germany, but the GWB does apply.

For information about proceedings regarding gas price calculations, *e.g.* against E.ON Hanse, see Item 3. Key Information Risk Factors.

**U.K.**

Liberalization of the electricity and gas industries in the United Kingdom largely pre-dated the requirements of the First and Second Electricity and Gas Directives described under EU/Germany: General Aspects (Electricity and Gas)

above, but the U.K. regulatory regime is basically consistent with the terms of such directives. E.ON UK is also subject to U.K. and EU legislation on competition.

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The gas and electricity markets in England, Wales and Scotland are regulated by a single energy regulator, the Gas and Electricity Markets Authority (the Authority), established in November 2000. The Authority is assisted by Ofgem, which is governed by the Authority. The principal objective of the Authority is to protect the interests of consumers of gas and electricity, wherever appropriate, by the promotion of effective competition in the electricity and gas industries. The Authority may grant licenses authorizing the generation, transmission, distribution or supply of electricity and the transportation, shipping or supply of gas. The Energy Act 2004 also gives the Authority power to license the operation of gas and electricity interconnectors. Any such license will incorporate by reference as appropriate the standard conditions determined for that type of license, which may be modified by the Authority. The license may also include other conditions that the Authority considers appropriate. License conditions may be modified in accordance with their terms or under the provisions of the Electricity Act 1989 (as amended) or Gas Act 1986 (as amended), as appropriate. The Authority has power to impose financial penalties on licensees and/or make enforcement orders for breach of license conditions and other relevant requirements.

The Authority also has within its designated areas of responsibility many of the powers of the Office of Fair Trading to apply and enforce the prohibitions in the Competition Act 1998 in relation to anti-competitive agreements or abuse of market dominance, including imposing financial penalties for breach. Since May 1, 2004, following reform of the EC competition law regime, the Authority also has the power to apply Articles 81 and 82 of the EC Treaty, which deal with control of anti-competitive agreements and abuse of market dominance. Within its designated areas, the Authority also exercises concurrently with the Office of Fair Trading certain functions under the Enterprise Act 2002 relating to the power to make market investigation references to the Competition Commission.

### ***Electricity***

Unless covered by a license exemption, all electricity generators operating a power station in England, Wales or Scotland are required to have a generation license. The principal generation license within the E.ON U.K. business is held by E.ON UK. Although generation licenses do not contain direct price controls, they contain conditions which regulate various aspects of generators' economic behavior.

The distribution licenses held by Central Networks East and Central Networks West (the two companies operating under the brand Central Networks) authorize the licensee to distribute electricity for the purpose of giving a supply to any premises in Great Britain. They provide for a distribution services area, equating to the former authorized area of the former public electricity suppliers in the East Midlands and West Midlands areas, respectively, in which the licensee has certain specific distribution services obligations. Under the Electricity Act 1989 (as amended), an electricity distributor has a duty, except in certain circumstances, to make a connection between its distribution system and any premises for the purpose of enabling electricity to be conveyed to or from the premises and to make a connection between its distribution system and any distribution system of another authorized distributor, for the purpose of enabling electricity to be conveyed to or from that other system.

The license obligations extend to not distorting the competitive market for the provision of those connections either through the distribution business' own connection activities, through an affiliate or through an unrelated third party. Presently a number of U.K. distributors, including both Central Networks companies, are under investigation by Ofgem over concerns that they may have breached this aspect of their licenses.

The distribution licenses place price controls on distribution. The current distribution price controls are in effect for a five year period ending March 2010, and are expected to provide for overall stable prices for the distribution of electricity over that period. The price controls are intended to provide companies with sufficient revenues to allow them to finance their operating costs and capital investment. In addition to caps on revenue, the price controls also include targets for network losses and overall quality of network performance based upon the average number and duration of supply outages experienced by consumers. Companies can be either rewarded or penalized for exceeding

or failing these targets.

The supply license held by Powergen Retail Limited authorizes the licensee to supply electricity to any premises in Great Britain. It provides for a supply services area, equating to the former authorized area of Powergen Energy plc, as the former public electricity supplier in the East Midlands, in which the licensee has certain specific supply services obligations. The supply license used to place price controls on supply; however, these price controls

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lapsed after March 31, 2002. Following the end of the price controls, Ofgem relies on monitoring competition and, where necessary, using its powers under the Competition Act 1998 to tackle abuse. In addition, Ofgem is pursuing a range of measures under its Social Action Plan to help vulnerable and low income customers. It is also continuing to work with the industry to improve the process for customers when they switch suppliers.

A separate supply license is held by E.ON UK, trading as E.ON Energy, which does not extend to supply to domestic premises. E.ON UK also continues to hold a second-tier supply license for Northern Ireland (to which the Utilities Act 2000 generally does not extend).

Following the acquisition of the U.K. retail energy business of the TXU Group in October 2002, E.ON UK also holds a number of additional electricity and gas supply licenses through certain of the companies that were acquired as part of that deal. Customers supplied under these licenses have been migrated to the supply licenses held by Powergen Retail Limited and E.ON UK.

In June 2005, E.ON UK acquired the electricity supply company of Economy Power. Migration of former Economy Power customers, which were supplied under a separate electricity supply license, to the supply licenses held by Powergen Retail Limited and E.ON UK was completed in June 2006.

Under section 33BC of the Gas Act 1986, section 41A of the Electricity Act 1989 and section 103 of the Utilities Act 2000, electricity and gas suppliers are subject to a statutory obligation (known as the Energy Efficiency Commitment (EEC)) which requires them to achieve targets for installing energy efficiency measures in the household sector. The current obligation (known as the Electricity and Gas (Energy Efficiency Obligations) Order 2004) covers the period from April 1, 2005 to March 31, 2008. A range of energy efficiency measures qualify for the obligation, with E.ON UK anticipating that about 60 percent of its expenditures will be on home insulation. The U.K. government estimates that the cost to suppliers of this requirement will be about GBP9 per year for each of their gas and electricity customers, although the actual cost will depend on the cost to suppliers of contracting for energy efficiency measures, which is to some extent uncertain.

***Gas***

Licenses to ship gas and to supply gas are held by a number of companies in the U.K. market unit.

E.ON UK operates gas pipelines that are subject to the Pipelines Act 1962 (as amended), including pipelines at Killingholme, Cottam, Connaught Quay, Enfield and Warrington. This legislation gives third parties rights to apply to the Secretary of State for a direction requiring the pipeline owner to make spare capacity available to the third party.

**NORDIC**

The description under EU/Germany: General Aspects (Electricity and Gas) above is applicable for E.ON Sverige AB and its two Finnish subsidiaries and these companies are also subject to EU and national legislation on competition.

*Electricity.* The primary legislation applicable to the electricity industry in Sweden is the Swedish Electricity Act (*Ellag (1997:857)*, or the Electricity Act ) that came into force on January 1, 1998, and the statutes and provisions issued pursuant to the Electricity Act.

The Electricity Act promotes competition by creating opportunity for customers to enter into agreements with the supplier of the customer's choice. In order to further ensure competition in sales of electricity, the Electricity Act also requires functional unbundling of the generation/sales and the transmission and distribution businesses, as well as legal unbundling of these businesses so that transmission and distribution operations are carried out by a separate legal



entity. As a consequence, electricity customers in Sweden have separate contracts with a retail supplier and an electricity distributor. In Sweden, retail prices are not regulated.

Transmission and distribution of electricity are considered to be natural monopolies and are subject to regulation. The Energy Markets Inspectorate ( EMI ), which is part of the Swedish Energy Agency, grants licenses to erect power lines and carry on distribution operations. As the regulator for the Swedish electricity and gas markets, EMI has the authority to supervise the monopoly transmission and distribution businesses in order to

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protect the interests of the customers. EMI also oversees third party access to the networks. It monitors network charges and other terms for the transmission and distribution of electricity and is responsible for setting certain standards with respect to transmission and distribution.

In Sweden, the high-voltage transmission grid is owned and operated by Svenska Kraftnät, the state-owned national grid company. The mid- and low-voltage distribution networks are owned and operated by a large number of both privately and publicly owned companies. A tariff, consisting of an annual connection fee and an hourly transmission charge, applies for access to the national transmission as well as the regional and local distribution networks. Market participants pay for the right to feed in or take out electricity at just one point, which gives the participant access to the entire grid system and enables it to trade with any of the other market participants in the Nordic grid system. EMI also monitors quality of supply data for statistical reasons.

Changes in the Electricity Act regarding distribution regulation came into force in July 2002. The amendments provide that network charges have to be reasonable compared to the distribution companies' performance. The concept of performance has initially been defined by EMI, which annually constructs a fictitious network for each utility in order to calculate the resources needed in the local network business. The resulting value of the network is then compared to the utility's actual revenues in order to assess the reasonableness of the network charges. For this purpose EMI has created a regulation model called the Network Performance Assessment Model (NPAM). At present, EMI is only assessing the performance of the local networks but intends to include the regional networks in the near future.

The NPAM was used for the first time to evaluate network charges for 2003. Swedish electricity distribution companies reported the required information to EMI, which examined the operation of the companies. EMI decided in December 2004 to prolong its inspection of a number of Swedish electricity distribution companies. Within E.ON Sverige, 14 distribution areas were initially subject to the additional inspection, with inspection satisfactorily concluded for 13 of these areas. For the remaining area, EMI initially decided that E.ON Sverige must reduce the network charges for 2003 by SEK 19.7 million, by repaying customers a portion of the network charges. E.ON Sverige has appealed the decision to the relevant administrative court. So far, EMI has admitted an increase of the weighted average cost of capital (WACC) from 4.8 percent interest pre tax to 6.2 percent, which has reduced the obligation of repayment to SEK 16.2 million. A judgment in the court case is expected at the beginning of 2008 at the earliest. With respect to 2004 network charges, EMI decided in October 2005 to prolong its inspection of 4 distribution areas within E.ON Sverige. EMI has not issued a final decision regarding 2004 network charges. With respect to 2005 network charges, EMI decided in December 2006 not to prolong its inspection of any distribution areas within E.ON Sverige, which means that the 2005 network charges cannot be subject to any further actions by EMI.

In July 2005, several sections of the Electricity Act were amended in order to comply with the Second Electricity Directive. Among other changes, the amendments require more detailed regulation concerning the calculation of network charges; more information on the invoice and in advertising about the composition of energy sources used in producing the delivered electricity; that distribution companies procure the electricity required to cover their net losses in an open, non-discriminatory and market-oriented manner; and that distribution companies establish a supervision plan which states what kind of actions will be taken in order to prevent discriminatory behavior towards other operators in the market.

As a result of a severe storm that hit Sweden in January 2005, the Swedish government passed new legislation concerning electricity distribution in December 2005. Under the new law (*SFS 2005: 1110*), which was incorporated into the Electricity Act and which came into force on January 1, 2006, a customer shall be compensated for power outages that last more than 12 hours, with the compensation payment being equal to at least 12.5 percent and up to 300 percent of the customer's annual network charges, with compensation being based on the length of the outage. With effect of new legislation from January 1, 2011, the maximum allowable period of time for a power outage will

be 24 hours. If this time period is exceeded the provisions concerning compensation payment will still be applied and if this occurs frequently, the network operator will risk losing its license to operate the grid area.

*Gas.* In order to comply with the requirements of the Second Gas Directive, a new Swedish Natural Gas Act (*Natargaslag (2005:403)* or the Natural Gas Act ) was implemented on July 1, 2005. From this date, all non-

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household customers may choose their gas supplier. Household customers will be eligible as of July 1, 2007. In addition, the Natural Gas Act stipulates legal and functional unbundling of the transmission, distribution, storage and regasification (LNG) businesses from the supply business and requires separate accounting for the transmission, distribution, storage and regasification (LNG) businesses. The law also requires non-discriminatory third party access to the gas networks based on published charges for eligible customers. Further, distribution and transmission companies must also establish a supervision plan which states what kind of actions will be taken in order to prevent discriminatory behavior towards other operators in the market. As in the former Natural Gas Act, the new Natural Gas Act contains rules regarding the granting of licenses to build and use natural gas pipelines and natural gas storage, as well as new rules regarding the granting of licenses for LNG facilities.

The Natural Gas Act also requires EMI to pre-approve the criteria used by network operators to establish network charges valid from 2006. EMI approved the model (the criteria for network charges) used by E.ON Sverige in November 2005. In addition, the Natural Gas Act requires that the revenues from network charges be reasonable compared to costs for capital and operations, and stipulates that the reasonableness of network charges remains subject to examination by EMI ex-post. The first examination will take place in 2007 regarding revenues for 2006. If EMI finds that revenues from network charges are not reasonable, it can obligate the operator to reduce network charges.

*Security of Energy Supply (Gas).* The Gas Supply Directive has been implemented into the Swedish Natural Gas Act. The amendments entered into force July 1, 2006 and impose a general obligation on the operators in the natural gas market to plan and take necessary measures to ensure the supply of natural gas. The Natural Gas Act does not give any detailed regulation on how the operators shall perform their obligation. Instead, the Swedish government has authorized the Swedish Independent System Operator (*Affärsverket svenska kraftnät*) to determine in more detail which measures shall be taken in this respect. At this time it is unclear which obligations can be imposed on the operators in Sweden.

*Renewable Energy and Electricity Certificates.* The Swedish energy policy is based on the assumption that Sweden will obtain all its energy from renewable energy sources in the long term. The most important policy instrument in promoting renewable electricity production is the electricity certificate system. The Swedish electricity certificate system has been in operation since May 2003. The objective of the system, which is based on the Swedish Act on Electricity Certificates (*SFS 2003:113*), was initially to increase the volume of electricity produced from renewable energy sources by 10 TWh by 2010 as compared with the 2002 level.

During 2004 EMI gave the Ministry of Sustainable Development recommendations on the electricity certificate system based on an analysis of the system. EMI recommended that the electricity certificate system be made permanent and that long-term quota levels be set if necessary investments in renewable energy are to take place. Due in part to this analysis, the Swedish government delivered proposals on an amendment of the Act on Electricity Certificates to the Swedish parliament. The proposed amendment contained suggestions that the Swedish electricity certificate system be extended until 2030 and that the objective of the system be revised to increase the volume of electricity produced from renewable energy sources by 17 TWh by 2016 as compared with the 2002 level. The proposals were adopted by the Swedish parliament in June 2006 and the amendments entered into force on January 1, 2007. For more information about the current system, see [Business Overview Nordic Market Environment](#).

**U.S. MIDWEST*****Retail Electric Rate Regulation***

The KPSC has regulatory jurisdiction over the rates and service of LG&E and KU and over the issuance of certain of their securities. The Virginia State Corporation Commission also has parallel regulatory jurisdiction with respect to certain of KU's operations. The KPSC, in the case of LG&E and KU, and the Virginia State Corporation Commission,

in the case of KU, regulate the retail rates and services of LG&E or KU and, via periodic public rate cases and other proceedings, establish tariffs governing the rates LG&E and KU may charge customers. Because KU owns and operates a small amount of electric utility property in Tennessee and serves five customers there, KU is also subject to the jurisdiction of the Tennessee Regulatory Authority.

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LG&E and KU are each a public utility as defined in the Federal Power Act. Each is subject to the jurisdiction of the Department of Energy and the FERC with respect to the matters covered in the Federal Power Act, including the wholesale sale of electric energy in interstate commerce. In addition, the FERC and certain states share jurisdiction over the issuance by public utilities of short-term securities.

In June 2004, the KPSC issued an order approving increases in the base electric and gas rates of LG&E and the base electric rates of KU. In the KPSC's order, LG&E was granted increases in annual base electric rates of approximately \$43.4 million or 7.7 percent and in annual base gas rates of approximately \$11.9 million or 3.4 percent. KU was granted an increase in annual base electric rates of approximately \$46.1 million or 6.8 percent. The rate increases took effect in July 2004. During 2004 and 2005, the Attorney General of Kentucky ( Kentucky Attorney General ) requested a rehearing on these rate increases and conducted an investigation into the communications between the companies and the KPSC during the rate proceedings. The KPSC also opened an investigation into the communications involved in the rate cases. In December 2005, the KPSC issued an order noting completion of its inquiry, including review of the Kentucky Attorney General's investigative report, and concluded no improper communications occurred during the rate proceedings. Final proceedings on the sole remaining issue on rehearing concerning state tax rates used in calculating the rate increases occurred during the first quarter of 2006. In March 2006, the KPSC issued a final order in the rate case proceedings which resolved this remaining calculational issue in LG&E's and KU's favor consistent with the original July 2004 rate increase order.

The electric rates of LG&E and KU in Kentucky contain fuel adjustment clauses whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to all retail electric customers. The KPSC requires public hearings at six-month intervals to examine past fuel adjustments, and at two-year intervals to review past operations of the fuel clause and transfer the then-current fuel adjustment charge or credit to the base charges. At present, the KPSC also requires that electric utilities, including LG&E and KU, publicly file certain documents relating to fuel procurement and the purchase of power and energy from other utilities.

In 1992, the Kentucky General Assembly enacted a statute which provides an alternative procedure to increasing base rates by allowing utilities to recover the costs of environmental compliance by means of a surcharge rather than by opening a general rate case. Pursuant to this statute, LG&E's and KU's electric rates in Kentucky contain an environmental cost recovery surcharge which recovers costs incurred by LG&E or KU that are required to comply with the U.S. Clean Air Act Amendments of 1990 and other environmental regulations which apply to coal combustion wastes and by-products from facilities utilized for the production of energy from coal. The magnitude of the surcharge fluctuates with the amount of approved environmental compliance costs incurred during each period. At six-month intervals, the KPSC reviews the operation of each utility's environmental surcharge, and, after review, may disallow any surcharge amounts found not to be just and reasonable. In addition, every two years the KPSC reviews and evaluates the past operation of the surcharge, and, after review, may disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found to be just and reasonable into the utility's existing base rates.

***Retail Gas Rate Regulation***

LG&E's gas rates in Kentucky contain a gas supply charge, whereby increases or decreases in the cost of gas supply are reflected in LG&E's rates, subject to approval of the KPSC. The gas supply charge procedure prescribed by order of the KPSC provides for quarterly rate adjustments to reflect the expected cost of gas supply in that quarter. In addition, the gas supply charge contains a mechanism whereby any over- or under-recoveries of gas supply cost from prior quarters will be refunded to or recovered from customers through the adjustment factor.

***Transmission Developments***

In September 2006, LG&E and KU withdrew from the MISO transmission organization. Regulatory proceedings regarding the costs and benefits of MISO participation and analyzing exit matters had been underway since July 2003 at the KPSC and October 2005 at the FERC. Primary regulatory orders authorizing the withdrawal from MISO were received in July 2006 from the KPSC and in March 2006 from the FERC. In LG&E's and KU's view, the costs of MISO membership outweighed the benefits, particularly in light of the financial impact of MISO's implementation of new day-ahead and real-time energy markets in April 2005. In October 2006, LG&E and KU

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paid MISO approximately \$33 million in satisfaction of the aggregate exit fee. Pursuant to agreement, LG&E and KU have commenced proceedings to confirm or adjust certain components of this calculated amount; these proceedings are ongoing. LG&E and KU estimate that the exit fee will be more than offset by savings resulting from withdrawal from MISO. Orders of the KPSC approving the exit from MISO have authorized the establishment of a regulatory asset for the exit fee, subject to adjustment for possible future MISO credits, and a regulatory liability for certain revenues associated with former MISO charges. Historically, LG&E and KU have received approval to recover regulatory assets and liabilities in future rate proceedings, although this cannot be assured. Pursuant to FERC requirements, LG&E and KU have contracted with independent third parties to manage applicable operational aspects of their transmission systems following the MISO exit, including functions relating to reliability coordinator and independent transmission system operator roles. The SPP will now function as the transmission system operator and the TVA will now function as the reliability coordinator, respectively, for LG&E and KU.

LG&E, KU and other E.ON U.S. subsidiaries sell excess power pursuant to FERC-granted market-based rate authority. In connection with recent FERC market-based rate and market power regulatory developments, the E.ON U.S. entities operate under an approved tariff whereby they may make applicable wholesale power sales within their own control areas (and one adjacent control area) subject to a price cap set at a relevant MISO power pool index price. The tariff further allows for sales at market-based rates at the boundary of such control areas, subject to certain restrictions. Industry-wide FERC proceedings continue with respect to market-based rate matters, and E.ON U.S. s market-based rate authority is subject to such future developments. It is noted that FERC decisions in certain other market-based rulings have involved cost-based, rather than market index price caps, when there is a deemed need to mitigate market power issues.

The charges relating to transmission and wholesale power market structures and prices following LG&E s and KU s exit from MISO are not completely estimable and may have variable effects on energy and transmission purchases and sales and on related costs and revenues. Additional changes may have an effect on LG&E s and KU s ability to access the transmission system for wholesale or native load power activities. LG&E and KU believe that, over time, the benefits and savings from their exit of MISO will outweigh the costs and expenses. However, until post-MISO market conditions and operations have matured, the effects on financial condition, liquidity and results of operations will remain difficult to fully predict.

A number of regional or industry-wide general FERC proceedings regarding transmission market structure changes are in varying stages of development. In the ordinary course of business, LG&E and KU, either directly or via industry groups, participate in many of these proceedings.

***Energy Policy Act of 2005 and Repeal of PUHCA***

The Energy Policy Act of 2005 ( EAct 2005 ) was enacted in August 2005. Among other matters, the comprehensive legislation contains provisions mandating improved electric reliability standards and performance; providing certain economic and other incentives relating to transmission, pollution control and renewable generation assets; increasing funding for clean coal generation incentives; repealing PUHCA; and establishing a new Public Utility Holding Company Act of 2005 ( PUHCA 2005 ). PUHCA 2005 reduces or eliminates many prior federal regulatory constraints applicable to public utility holding companies in such areas as mergers and acquisitions, non-energy-related investments, financial and capital structures, utility system integration, affiliate services, and reporting and record-keeping requirements.

The FERC was directed by the EAct 2005 to adopt rules to address many areas previously regulated by other agencies under other statutes, including PUHCA. The FERC continues to be in final stages of rulemaking on certain issues and E.ON U.S. is monitoring these rulemaking activities and actively participating in applicable proceedings. In general, where FERC rules have been finalized, such rules similarly liberalize federal regulation or oversight in these



areas. E.ON U.S. continues to evaluate the potential impacts of EPAct 2005, PUHCA 2005 and the associated rulemakings and cannot predict what impact the legislation and such rulemakings will have on its operations or financial position.

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***Other Regulations***

Integrated resource planning regulations in Kentucky require LG&E, KU and other major utilities to make triennial filings with the KPSC of historical and forecasted information relating to forecasted load, capacity margins and demand-side management techniques. The two utilities filed such integrated resource plans in April 2005 and the Kentucky Attorney General and representatives of an industrial customer group were granted intervenor status. In February 2006, the KPSC issued a staff report noting no substantive issues and closed the integrated resource planning proceedings.

Pursuant to Kentucky law, the KPSC has established the service boundaries for LG&E, KU and other utility companies, other than municipal corporations, within which each such supplier has the exclusive right to render retail electric service.

**ENVIRONMENTAL MATTERS**

**GENERAL**

E.ON is subject to numerous national and local environmental laws and regulations concerning its operations, products and other activities in the various jurisdictions in which it operates. Although E.ON believes that its domestic and international production facilities and operations are currently in material compliance with the laws and regulations with respect to environmental matters, such laws and regulations could require E.ON to take future action to remediate the effects on the environment of prior disposal or release of substances or waste. Such laws and regulations could apply to various sites, including power plants, pipelines and gas storage facilities, and waste disposal sites. Such laws and regulations could also require E.ON to install additional controls for certain of its emission sources or undertake changes in its operations in future years. For greater detail on the application of environmental laws and regulations to E.ON's operations, see below. E.ON has established and continues to establish accruals for environmental liabilities where it is probable that a liability will be incurred and the amount of the liability can be reasonably estimated. The provisions made are considered to be sufficient for known requirements. E.ON adjusts accruals as new remediation commitments are made and as information becomes available which changes estimates previously made.

The extent and cost of future environmental restoration and remediation programs are inherently difficult to estimate. They depend on the magnitude of any possible contamination, the timing and extent of corrective actions required and E.ON's share of liability relative to that of other responsible parties.

Any failure to comply with present or future environmental laws or regulations could result in the imposition of fines, suspension of operations or production or alteration of production processes. Such laws or regulations could also require acquisition of expensive remediation equipment or other expenditures to comply with environmental regulation.

**GERMANY: ELECTRICITY**

*Air Pollution.* All of E.ON Energie's plants are subject to EU and/or national regulations, and are equipped where necessary with pollution removal devices. The most important pollution law applicable to E.ON Energie's German plants is the German Federal Pollution Control Act (*Bundesimmissionsschutzgesetz*, or *BImSchG*) and its implementing ordinances. One of such ordinances, the Ordinance on Large Combustion Plants (*Verordnung über Großfeuerungsanlagen*, or *13. BImSchV*), sets stringent emission limits for power stations for all known air pollutants, such as sulphur oxides (  $SO_x$  ),  $NO_x$  and dust. The relevant emissions of E.ON Energie's power plants are continuously measured and reported. Due to the extensive installation of scrubbers, catalysts, electrostatic

precipitators and other pollution control devices, E.ON Energie's power plants comply with all current requirements. In order to implement the EU environmental guideline 2001/80/EU, the German government amended 13. BImSchV in 2004 to introduce lower emission limits. Because of the reduction in emission limits, especially for particulate emissions, some of E.ON Energie's power plants require retrofitting of their instrumentation and/or electrostatic precipitators in order to comply with the amended ordinance. E.ON Energie expects to implement most of these retrofits between 2008 and 2011. The total cost of compliance is currently

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expected to be approximately 10 million, primarily for efficiency improvements in some electrostatic precipitators.

Emission trading for carbon dioxide started in the EU on January 1, 2005. For details on the Emissions Trading Directive, applicable German legislation and effects on E.ON Energie, see Regulatory Environment.

*Nuclear Energy.* Details of E.ON Energie's nuclear power operations in Germany and those of its 21 percent minority investee BKW in Switzerland can be found under Business Overview Central Europe Power Generation and Other Other Minority Shareholdings above. E.ON Energie does not own interests in or operate any nuclear power facilities in any other country. German safety standards for nuclear power stations are among the most stringent in the world. German nuclear power regulations are found in the AtG and a number of national regulations, guidelines and technical rules. The German regulatory framework regarding nuclear power regulations is also governed by international agreements, including the Euratom Agreement, dated March 23, 1957 (*Euratomvertrag*), the Paris Liability Agreement, dated July 29, 1960 (*Pariser Haftungsübereinkommen*), and the Non-Proliferation Treaty, dated July 1, 1968 (*Nichtverbreitungsvertrag*).

Under the AtG, the import, export, transportation or storage of nuclear materials (*Kernbrennstoff*) requires the approval and supervision of regulatory authorities. The building, operating, owning or materially altering by any entity of any plants or installations that produce, fission or otherwise process or reprocess nuclear materials ( Nuclear Plants ) also requires approvals of, and is supervised by, regulatory authorities. Approvals can be subject to limitations or conditions, including conditions subsequent, and may also be subsequently revoked if they are not complied with or one of their preconditions has ceased to exist. The regulatory authorities may also give orders to obtain information from, enter and inspect any Nuclear Plants.

According to the AtG, radioactive wastes and dismantled radioactive parts must either be recycled or permanently disposed of by any entity handling or otherwise using nuclear power. The AtG follows the so-called polluter pays principle, which requires such entity to pay for the recycling or permanent disposal of nuclear waste.

*Liability.* In case of environmental damages, the owner of a German facility is subject to liability provisions that guarantee comprehensive compensation to all injured parties. Because of achievements in pollution control, the issue of environmental damage due to air pollutants from electric utilities has not recently been a subject of public debate in Germany. In general, subjects such as acid rain, as well as high concentrations of ground level ozone have been linked to accumulated deposits from many emission sources or, in the case of the ozone, predominantly from traffic emissions. There has been some relaxation in the evidence required under the German Environmental Liability Law (*Umwelthaftungsgesetz*) to establish and quantify environmental claims. If claims were to arise in relation to environmental damages and plaintiffs were successful in overcoming problems of proof and other issues, such claims could result in costs to E.ON Energie that might be material. So far as E.ON Energie is aware, no material environmental claims have been made against it and, under current circumstances, E.ON Energie does not believe that there is a significant risk of material liability in respect of any potential claims.

In case of a nuclear accident in Germany, the owner of the reactor, the factory or the nuclear materials storage facility (the Proprietor ) is subject to liability provisions that guarantee comprehensive compensation to all injured parties. Under German nuclear power regulations, the Proprietor is strictly liable, and the geographical scope of its liability is not limited to Germany or the contractual territory of the Paris Liability Agreement. The Proprietor is in principle subject to unlimited liability. The AtG and the Regulation regarding the Provision for Coverage pursuant to the AtG (*Atomrechtliche Deckungsvorsorge-Verordnung*, or AtDeckV ) require every Proprietor to provide liability coverage by either insurance or financial security. The amount of coverage required is reevaluated every five years. In February 2002, the AtG was amended and the required liability coverage was increased from 256 million to 2.5 billion. E.ON Energie has insurance covering the first 256 million of damages. To provide liability coverage for the additional amounts required by the AtG amendment, the German nuclear power plant operators entered into a solidarity

agreement to cover the increase, which provides that the costs of liability exceeding the operator's own resources and those of its parent company in the event of a nuclear accident will be covered by a pool, with the nuclear facility operators having a mutual responsibility to cover each other's damages. For details, see Note 25 of the Notes to Consolidated Financial Statements. For this reason, the AtG amendment has resulted in only a slight cost increase for liability coverage.

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In 2006, the European Commission issued a recommendation on the management of financial resources for the decommissioning of nuclear installations, spent fuel and radioactive waste. The European Commission recommends that financial resources be identified as decommissioning funds if they are identifiable and traceable at any given time and if they have a secure risk profile that ensures a positive return over any period of time. However, it is not clear at present whether member states will follow this recommendation by implementing the provisions into national law.

**GERMANY: GAS**

*Air Pollution.* The construction and operation of E.ON Ruhrgas gas pipeline system is subject to EU and national law, rules and regulations. The most important pollution law applicable to E.ON Ruhrgas gas transport and storage facilities is the BImSchG and its implementing ordinances. E.ON Ruhrgas facilities comply with all of the current requirements. One of such ordinances, 13. BImSchV, was amended in 2004 to require reduced emission limits also for existing gas turbines for air pollutants such as NO<sub>x</sub> and carbon monoxide (by 2015). For more information, see

Germany: Electricity. E.ON Ruhrgas uses gas turbines to drive compressors for gas transportation and storage. If the turbines do not comply with the new emission limits, E.ON Ruhrgas will have to take measures to retrofit the non-complying turbines. E.ON Ruhrgas cannot currently quantify the measures that will be required by the amendment of 13. BImSchV. Any other amendments to or new environmental legislation that creates new or more stringent environmental standards could also affect the future operation of E.ON Ruhrgas facilities and related costs.

Emission trading for carbon dioxide started in the EU on January 1, 2005. For details on the Emissions Trading Directive, applicable German legislation and effects on E.ON Ruhrgas, see Regulatory Environment.

*Gas Storage.* Natural gas underground storage facilities in Germany are subject to the 12th Ordinance on the Implementation of the German Federal Pollution Control Act (*12. Verordnung zur Durchführung des Bundesimmissionsschutzgesetzes, or Störfallverordnung*), which came into force in May 2000. Since then, all facilities operated by E.ON Ruhrgas have complied with all relevant requirements. Further compliance is continuously measured and reported by public authorities.

For information on E.ON Ruhrgas environmental management system, see Business Overview Pan-European Gas Transmission and Storage. For information on the German Environmental Liability Law, see Germany: Electricity above.

**U.K.**

While E.ON UK in the United Kingdom is subject to the same EU environmental legislation as is E.ON Energie (described above under Germany: Electricity), details of the implementation of that legislation as adopted in the United Kingdom differ from those implemented by the German government. E.ON UK is also subject to national legislation which includes the obligations of the United Kingdom and international conventions to which the United Kingdom adheres. These obligations relate principally to emissions from generating facilities to air, notably of SO<sub>2</sub>, NO<sub>x</sub> and dust. Although historically such legislation has primarily affected coal-fired plants, all fossil-fuelled generation may be impacted in the future. E.ON UK is currently in compliance with all applicable emissions regulations.

As an alternative to setting rigid emission limit values, the EU Large Combustion Plants Directive allows each member state to include its existing large combustion plants within a single National Emissions Reduction Plan. The European Commission has agreed to the United Kingdom using a combined approach scheme which would allow individual plants to elect to either to be subject to emission limit values, to be part of the National Emissions Reduction Plan or to opt out of the scheme (in which case the plant must shut by the end of 2015 and is limited to 20,000 hours of operation in the period from 2008 to 2015). E.ON UK has decided to opt out the Grain, Kingsnorth

and Ironbridge power stations (which it must therefore close by 2015) and to use the emission limit value option for the Ratcliffe power station. The scheme is scheduled to take effect as of January 1, 2008.

The U.K. government has implemented a greenhouse gas emissions allowance trading scheme, as required by the EU's Emissions Trading Directive. For more information on the Emissions Trading Directive, see

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**Regulatory Environment.** The trading scheme requires that each participating plant be covered by one or more CO<sub>2</sub> emission certificates, which initially were issued free of charge. E.ON UK has obtained the necessary certificates and is currently participating in the trading scheme. The draft regulations for implementing the trading scheme were initially published in January 2004, releasing for consultation a draft National Allocation Plan which includes the proposed allocation of CO<sub>2</sub> emissions certificates for E.ON UK's plants and for other power stations in the United Kingdom. Following this, the U.K. government recalculated and increased the size of its requested allowance for CO<sub>2</sub> emission certificates, but the European Commission chose not to increase the allowance. The matter has been referred to the EU Court of First Instance, which asked the European Commission to reconsider its position. The European Commission has announced that it is not prepared to change its position, and the U.K. government has decided that it will not pursue further court action.

Each of E.ON UK's fossil-fuelled power stations in the United Kingdom is required to have an Integrated Pollution Control Authorization, issued by a government agency, which regulates releases into the environment and seeks to minimize their impact. The current system of authorizations is to be expanded via a new permit system to cover a wider range of matters such as noise, waste minimization and energy conservation, reflecting extended requirements now applicable to all new installations. Applications were made for the necessary permits to bring existing power stations into compliance with the newly-expanded Integrated Pollution Prevention and Control regime during 2006. The permits are expected to be issued during 2007.

Using the flexibility available to it, E.ON UK has responded to the requirements imposed by emission controls with a combination of actions, notably the increased use of gas-fired CCGT plants, the use of low sulphur content fuels, the installation of emission abatement equipment and the development of renewable energy systems.

E.ON UK has operated its own environmental management system since 1991. On January 1, 1999, E.ON UK achieved corporate certification to ISO 14001, the international standard for environmental management, for its electricity production, gas operations and associated services. The certificate was updated to the revised standard ISO 14001:2004 on November 13, 2006 and is valid for a further three years.

E.ON UK is also subject to further environmental regulations affecting its business, including packaging waste regulations and oil storage regulations. In order to comply with the applicable packaging waste regulations, E.ON UK has joined an appropriate recycling scheme. The majority of the waste involved is paper. The oil storage regulations require E.ON UK to ensure that oil is appropriately stored and managed.

**NORDIC**

*Air Pollution.* The power and heat production plants of E.ON Nordic's subsidiaries are subject to EU, international and/or national regulations, and are equipped where necessary with pollution removal devices. The production plants are subject to emission limits for air pollutants such as SO<sub>x</sub>, NO<sub>x</sub> and dust, and relevant emissions are continuously measured and reported. In Sweden, there are taxes attached to emitting SO<sub>x</sub> (for coal, oil and peat) and CO<sub>2</sub> (applicable primarily to heat production from coal, oil, natural gas and liquified petroleum gas). There is also a fee for emitting NO<sub>x</sub> (applicable to large combustion plants).

Emissions trading for carbon dioxide started in the EU on January 1, 2005. For details on the Emissions Trading Directive, as well as information on the Swedish electricity certificate system, see Regulatory Environment.

The major subsidiaries within E.ON Nordic are operated according to certified environmental management systems (ISO 14001).



*Nuclear Energy.* In Sweden, the regulatory framework regarding nuclear power regulations is also governed by the international agreements discussed in Germany: Electricity above. In addition, Swedish nuclear power regulations are governed by Swedish law, mainly the Act on Nuclear Activities (*SFS 1984:3*), the Nuclear Liability Act (*SFS 1968:45*) and the Act on Financing of Future Charges for Spent Nuclear Fuel (*SFS 1992:1537*), which is being replaced by the Financing Act (see below). Under Swedish law, the owner of a nuclear power station is obliged to conduct operations in such a manner that the required safety standards are maintained and is responsible for nuclear waste management and decommissioning of nuclear facilities. A license is required in order to own or

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operate a nuclear facility, which is granted by the Swedish government on recommendation by the Swedish Nuclear Power Inspectorate, which supervises all nuclear facilities in Sweden.

According to the Act on Financing of Future Charges for Spent Nuclear Fuel, the owner of a nuclear facility in Sweden is under the obligation to pay an amount determined by the Swedish government for each kWh produced in the facility to the Swedish Nuclear Waste Fund. The amounts thus paid, together with any capital gains on the amounts, are to cover the costs for nuclear waste management and the decommissioning of nuclear facilities. In accordance with Swedish law, E.ON Nordic has also given guarantees to governmental authorities to cover possible additional costs related to the disposal of high-level radioactive waste and nuclear power plant decommissioning. See also Note 25 of the Notes to Consolidated Financial Statements.

On May 16, 2006, a new Financing Act (*SFS 2006:647*) was approved by the Swedish government. The new Financing Act will replace the Act on Financing of Future Charges for Spent Nuclear Fuel and will enter into force at various dates, beginning March 1, 2007. The main change is that the licensed owner and operator of a nuclear reactor will be required to pay an annual fee until the final disposal of nuclear waste, instead of paying fees based on the amount of electricity generated. The annual fee will be payable from 2008; the amount of such fee has not yet been determined.

For more information about E.ON Nordic's nuclear power operations, see [Business Overview Nordic Power Generation](#). E.ON Nordic does not own interests in or operate any nuclear power facilities in any country other than Sweden.

*Liability.* In Sweden, the owner of a nuclear facility is liable for damages caused by accidents in the nuclear facility and accidents caused by nuclear substances to and from the facility. As of December 31, 2006, the liability is limited to an amount equal to SEK3,102 million ( 343 million) per accident, which must be insured according to the Nuclear Liability Act. E.ON Nordic has the necessary insurance for its nuclear power plants.

In November 2004, the Swedish government began an inquiry on Swedish nuclear liability. In April 2006, a final report issued by the inquiry proposed unlimited liability for the Proprietor and that Proprietors should be obligated to purchase insurance covering an amount of 700 million per nuclear facility, with an upper limit on obligations to finance the unlimited liability set at 1.2 billion per nuclear facility. If at any given facility one reactor fails, it is not possible to run the remaining reactors. The inquiry has also proposed that the Swedish government within the model of state guarantees enter into a reinsurance agreement with the Nordic Nuclear Insurers as direct insurer to cover any remaining liability. It is still unclear whether the inquiry's report will lead to a legislative proposal from the government.

**U.S. MIDWEST**

E.ON U.S.'s operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates, governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety.

*Clean Air Act Requirements.* The Clean Air Act (CAA) establishes a comprehensive set of programs aimed at protecting and improving air quality in the United States by, among other things, controlling stationary sources of air emissions such as power plants. While the general regulatory framework for these programs is established at the federal level, most of the programs are implemented and administered by the states under the oversight of the U.S. EPA. The key CAA programs relevant to E.ON U.S.'s business operations are described below.

**Ambient Air Quality.** The CAA requires the EPA to periodically review the available scientific data for six criteria pollutants and establish concentration levels in the ambient air sufficient to protect the public health and welfare with an extra margin for safety. These concentration levels are known as national ambient air quality standards ( NAAQS ). Each state must identify non-attainment areas within its boundaries that fail to comply with the NAAQS and develop a state implementation plan ( SIP ) to bring such non-attainment areas into compliance. If a state fails to develop an adequate plan, the EPA must develop and implement a plan. As the EPA increases the stringency of the NAAQS through its periodic reviews, the attainment status of various areas may

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change, thereby triggering additional emission reduction obligations under revised SIPs aimed at achieving attainment.

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final NQSIP Call rule requiring reductions in NO<sub>x</sub> emissions of approximately 85 percent from 1990 levels in order to mitigate ozone transport from the midwestern United States to the northeastern United States. To implement the new federal requirements, in 2002 Kentucky amended its SIP to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per million British thermal units ( lb./mmBtu ) on a company-wide basis. In 2005, the EPA issued the Clean Air Interstate Rule ( CAIR ), which requires additional SO<sub>2</sub> emission reductions of 70 percent and NO<sub>x</sub> emission reductions of 65 percent from 2003 levels. The CAIR provides for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. The final rule is currently being challenged in a number of federal court proceedings. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR. Depending on the level of action determined necessary to bring local non-attainment areas into compliance with the new ozone and fine particulate standards, E.ON U.S.'s power plants are potentially subject to additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions.

**Hazardous Air Pollutants.** As provided in the 1990 amendments to the CAA, the EPA investigated hazardous air pollutant emissions from electric utilities and submitted a report to Congress identifying mercury emissions from coal-fired power plants as warranting further study. In 2005, the EPA issued the Clean Air Mercury Rule ( CAMR ), establishing mercury standards for new power plants and requiring all states to issue new SIPs including mercury requirements for existing power plants. The EPA issued a model rule which provides for a two-phase cap and trade program with initial reductions due by 2010 and final reductions due by 2018. The CAMR provides for reductions of 70 percent from 2003 levels. The EPA closely integrated the CAMR and CAIR programs to ensure that the 2010 mercury reduction targets will be achieved as a co-benefit of the controls installed for purposes of compliance with the CAIR. The CAMR is also currently being challenged in the federal courts. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAMR. In addition, in 2005 and 2006 state and local air agencies in Kentucky have proposed or adopted rules aimed at regulating additional hazardous air pollutants from sources including power plants. To the extent those rules are final, they are not expected to have a material impact on E.ON U.S.'s power plant operations.

**Acid Rain Program.** The 1990 amendments to the CAA imposed a two-phase cap and trade program to reduce SO<sub>2</sub> emissions from power plants that were thought to contribute to acid rain conditions in the northeastern United States. The 1990 amendments also contained requirements for power plants to reduce NO<sub>x</sub> emissions through the use of available combustion controls.

**Regional Haze.** The CAA also includes visibility goals for certain federally designated areas, including national parks, and requires states to submit SIPs that will demonstrate reasonable progress toward preventing future impairment and remedying any existing impairment of visibility in those areas. In 2005, the EPA issued its Clean Air Visibility Rule ( CAVR ), detailing how the CAA's best available retrofit technology ( BART ) requirements will be applied to facilities, including power plants, built between 1962 and 1974 that emit certain levels of visibility impairing pollutants. Under the final rule, since the CAIR will result in more visibility improvement than BART, states are allowed to substitute the CAIR requirements in their regional haze SIPs in lieu of controls that would otherwise be required by BART. The CAVR is also currently being challenged in the federal courts.

*Installation of Pollution Controls.* Many of the programs under the CAA utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and

utilize the resulting emission allowances for smaller plants where such controls are not cost effective. LG&E had previously installed flue gas desulphurization equipment on all of its generating units prior to the effective date of the acid rain program, while KU met its acid rain Phase I SO<sub>2</sub> requirements primarily through installation of flue gas desulphurization equipment on Ghent Unit 1. E.ON U.S.'s combined strategy for its acid rain Phase II SO<sub>2</sub> requirements, which commenced in 2000, uses accumulated emissions allowances to defer additional capital

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expenditures and also includes fuel switching or the installation of additional flue gas desulphurization equipment. In order to achieve the NO<sub>x</sub> emission reductions mandated by the NO<sub>x</sub> SIP Call, E.ON U.S. installed additional NO<sub>x</sub> controls, including selective catalytic reduction technology, during the 2000 to 2006 time period at a cost of \$409 million, including \$7 million of costs to remove equipment. In 2001, the KPSC granted recovery in principal of these costs incurred by LG&E and KU under its periodic environmental surcharge review mechanisms.

In order to achieve the emissions reductions mandated by the CAIR and CAMR, E.ON U.S. expects to incur additional capital expenditures for pollution controls including flue gas desulphurization and selective catalytic reduction and to incur additional operating and maintenance costs in operating such controls. E.ON U.S. expects to incur total costs of \$1.1 billion in installing these pollution controls during the 2007 through 2009 time period. In 2005, the KPSC granted recovery in principal of these costs incurred by LG&E and KU under its periodic environmental surcharge review mechanisms. E.ON U.S. believes its costs in reducing SO<sub>2</sub>, NO<sub>x</sub> and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. E.ON U.S.'s compliance plans are subject to many factors including developments in the emissions allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. E.ON U.S. will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

*Potential Greenhouse Gas Controls.* In 2005, the Kyoto Protocol for reducing greenhouse gas emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in greenhouse gas emissions. For details, see Regulatory Environment EU/Germany: General Aspects (Electricity and Gas) Greenhouse Gas Emissions Trading. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory greenhouse gas emissions reduction requirements at the federal level. Legislation mandating greenhouse gas reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own greenhouse gas emissions reduction programs, including 11 northeastern states under the Regional Greenhouse Gas Initiative program as well as California. Substantial efforts to pass federal greenhouse gas legislation are ongoing. In addition, litigation is currently pending before various courts to determine whether the EPA and the states have the authority to regulate greenhouse gas emissions under existing law. E.ON U.S. is monitoring ongoing efforts to enact greenhouse gas reduction requirements at the state and federal level. E.ON U.S. is unable to predict whether mandatory greenhouse gas reduction requirements will ultimately be enacted or to determine the reduction targets and deadlines that would be applicable under such programs. As a company with significant coal-fired generating assets, E.ON U.S. could be substantially impacted by programs requiring mandatory reductions in greenhouse gas emissions, although the precise impact on the operations of E.ON U.S. cannot be determined prior to the enactment of such programs.

*General Environmental Proceedings.* From time to time, E.ON U.S. appears before the EPA, various state or local regulatory agencies, and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include notices of violation for alleged noncompliance with the new source review provisions of the CAA and permit requirements at KU's Brown station; remediation obligations for former manufactured gas plant sites; liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites; ongoing claims regarding alleged particulate emissions from LG&E's Cane Run station; and ongoing claims regarding greenhouse gas emissions from E.ON U.S. generating stations. Based on analysis to date, the resolution of such matters is not expected to have a material impact on the operations of E.ON U.S.

**OPERATING ENVIRONMENT**

As Germany's largest industrial group on the basis of market capitalization, all social, political and economic developments and conditions in Germany affect E.ON. Labor costs, corporate taxes and employee benefit expenses in

Germany are high and weekly working hours are shorter compared with most other EU member states, the United States and Japan. Nonetheless, many factors, including monetary and political stability, high environmental protection and standards and a well-educated, highly qualified workforce continue to positively affect Germany's competitive position in world trade.

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By virtue of its operations outside the European Monetary Union ( EMU ), the Group is also subject to the risks normally associated with cross-border business transactions and business activities, particularly those relating to exchange rate fluctuations. In addition, because most of the Group's operations are based in Europe, both the development of the European market and the entry of new members into the EU will continue to create new opportunities and challenges for E.ON.

**ECONOMIC BACKGROUND*****Germany***

During 2006, the general economic situation improved worldwide. German export performance was good as a consequence of improved worldwide economic conditions and despite the surge in oil prices and the appreciation of the euro. Domestic demand also stimulated Germany's economic performance compared with 2005. Despite this upswing, in 2006 the German economy performed slightly worse than the Eurozone as well as compared with all 27 EU member states. The 2006 real gross domestic product rose by 2.7 percent according to the German Federal Statistical Office, compared with an increase of 0.9 percent in 2005. Capital spending by businesses increased by 5.3 percent, mainly due to investment in machinery and equipment and a positive contribution by the construction industry. Other investment grew by 5.9 percent in 2006. The German Council of Economic Experts forecasts ongoing global economic growth in 2007, with a German growth rate of 1.8 percent in 2007.

Germany's competitive position in world trade continues to benefit from many factors, including monetary stability, a reputation for quality and recent productivity gains. In 2006, Germany achieved a surplus in exports and services in nominal terms of 114.1 billion. Despite a good economic performance, unemployment remained high in Germany in 2006. The reasons for unemployment are predominantly of a structural nature and include, among other factors, extensive regulation of the labor market and high labor costs (compared with the rest of the EU and the United States).

For information on the tax regime applicable to German corporations, see Item 10. Additional Information Taxation Taxation of German Corporations. For information on changes in German tax regulation that have a material impact on the Company, see Note 7 of the Notes to Consolidated Financial Statements.

***Europe***

In 1992, the twelve original members of the former European Economic Community signed the Treaty on European Union (the Treaty), a significant step toward creating a single integrated market. The Treaty provided a working program for European integration, including the coordination of economic policies of the EU countries and preparations for the introduction of a single currency. On January 1, 1999, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland (the participating countries) adopted the euro as their single currency through the EMU, with fixed exchange rates for the participating currencies (the legacy currencies) against the euro. In the beginning of 2001, Greece also joined the EMU, becoming a participating country. On January 1, 2002, the euro became the official legal tender for cash transactions in all participating countries. The legacy currencies have been withdrawn from circulation. Not all EU member states participate in the EMU. The United Kingdom, Sweden and Denmark chose not to be initial participants in the euro.

Since the ratification of the Treaty, the EU has been enlarged from 12 to 25 member states, with the entry of Austria, Finland and Sweden in January 1995 and Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia as of May 1, 2004. On January 1, 2007, the euro became the official currency in Slovenia. In all the other new member states, the national currencies are still valid. As new countries join the EU, significant institutional reform within the existing EU member states will be necessary to enable the EU to integrate the new members. As a first step, an EU convention drafted a treaty establishing a European Constitution. The new



Constitution, which includes significant institutional reforms of the European Commission and the EU policy-making process, was defeated in national referendums in France and the Netherlands in 2005. Currently, the ratification process is at a standstill.

In addition to the countries which joined in May 2004, Bulgaria and Romania joined the EU in January 2007. Negotiations with Croatia to join the EU began in 2005, although further institutional reforms must be implemented

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in Croatia before it also may join the EU. In October 2005, the EU also started negotiations with Turkey to join the EU. Since these negotiations may take years, there is no fixed date for Turkey to join the EU.

Long-term interest rates in the Eurozone increased by 0.49 percentage points by December 2006 compared to December 2005. In December 2006, the European Central Bank raised its deposit facility and margin lending rates to 2.5 percent and 4.5 percent, respectively.

***United Kingdom***

The U.K. economy performed slightly worse in 2006 than many other EU economies, although household demand and public and private expenditures were stronger than in 2005. Monetary and fiscal policy provided a stable macroeconomic environment, so that prospects for 2007 are quite good. The U.K. economy is estimated to have grown at a rate of 2.6 percent in 2006 in real terms, according to the German Council of Economic Experts. It is expected to remain unchanged with a growth rate of 2.6 percent again in 2007. Inflation in 2006 is estimated to have been at 2.4 percent.

***Sweden***

In 2006, the Swedish economy again performed well above average compared with other EU member states, driven by a robust investment performance. The Swedish economy is estimated to have grown at a rate of 4.5 percent in real terms, according to data from the German Council of Economic Experts. This is expected to slow down to a growth rate of 3.2 percent in 2007. Inflation is estimated to have remained low with an annual rate of 1.5 percent for 2006.

***United States***

Since 2003, the United States economic growth has increased, stimulated by expansive fiscal and monetary policies. In 2006, private consumption and business investment were weaker than in 2005, but still at a high level. Despite tighter monetary policy, interest rates remained relatively low in 2006, supporting growth. The United States is estimated to have grown at a rate of 3.3 percent in 2006, with a decrease to 2.5 percent expected in 2007, according to the German Council of Economic Experts. Inflation is expected to have grown, with an annual rate of 3.5 percent for 2006.

**RISK MANAGEMENT**

While E.ON's market units have varying exposures to fluctuations in exchange rates, on an overall basis E.ON has certain exposures mainly to fluctuations between the euro and the U.S. dollar, the British pound, the Swedish krona and the Hungarian forint, respectively, that it seeks to manage through hedging activities. Foreign exchange rate risk management, along with liquidity management and interest rate risk management, is generally centralized on a Group-wide basis and is the responsibility of the Group treasury. The currency and interest rate risks of Group companies are hedged with Group treasury in conformity with E.ON's financial guidelines, or, in certain cases, with external counterparties with E.ON AG's approval. E.ON uses interest rate and currency derivatives only to hedge its risk positions deriving from underlying business transactions, and E.ON continually assesses its exposure to these risks resulting from the underlying exposures and the results of hedging transactions. Moreover, E.ON is exposed to risks from fluctuations in the prices of commodities and raw materials which are subject to commodity risk hedging activities. The market units also engage in the trading of energy-related commodity derivatives, which is also subject to guidelines for risk management. For a more detailed discussion of the current exchange rate, interest rate and commodity price risk exposures and risk management policies of the Group, see Item 5. Operating and Financial Review and Prospects Exchange Rate Exposure and Currency Risk Management, Item 11. Quantitative and Qualitative Disclosures about Market Risk and Notes 28 and 29 of the Notes to Consolidated Financial Statements.



**Table of Contents****ORGANIZATIONAL STRUCTURE**

E.ON AG is the Group's Düsseldorf-based management holding company. E.ON AG provides strategic management for Group companies and coordinates Group activities. E.ON AG also serves as the Group's corporate center, providing centralized controlling, treasury, risk management (including hedging) and service functions to Group members, as well as communications, capital markets and investor relations functions. E.ON AG is responsible for the design and implementation of strategies and policies with the goal of optimizing the Group's results across the energy markets in which it is active, the pursuit of operational excellence at each of the market units through the transfer of best practice, as well as a strong role in regulatory affairs that may affect several market units at the same time. E.ON AG also has direct responsibility for strategic acquisitions throughout the Group. Human resources management and career development for 200 top executives currently working across the Group have also been centralized at the Corporate Center. The Group's operating activities are organized into market units, each of which is responsible for managing its own day-to-day business. The parent companies of each market unit report directly to E.ON AG.

The following table sets forth certain information about each of the entities which served as a parent company of an E.ON market unit as of December 31, 2006:

<b>Name of Subsidiary</b>	<b>Country of Incorporation</b>	<b>Percentage Ownership Interest held by E.ON</b>	<b>Percentage Voting Interest held by E.ON</b>
E.ON Energie AG (energy)	Germany	100.0%	100.0%
E.ON Ruhrgas AG (energy)	Germany	100.0%	100.0%
E.ON UK plc (energy)	U.K.	100.0%	100.0%
E.ON Nordic AB (energy)	Sweden	100.0%	100.0%
E.ON U.S. LLC (energy)	U.S.A.	100.0%	100.0%

**PROPERTY, PLANTS AND EQUIPMENT****GENERAL**

The Company owns most of its production facilities and other properties. Some of E.ON's facilities are subject to mortgages and other security interests granted to secure indebtedness to certain financial institutions. As of December 31, 2006, the total amount of indebtedness collateralized by these facilities was approximately 0.9 billion. E.ON believes that the Group's principal production facilities and other significant properties are in good condition and that they are adequate to meet the needs of the E.ON Group. E.ON's headquarters are located at E.ON-Platz 1, D-40479 Düsseldorf, Germany. E.ON owns its headquarters.

**PRODUCTION FACILITIES***Central Europe*

E.ON Energie produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 36,800 MW, E.ON Energie's attributable share of which is approximately 28,200 MW (not including mothballed, shutdown and reduced power plants). Electricity is transmitted to purchasers

by means of high-voltage transmission lines and underground cables owned by E.ON Energie. For further details, see Business Overview – Central Europe. E.ON Energie believes that its power plants are in good operating condition and that its machinery and equipment have been well maintained. E.ON Energie's German base load nuclear power plants operated at approximately 92.5 percent of available capacity in 2006. E.ON Energie believes that average utilization data calculated on the basis of all of its international and German power stations would not reflect differences between base load and peak load requirements or differential costs of generation and would therefore dilute the significance of such a measure.

**Table of Contents*****Pan-European Gas***

E.ON Ruhrgas AG owns, co-owns or has interests through project companies in gas pipelines in Germany totaling 11,405 km. In addition, E.ON Ruhrgas AG owns, co-owns or has interests through project companies in 34 compressor stations in Germany. The current installed capacity of these compressor stations totals 992 MW. E.ON Ruhrgas AG also owns, co-owns, leases or has interests through project companies in 11 underground gas storage facilities in Germany; E.ON Ruhrgas AG's share in the usable working gas storage capacity of these facilities is approximately 5.2 billion m<sup>3</sup>. Due to the number and complexity of factors influencing gas pipeline and storage utilization, E.ON Ruhrgas AG does not consider data on the utilization of the transmission system and gas storage capacity to be meaningful. E.ON Ruhrgas AG also owns interests in three project companies operating gas transmission systems and in one project company developing a gas transmission system outside of Germany. For further details, see [Business Overview Pan-European Gas Transmission and Storage](#).

E.ON Ruhrgas AG believes that its transmission system (including transport compressor stations) and gas storage facilities (including storage compressor stations) are in good operating condition and that its machinery and equipment have been well maintained.

***U.K.***

E.ON UK produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 10,800 MW, E.ON UK's attributable share of which is approximately 10,500 MW. Electricity is transmitted to purchasers by means of the National Grid transmission network in the United Kingdom. For further details, see [Business Overview U.K.](#) E.ON UK believes that its power plants are in good operating condition and that its machinery and equipment have been well maintained. In 2006, E.ON UK's power plants operated at approximately 41 percent of theoretical capacity. This average utilization is calculated for all U.K. power stations and does not reflect differences between base load and peak load power stations.

***Nordic***

E.ON Nordic produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 14,800 MW, its attributable share of which is approximately 7,300 MW (not including mothballed and shutdown power plants). In Sweden and Finland, electricity is transmitted to purchasers via 200-400 kV electricity grids, which are operated by state-owned companies, and through regional and local distribution networks. E.ON Nordic owns and operates regional and local electricity distribution networks in Sweden and Finland through E.ON Sverige. Through E.ON Sverige, E.ON Nordic also owns one-third of the Baltic Cable, an undersea electricity cable linking the Swedish electricity grid to the grid of E.ON Energie in Germany. In Sweden, E.ON Nordic also owns and operates high-and low-pressure gas pipelines through E.ON Sverige. For more information, see [Business Overview Nordic](#). E.ON Nordic believes that its power plants, electricity distribution networks and gas pipelines are in good operating condition and that its machinery and equipment have been well maintained. The Swedish base load nuclear power plants in which E.ON Nordic holds an interest operated at approximately 84 percent of available capacity in 2006. E.ON Nordic believes that average utilization data calculated on the basis of all of its power stations would not reflect differences between base load and peak load requirements or differential costs of generation and would therefore dilute the significance of such a measure.

***U.S. Midwest***

E.ON U.S. produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 7,600 MW, E.ON U.S.'s attributable share of which is approximately 7,500 MW (not including mothballed and shutdown power plants). Electricity is transmitted to purchasers by means of E.ON

U.S. transmission network (for which certain functional control is provided by third parties pursuant to FERC regulation) in the United States. For further details, see Business Overview U.S. Midwest. E.ON U.S. believes that its power plants and transmission networks are in good operating condition and that its machinery and equipment have been well maintained. In 2006, E.ON U.S. power plants operated at approximately 54 percent

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of theoretical capacity. This average utilization is calculated for all U.S. power stations and does not reflect differences between base load and peak load power stations.

### **INTERNAL CONTROLS**

E.ON's own financial controls indicate that E.ON is organized, and will continue to be operated, in a financially sound manner. E.ON's internal controls and procedures are integrated with its firm-wide risk management system. E.ON's integrated risk management and internal controls system have the following key elements: the planning and controlling process, the reporting structure, E.ON Group-wide guidelines, internal control and monitoring by E.ON's Management Board and Supervisory Board, the internal auditing process and the risk reporting system.

E.ON's internal control systems and procedures are used to monitor the Company's investments, obligations, commitments and operations. The internal control system is not restricted to identifying and monitoring balance sheet items, but also identifies and monitors off-balance sheet transactions. The formation of corporate or other business entities to hold, control or own any investment, asset or liability would also be controlled by the process to manage the risks associated therewith.

E.ON believes that appropriate internal controls are in place to achieve effective and efficient operations as well as reliable internal and external reporting, and to ensure compliance with applicable laws and regulations as well as internal policies and procedures. In addition, E.ON believes that its internal controls over financial reporting provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with applicable law and generally accepted accounting principles.

As a result of the listing of its ADRs on the NYSE, E.ON is also subject to the listing requirements of the NYSE and the U.S. federal securities laws, including the U.S. Sarbanes-Oxley Act of 2002 ( "Sarbanes-Oxley" ) and the rules and regulations thereunder. For more information on E.ON's compliance with these requirements, see Item 10. Additional Information Memorandum and Articles of Association, Item 15. Controls and Procedures, Item 16A. Audit Committee Financial Expert, Item 16B. Code of Ethics, Item 16C. Principal Accountant Fees and Services, Item 16D. Exemptions from the Listing Standards for Audit Committees and Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers, as well as the certifications included as exhibits to this annual report.

#### **Item 4A. Unresolved Staff Comments.**

Not applicable.

#### **Item 5. Operating and Financial Review and Prospects.**

### **OVERVIEW**

On June 16, 2000, the Company completed the merger between VEBA and VIAG. The VEBA-VIAG merger was accounted for under the purchase method of accounting. The operations of VIAG have been included in E.ON's financial data since July 1, 2000. For more information on the VEBA-VIAG merger, see Item 4. Information on the Company History and Development of the Company VEBA-VIAG Merger.

In March 2003, E.ON completed the acquisition of all of the outstanding shares of the former Ruhrgas and has fully consolidated Ruhrgas results since February 2003. The total cost of the transaction to E.ON, including settlement costs and excluding dividends acquired, amounted to 10.2 billion. Goodwill in the amount of 2.9 billion resulted from the purchase price allocation. The acquisition had initially been blocked by the German Federal Cartel Office and then by a temporary injunction imposed by the courts following lawsuits brought by a number of plaintiffs who had



challenged the validity of the ministerial approval that had overturned the Federal Cartel Office's decision. In January 2003, E.ON reached settlement agreements with all of the plaintiffs, allowing the transaction to proceed. For further information, see Item 4. Information on the Company History and Development of the Company Ruhrgas Acquisition.

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Upon termination of the Ruhrgas court proceedings in late January 2003, E.ON completed the first step of the two-step RAG/Degussa transaction. In the first step, E.ON acquired RAG's Ruhrgas stake and tendered 37.2 million of its shares in Degussa to RAG at the price of €38 per share, receiving total proceeds of €1.4 billion. A gain of €168 million was realized from the sale. Following this transaction and the completion of the tender offer to the other Degussa shareholders, RAG and E.ON each held a 46.5 percent interest in Degussa, with the remainder being held by the public. In the second step, E.ON sold a further 3.6 percent of Degussa to RAG on May 31, 2004, reducing its stake to 42.9 percent of Degussa. Total proceeds from this transaction amounted to €283 million, resulting in a gain of €51 million. In December 2005, E.ON AG and RAG signed a framework agreement on the sale of E.ON's 42.9 percent stake in Degussa to RAG. As part of the implementation of that framework agreement, E.ON transferred its stake in Degussa to RAG Projektgesellschaft in March 2006 and agreed on the forward sale of that entity to RAG for a purchase price of approximately €2.8 billion (equal to €31.50 per Degussa share). The transaction closed in July 2006, with E.ON recording a book gain of approximately €376 million on the forward sale. Until the completion of this transaction, E.ON and RAG operated Degussa under joint control, and E.ON accounted for its 42.9 percent interest in Degussa under the equity method. E.ON owns a 39.2 percent interest in RAG.

E.ON participates in a number of different businesses. E.ON operates in the continental European energy business through E.ON Energie, E.ON Ruhrgas and E.ON Nordic, in the U.K. energy business through E.ON UK and in the U.S. energy business through E.ON U.S. Outside its core energy business, E.ON disposed of its real estate business Viterra in 2005, and completed the sale of its minority equity interest in the chemicals company Degussa in 2006. The E.ON Group also has minority participations in numerous companies, particularly in the Central Europe and Pan-European Gas market units, which are classified as associated companies. Income from these participations is reflected in the income statement as income from equity interests and is generally included in adjusted EBIT. Management views these associated companies as an integral part of the operations of E.ON. In line with its objective to focus on energy as its core business, E.ON has sold or classified as discontinued the operations of its former aluminum and oil segments and chemicals and real estate businesses, as well as certain components of its Pan-European Gas, Nordic and U.S. Midwest market units. For additional information, see Item 4. Information on the Company Business Overview Discontinued Operations and Acquisitions and Dispositions Discontinued Operations.

*2006 Highlights.* E.ON's sales in 2006 increased 24.4 percent to €64,197 million from €51,616 million in 2005 (in each case net of electricity and natural gas taxes). The increase was primarily attributable to higher average electricity and gas sales prices at the Central Europe and Pan-European Gas market units, and consolidation effects, including the first-time full-year consolidation of Distrigaz Nord (renamed E.ON Gaz România) and E.ON Moldova (consolidated in September 2005). Net income decreased by 31.7 percent to €5,057 million in 2006 from €7,407 million in 2005, primarily reflecting lower income from discontinued operations, partially offset by higher income from continuing operations, each as described in more detail below. Cash provided by operating activities increased 9.9 percent to €7,194 million in 2006 from €6,544 million in 2005, with the increase being primarily attributable to increases at the Central Europe and U.K. market units, which were offset in part by a decline in the cash generated by Pan-European Gas.

**ACQUISITIONS AND DISPOSITIONS**

The following discussion summarizes each of the principal acquisitions and dispositions made by E.ON since January 1, 2004, and is organized by business segment according to E.ON's market unit structure, which was adopted in January 2004. In particular, transactions with respect to E.ON Nordic, E.ON Sverige, Grange and Thüga are described according to the market unit each entity currently belongs to, rather than the former segment it belonged to at the time of the relevant transaction. For information on the accounting treatment of the most significant of these transactions, see Note 4 of the Notes to Consolidated Financial Statements. For information on E.ON AG's acquisition of the Powergen Group in 2002 and the former Ruhrgas in 2003, see Item 4. Information on the Company History and Development of the Company Powergen Group Acquisition and Ruhrgas Acquisition.



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*Central Europe.* In September 2003, E.ON Energie acquired majority stakes in the Czech regional electricity utilities Jihomoravská energetika a.s. ( JME ) and Jihočeská energetika a.s. ( JCE ) through a series of transactions. As of December 31, 2003, E.ON's interest in JME and JCE was 85.7 percent and 84.7 percent, respectively. The total aggregate purchase price amounted to 207 million. Goodwill in the amount of 48 million resulted from the final purchase price allocation for these stakes (at December 31, 2003, goodwill of 152 million had been recorded according to the preliminary purchase price allocation). The acquisition process also involved the sale of E.ON Energie's minority stakes in the regional power distributors Západočeská energetika a.s. and Východočeská energetika a.s. to the Czech state-owned company CEZ for 206 million, resulting in a gain of 2 million. In December 2004, E.ON Energie acquired additional stakes in JME and JCE, increasing its interests in the two companies to 99.0 percent and 98.7 percent, respectively. The aggregate acquisition costs for the 2004 transactions amounted to 81 million. In 2005, E.ON Energie acquired all remaining interests in the two companies for a total of 5 million. As of January 1, 2005, E.ON Energie re-organized the entities and fulfilled legal unbundling requirements by transferring the businesses of JME and JCE to three new subsidiaries. E.ON Energie now holds 100.0 percent of each of E.ON Česká republika, a.s., E.ON Distribuce, a.s. and E.ON Energie, a.s. No goodwill resulted from the purchase price allocation for the acquisitions in 2004 and 2005.

In January 2004, E.ON Energie sold its 4.99 percent shareholding in the Spanish utility Union Fenosa S.A. ( Union Fenosa ) on the market for approximately 217 million, realizing a gain on the sale of approximately 26 million.

In July 2004, E.ON Energie completed the statutory squeeze-out procedure to obtain the remaining 1.1 percent of E.ON Bayern AG ( E.ON Bayern ) held by minority shareholders. The aggregate purchase price amounted to 189 million ( 165 million of which was paid in E.ON shares), with goodwill of 148 million resulting from the purchase price allocation.

In December 2004, E.ON Energie increased its stake in the German regional electricity distribution company Avacon (since renamed E.ON Avacon) by 13.1 percent to 69.6 percent in a multistage process involving the acquisition of the intermediate holding companies Ferngas Salzgitter GmbH ( Ferngas Salzgitter ) and FSG Holding GmbH ( FSG Holding ). E.ON Energie increased its stake in FSG Holding to 100 percent by acquiring a 10.0 percent interest from Bayerische Landesbank and the remaining 90.0 percent from three companies in the Pan-European Gas market unit (RGE Holding GmbH (45.0 percent), Thüga-Konsortium Beteiligungs GmbH (35.0 percent) and Thüga (10.0 percent)). In addition, E.ON Energie purchased direct shareholdings in Ferngas Salzgitter from BEB (13.0 percent), Erdgas-Verkaufs-Gesellschaft Münster ( EGM ) (13.0 percent) and RGE Holding GmbH (39.0 percent). Following these acquisitions, FSG Holding was merged into E.ON Energie and Ferngas Salzgitter into Avacon. The aggregate purchase price paid to Bayerische Landesbank, BEB and EGM was 133 million, with 38 million in goodwill resulting from the purchase price allocation.

In February 2005, E.ON Energie acquired 67.0 percent stakes in each of the two Bulgarian electricity distribution companies Varna and Gorna Oryahovitza. The aggregate purchase price of 141 million, which was subsequently reduced to 138 million, had already been paid in 2004. Goodwill of 16 million resulted from the purchase price allocation. The companies were fully consolidated as of March 1, 2005.

In 2005, E.ON Energie increased its stake in the Hungarian gas distribution and supply company KÖGÁZ from 31.2 percent to 98.1 percent in several steps for aggregate consideration of 27 million. No goodwill resulted from the purchase price allocation. KÖGÁZ was consolidated as of April 1, 2005.

In July 2005, E.ON Energie transferred its 51.0 percent interest (49.0 percent voting interest) in GVT and its 72.7 percent interest in TEAG to Thüringer Energie Beteiligungsgesellschaft mbH ( TEB ). Municipal shareholders also transferred to TEB interests in GVT totaling 43.9 percent. Consequently, GVT was merged into TEAG and the merged entity was renamed ETE. Following this reorganization, E.ON Energie holds an 81.5 percent interest in TEB

and TEB holds a 76.8 percent interest in ETE. The consolidation of GVT as of July 1, 2005, with an acquisition cost of 168 million, led to goodwill of 58 million as a result of the purchase price allocation. The transfer of the stakeholding in TEAG resulted in a gain of 90 million.

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In September 2005, E.ON Energie completed the acquisition of 100.0 percent of the Dutch electricity and gas distributor NRE. The purchase price amounted to 79 million, with 46 million in goodwill resulting from the purchase price allocation. NRE was consolidated as of September 1, 2005.

In September 2005, E.ON Energie acquired a 24.6 percent stake in the Romanian electricity distribution company Electrica Moldova now E.ON Moldova and simultaneously increased its stake in the company to 51.0 percent by subscribing to a capital increase. The aggregate purchase price for the 51.0 percent interest amounted to 101 million, with no goodwill resulting from the purchase price allocation. E.ON Moldova was consolidated as of September 30, 2005.

In June 2005, the general meeting of Contigas passed a resolution authorizing E.ON Energie to use a squeeze-out procedure to acquire any remaining Contigas stock still held by minority shareholders. In July 2005, E.ON Energie acquired an additional 0.9 percent interest in Contigas through a public offer. Following the completion of the squeeze-out in November 2005, E.ON Energie acquired the remaining 0.2 percent and now owns 100.0 percent of Contigas. Total consideration was 45 million (of which 35 million was attributable to the transfer of E.ON shares), resulting in goodwill from the purchase price allocation of 36 million.

In August 2006, E.ON Energie and RWE swapped certain of their respective shareholdings in Hungary and the Czech Republic. In Hungary, E.ON Energie acquired in addition to its existing interest of 50.02 percent 49.9 percent of the shares of DDGÁZ, a gas distribution company (fully consolidated in 2005). RWE acquired E.ON Energie's interest of 16.3 percent in FÖGÁZ. In the Czech Republic, E.ON Energie gave up certain minority shareholdings and increased its interest in JCP (a gas distribution company) in two steps, first acquiring additional shares from RWE to increase its existing interest of 13.1 percent to 59.8 percent, and then in September 2006 acquiring an additional 39.2 percent interest in JCP from Oberösterreichische Ferngas and other minority shareholders. As of December 31, 2006, E.ON Energie held a 99.0 percent interest in JCP, which was consolidated as of September 1, 2006. The purchase price (for JCP and DDGÁZ) including the fair value of the swapped E.ON interest amounted to 103 million, of which 29 million was paid in cash, with 3 million in goodwill resulting from the purchase price allocation for DDGÁZ (the preliminary allocation for JCP resulted in no goodwill). As part of the asset swap, E.ON Energie acquired in the Czech Republic a 25.0 percent interest in PPH and a 49.3 percent interest in PP for 63 million. In January 2007, E.ON Energie received the remaining 1.0 percent in JCP in a squeeze-out proceeding and now holds 100 percent of JCP.

In December 2006, E.ON Energie acquired a 49.9 percent minority interest in the waste incineration company SOTEC. The purchase price amounted to 60 million. For the remaining shares the parties agreed on a put/call option which is exercisable if certain conditions are met.

In December 2006, E.ON Energie acquired 75.0 percent of the share capital of Dalmine, an Italian company that focuses on the wholesale of electricity and gas, primarily to industrial customers. The purchase price amounted to 47 million, with 30 million in goodwill resulting from the preliminary purchase price allocation. Dalmine has been consolidated since December 1, 2006.

*Pan-European Gas.* In May 2004, E.ON AG completed a squeeze-out procedure to obtain the remaining 3.4 percent of Thüga. The total purchase price for the 2.9 million shares amounted to 223 million. Goodwill of 106 million resulted from the purchase price allocation.

In November 2004, ERI signed an agreement with the Hungarian oil and gas company MOL for the acquisition of interests of 75.0 percent minus one share in each of MOL's gas trading and gas storage units and its 50.0 percent interest in the gas importer Panrusgáz. The agreement also included put options allowing MOL to sell its remaining interests in the gas trading and gas storage units, as well as an interest of up to 75.0 percent minus one share of its gas transmission business, to ERI for a period of 5 years from the closing date and through July 1, 2007, respectively. In

December 2005, the European Commission approved the acquisitions of the gas trading and storage businesses subject to certain conditions. One of these conditions is that MOL must fully divest its gas storage and trading businesses. As a result, ERI signed an agreement providing for its acquisition of the remaining 25.0 percent plus one share of the two businesses. The initial purchase price was set at approximately 450 million. In addition, ERI assumed debt amounting to approximately 600 million. ERI and MOL also agreed upon a purchase price adjustment mechanism designed to reflect developments in the relevant regulatory framework through 2009. The

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acquisition of the gas trading and gas storage units was completed by the end of March 2006, and the purchase price was subsequently adjusted to approximately 400 million. The initial goodwill of 205 million was reduced to 119 million after a purchase price adjustment and the purchase price allocation. The acquisition of MOL's 50.0 percent interest in Panrusgáz was completed at the end of October 2006.

In June 2005, after clearance was obtained from the relevant authorities, E.ON Ruhrgas acquired a 51.0 percent stake in the Romanian gas supplier Distrigaz Nord from the Romanian government in a two-step transaction. In the first step, E.ON Ruhrgas acquired a 30.0 percent share in Distrigaz Nord. In the second step, which immediately followed the first, this stake was increased to 51.0 percent through a capital increase. E.ON Ruhrgas paid an aggregate of approximately 305 million for the 51.0 percent stake; 127 million for the 30.0 percent interest and 178 million in the capital increase. Goodwill of 60 million resulted from the purchase price allocation. Distrigaz Nord was consolidated as of June 30, 2005 and has since been renamed E.ON Gaz România.

In November 2005, E.ON Ruhrgas acquired Caledonia Oil and Gas Ltd. ( Caledonia ), a U.K. gas production company with interests in a number of producing gas fields and development projects in the British North Sea, two field pipelines and 100 percent of a gas trading company. The seller was a group of investors led by the private equity firm First Reserve. Caledonia was subsequently renamed E.ON Ruhrgas North Sea. The total purchase price for the 100 percent interest in Caledonia amounted to 602 million and was primarily paid through the issuance of loan notes. For more information on these loan notes, see Note 24 of the Notes to Consolidated Financial Statements. Goodwill of 390 million resulted from the final purchase price allocation. Caledonia was fully consolidated as of November 1, 2005.

*U.K.* In November 2002, in accordance with E.ON UK's strategy to focus on the core U.K. market, E.ON UK reached agreements to sell its share in certain joint venture companies holding interests in independent power projects in India, Australia and Thailand. The sale of these interests in 2003 generated aggregate proceeds of 112 million and a gain of 29 million. In January 2004, E.ON UK reached an agreement to sell its only remaining Asian interests, a 35.0 percent stake in PT Jawa Power, owner of a 1,220 MW plant in Indonesia, and 100 percent of the associated operations and maintenance company, PT Jawa Power Timur, to Keppel Energy Pte Ltd ( Keppel Energy ) and Electric Power Development Co Ltd ( J-Power ). In April 2004, an existing shareholder, PT Bumipertiwi Tatapradipta ( Bumipertiwi ), exercised its pre-emption rights over this sale. In July 2004, E.ON UK terminated the agreement with Keppel Energy and J-Power and in August 2004, E.ON UK entered into agreements with Bumipertiwi and YTL Power International ( YTL PI ) reflecting Bumipertiwi's exercise of its pre-emption rights and subsequent sale of its interests to YTL PI. On December 7, 2004, E.ON UK completed the disposal of its investment in PT Jawa Power and PT Jawa Power Timur. The sale of these interests in 2004 generated aggregate proceeds of 120 million and a loss of 6 million.

In January 2004, E.ON UK completed the acquisition of Midlands Electricity from Aquila Energy Inc. and FirstEnergy Corp. for 1.7 billion (GBP1,180 million), net of 0.1 billion cash acquired. The acquisition price comprised 55 million paid to stockholders, 881 million paid to creditors and 856 million of debt assumed. Cash acquired amounted to 86 million. In the transaction, E.ON UK also acquired a number of other businesses, including an electrical contracting operation and an electricity and gas metering business in the United Kingdom, as well as minority equity stakes in companies operating three generation plants in the United Kingdom, Turkey and Pakistan. Goodwill in the amount of 473 million resulted from the purchase price allocation. Midlands Electricity was fully consolidated as of January 16, 2004.

In the first half of 2005, E.ON UK acquired, in two tranches, 100 percent of the equity of Enfield Energy Centre Ltd. ( Enfield ) from NRG, El Paso and Indeck. The purchase price amounted to approximately 185 million (GBP127 million), with no goodwill resulting from the purchase price allocation. Enfield was fully consolidated as of April 1, 2005.



In July 2005, E.ON UK acquired 100 percent of Holford Gas Storage Limited ( HGSL ) from Scottish Power Energy Management Limited. The purchase price amounted to 140 million (GBP96 million), with no goodwill resulting from the purchase price allocation. HGSL was consolidated as of July 28, 2005.

In December 2006, E.ON UK sold its shareholding in Edenderry to Bord na Mona plc for approximately 80 million, realizing a gain on the sale of approximately 20 million.

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*Nordic.* In October 2001, the Company concluded a put option agreement, which allows a minority shareholder of E.ON Sverige to sell any or all of its shares of E.ON Sverige to E.ON Energie at any time through December 15, 2007. The consideration payable by E.ON Energie upon the exercise of this option in full is approximately 2.0 billion.

Beginning in November 2003, following its receipt of the required approvals from the relevant antitrust authorities, E.ON Sverige increased its stake in the Swedish utility Graninge from 36.3 percent to 79.0 percent by acquiring shares from Electricité de France and other shareholders. Swedish law required E.ON Sverige to make a public tender for all outstanding Graninge shares following the acquisition of a majority stake. At the close of this mandatory offer in January 2004, E.ON Sverige's indirect stake in Graninge had increased to 97.5 percent and Graninge was delisted. By June 2004, E.ON Sverige had acquired the remaining outstanding shares and controlled 100 percent of Graninge. Total acquisition costs to E.ON Sverige in 2003 (therefore not including those relating to the tender offer) amounted to 628 million. The purchase price for the Graninge shares acquired in 2004 was approximately 307 million, with 76 million in goodwill resulting from the purchase price allocation. As of December 31, 2004, the goodwill relating to E.ON Sverige's 100 percent interest in Graninge amounted to 233 million.

In September 2004, E.ON agreed further details regarding its agreement in principle with Statkraft to sell a portion (1.6 TWh) of the generating capacity that E.ON Sverige had acquired as part of the Graninge acquisition to Statkraft. In July 2005, Sydkraft and Statkraft signed the corresponding agreement, whereby Statkraft would acquire a total of 24 hydroelectric power plants. In accordance with the agreement, Statkraft took ownership of the plants in October 2005. The purchase price amounted to approximately 480 million, corresponding to the assets' book value. Because assets and liabilities were recognized at fair values as part of the purchase price allocation following the acquisition of Graninge, the sale of the disposal group did not result in a significant effect on income. The major balance sheet line items affected by the transaction were presented in the Consolidated Balance Sheet as of December 31, 2004 under Assets/Liabilities of disposal groups.

In August 2006, E.ON Sverige sold a 75.1 percent interest in the broadband communication business E.ON Sverige Bredband to Tele2 for consideration of approximately 44 million. The sale agreement also provides E.ON Sverige with the option to put its remaining 24.9 percent interest to Tele2 within 24 months and Tele2 with the call option to acquire E.ON Sverige's remaining shares in E.ON Sverige Bredband in the event that E.ON Sverige does not exercise the put option. E.ON recorded a gain of approximately 28 million on the disposal.

*U.S. Midwest.* In June 2006, LPI sold its 50.0 percent ownership interest in a 209 MW coal-fired facility in North Carolina and LPS sold its remaining operations and maintenance contracts relating to the North Carolina plant along with four independent power generation facilities contracts for total consideration of 21 million.

*Corporate Center.* In December 2005, E.ON AG and RAG signed a framework agreement on the sale of E.ON's 42.9 percent participation in Degussa to RAG. As part of the implementation of that framework agreement, E.ON transferred its stake in Degussa to RAG Projektgesellschaft in March 2006 and agreed on the forward sale of that entity to RAG for a purchase price of approximately 2.8 billion (equal to 31.50 per Degussa share). The transaction closed in July 2006, with E.ON recording a book gain of approximately 376 million on the forward sale. Until the completion of this transaction, E.ON and RAG operated Degussa under joint control, and E.ON accounted for its 42.9 percent interest in Degussa under the equity method. E.ON owns a 39.2 percent interest in RAG.

*Discontinued Operations.* Consistent with its plans to focus on its core energy business, E.ON has disposed of a number of its non-core divisions and businesses in recent years. As a result of divestitures in 2001, the Company's former aluminum business segment was accounted for as discontinued operations in accordance with Accounting Principles Bulletin No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions (APB 30). On January 1, 2002, the Company adopted SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets

( SFAS 144 ), which requires it to account for disposals of a component of a segment as discontinued operations, thereby reducing the threshold needed for a particular divestiture to result in discontinued operations treatment. In 2002, E.ON discontinued the operations of its former oil business segment, following its disposal of VEBA Oel. In 2003, E.ON discontinued and disposed of certain operations in the U.S. Midwest market

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unit, as well as certain activities of Viterra in the Other Activities business segment. In 2005, E.ON discontinued and either disposed of certain operations or classified certain businesses as held for sale in the Pan-European Gas and U.S. Midwest market units, as well as Viterra in the Other Activities business segment. Finally, in 2006, the Nordic market unit disposed of its entire stake in E.ON Finland. These transactions are summarized below.

On January 6, 2002, E.ON entered into an agreement to sell its 100 percent stake in its former aluminum division VAW to Norsk Hydro ASA for 3.1 billion. The results of the ongoing operations of VAW up to the date of disposal and the 893 million gain realized by E.ON on its disposal were reported in Income (Loss) from discontinued operations, net in the income statement for the relevant period. The net gain on disposal of 893 million does not include the reversal of VAW's negative goodwill of 191 million, as this amount was required to be recognized as income from a change in accounting principles upon the adoption of SFAS 142 on January 1, 2002. In 2005, E.ON recognized a gain of 10 million before income taxes resulting from the release of a related provision. This effect was recorded under Income (Loss) from discontinued operations, net in the Consolidated Statements of Income. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Aluminum.

In July 2001, E.ON and BP entered into an agreement pursuant to which BP agreed to acquire a 51.0 percent stake in VEBA Oel by way of a capital increase. The agreement also provided E.ON with a put option that allowed it to sell its remaining 49.0 percent interest in VEBA Oel to BP at any time from April 1, 2002 for an exercise price of 2.8 billion, subject to certain purchase price adjustments. The capital increase took place in February 2002, giving BP majority control of VEBA Oel as of February 1, 2002. E.ON exercised its put option effective June 30, 2002. E.ON received proceeds of 2.8 billion for its VEBA Oel shares. In addition, 1.9 billion in shareholder loans made previously by the E.ON Group to VEBA Oel were repaid. In April 2003, E.ON and BP reached an agreement setting the final purchase price for VEBA Oel (without prejudice to the standard indemnities in the contract) at approximately 2.9 billion. The disposal of VEBA Oel resulted in a loss from discontinued operations net of income taxes of 37 million in 2003, and income from discontinued operations net of income tax of 1,784 million in 2002. E.ON recognized a loss on disposal of 35 million in 2003 and a gain of 1,367 million in 2002. In 2004, E.ON recognized a loss of 19 million resulting from claims under standard contractual indemnities. These effects were each recorded under Income (Loss) from discontinued operations, net in the income statement for the relevant period. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Oil.

As a condition to its approval of the former Powergen's acquisition of LG&E Energy (now E.ON U.S.), the SEC had required that LG&E Energy sell CRC-Evans. Effective October 31, 2003, LG&E Energy sold CRC-Evans to an affiliate of Natural Gas Partners for 37 million. Approximately 1 million in income from discontinued operations net of income taxes and minority interests was recorded in 2005. E.ON realized no gain or loss on the disposal. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other.

Viterra Energy Services was accounted for as a discontinued operation in the Consolidated Financial Statements for 2002. In June 2003, Viterra sold this wholly-owned subsidiary to CVC Capital Partners. In March 2003, Viterra sold its Viterra Contracting subsidiary to Mabanaft. The aggregate consideration for both transactions totaled 961 million, including approximately 112 million of assumed liabilities, with Viterra realizing a gain of 641 million. The portion of 2003 and 2002 results included in Income (Loss) from discontinued operations, net in the income statements for the relevant periods amounted to 681 million and 52 million, respectively. In 2004, the release of previously recorded provisions resulted in income in the amount of 10 million, which is recorded in Income (Loss) from discontinued operations, net. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other Activities.

In May 2005, E.ON sold Viterra to Deutsche Annington. The purchase price for 100 percent of Viterra's equity was approximately 4 billion. The company was classified as a discontinued operation in May 2005 and deconsolidated as

of July 31, 2005. E.ON recorded a gain of just over 2.4 billion on the sale, which closed in August. The portion of Viterra's 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to 2,558 million and 294 million, respectively. In 2005, Viterra had revenues of 453 million. In 2006, E.ON recognized gains of 52 million resulting from

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adjustments of the purchase price and the partial release of a related provision. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other Activities.

In June 2005, E.ON Ruhrgas signed an agreement for the sale of Ruhrgas Industries to CVC Capital Partners, a European private equity firm. The purchase price for 100 percent of Ruhrgas Industries was approximately 1.2 billion, with the purchasers' assumption of Ruhrgas Industries' debt and provisions bringing the total value of the transaction to approximately 1.5 billion. The transaction received antitrust approvals in July and September and was closed on September 12, 2005. The company was classified as a discontinued operation in June 2005, and deconsolidated as of August 31, 2005. The portion of Ruhrgas Industries' 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to 628 million and 29 million, respectively. In 2005, Ruhrgas Industries had revenues of 847 million. E.ON recorded a gain on the disposal of roughly 0.6 billion. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other.

WKE operates the generating facilities of BRECO, a power generation cooperative in western Kentucky, and a coal-fired facility owned by the city of Henderson, Kentucky, under a 25-year lease. In November 2005, E.ON U.S. entered into a letter of intent with BRECO regarding a proposed transaction to terminate the lease and operational agreements among the parties and other related matters. The parties are in the process of negotiating definitive agreements regarding the transaction, the closing of which would be subject to the review and approval of various regulatory agencies and other interested parties. Subject to such contingencies, the parties are working on completing the proposed termination transaction during 2007. WKE's results are classified as discontinued operations resulting in income from discontinued operations, net of income taxes of 64 million in 2006, and net losses of 162 million and 2 million in 2005 and 2004, respectively. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other.

In February 2006, E.ON Nordic and Fortum signed an agreement providing for Fortum's acquisition of E.ON Nordic's entire 65.6 percent stake in E.ON Finland for a total of approximately 390 million. The transaction closed in June 2006, and E.ON Nordic recorded a gain of approximately 11 million on the sale. E.ON Finland was accounted for as discontinued operations from January 16, 2006 (the date on which a legal impediment to E.ON Nordic's sale of the stake was removed) through the date of its disposal. The portion of E.ON Finland's 2006 and 2005 results included in Income (Loss) from discontinued operations, net in E.ON's Consolidated Statements of Income amounted to 11 million and 24 million, respectively. In 2006, E.ON Finland had revenues of 131 million. For further information, see Item 4. Information on the Company Business Overview Discontinued Operations Other.

The Consolidated Financial Statements and related notes thereto for the years ending December 31, 2006, 2005 and 2004, as well as the related notes thereto, have been reclassified to reflect the discontinued operations treatment outlined above. Operating results for discontinued operations through the disposal date, as well as the gains or losses from ultimate sale, are reported in Income (Loss) from discontinued operations, net in the Consolidated Statements of Income. The assets and liabilities of the business units which were classified as held for sale as of December 31, 2006 and 2005, but which were not yet sold as of the respective balance sheet date, are reported as Assets of disposal groups and Liabilities of disposal groups, respectively, in the respective Consolidated Balance Sheets. Cash flows from discontinued operations have been presented separately from the Consolidated Statements of Cash Flows for all periods presented.

For more information on the discontinued operations, including certain selected financial information, see Note 4 of the Notes to Consolidated Financial Statements.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The discussion and analysis of E.ON's financial condition and results of operations are based on its Consolidated Financial Statements, which are prepared in accordance with U.S. GAAP and included in Item 18. The reported financial condition and results of operations of E.ON are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. Certain of the Company's significant accounting policies (as described in Note 2 of the Notes to Consolidated Financial Statements) require

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critical accounting estimates that involve complex and subjective judgments and the use of assumptions, some of which may be inherently uncertain and susceptible to change. Application of those policies and estimates and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered in reviewing E.ON's Consolidated Financial Statements and the discussions below in Results of Operations.

**Business Combinations**

E.ON's group strategy is to maximize the value of its portfolio of businesses through creating value from the convergence of European energy markets and of the electricity and gas value chains. Another element of that strategy is the improvement of the Group's position in target markets through pursuing selective market investments. This strategy has resulted in E.ON completing a significant number of acquisitions in recent years, and E.ON can be expected to continue to make acquisitions in the future. E.ON's acquisitions have been, and, as required, will continue to be, accounted for under the purchase method of accounting (the purchase method). Under the purchase method, an acquired company is recorded on E.ON's balance sheet using the fair values of the acquired assets (tangible and intangible) and liabilities assumed as of the acquisition date.

The application of the purchase method requires a company to make certain estimates and judgments. One of the most significant estimates relates to the determination of the fair value of assets and liabilities acquired. E.ON determines the fair value based on the nature of the asset, generally consulting with an independent valuation expert in significant purchase price allocations. For example, marketable securities are valued at the market rate on the date of acquisition, while an independent appraisal is often obtained for inventory, land, buildings and equipment. The Company also assesses whether any significant intangible assets arise from contractual or other legal rights of the acquired entity or are separable from the acquired entity (*i.e.* capable of being sold). If any intangible assets are identified, the Company determines the value of these intangibles on the basis of estimated fair value, which is defined as the amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Thus, quoted market prices in active markets are the most reliable measure of fair value. If quoted market prices are not available, the estimate of fair value is based on the best information available, including prices for similar assets and the results of other valuation techniques. The determination of the useful lives of intangible assets and other long-lived assets are based upon the nature of the intangible, as well as the characteristics of the acquired business and the industry in which it operates. Any residual amount remaining after allocation of the purchase price to the fair value of all assets and liabilities acquired is goodwill.

Management utilizes certain assumptions and estimates believed to be reasonable in fair valuing assets and liabilities assumed in a business combination. These estimates are based on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Critical estimates used in valuing certain assets include, but are not limited to, future expected cash flows, discount rates, the useful life over which cash flows will occur, the acquired company's market position and regulatory environment. Any changes in these underlying factors and assumptions may materially affect the Company's financial position and net income.

**Impairment of Assets**

*Goodwill and Intangible Assets not Subject to Amortization.* In accordance with SFAS 142, E.ON performs impairment tests for goodwill and indefinite-lived intangible assets at least on an annual basis, or more frequently if events or changes in circumstances indicate that these assets might be impaired. The first step to test goodwill for impairment requires E.ON to identify potential impairment situations by comparing the fair value of a reporting unit with its carrying value including goodwill. When determining the fair value of its reporting units, E.ON utilizes appropriate valuation techniques. Unless quoted market prices in active markets or prices for similar groups of net assets (such as a reporting unit) are available, the input data for the valuation is in principle based on the Company's mid-term plan. In such cases, E.ON determines fair value of each reporting unit using estimated future cash flows for



the reporting unit discounted by a weighted average cost of capital specific to that unit. Estimated cash flows are based on E.ON's medium-term planning data for the next three years, and projections for the following years based on an expected growth rate based on industry and internal projections. The discount rates reflect any inflation in local cash flows and risks inherent to each reporting unit. Additionally, market comparables are analyzed to

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support the fair value determination as described above. Changes in the aforementioned assumptions and factors may materially affect the Company's financial position and net income.

If the carrying value exceeds the fair value of a reporting unit, thus indicating a possible impairment, E.ON performs the second step of the impairment test, which requires E.ON to allocate the fair value to the assets and liabilities of the reporting unit using a methodology consistent with the application of the purchase method. Any excess of fair value of the reporting unit over the fair value of net assets is compared to the allocated goodwill as recorded. If the allocated goodwill exceeds the residual fair value, an impairment charge equal to the difference is recognized.

The impairment test for intangible assets with indefinite lives consists of a comparison of the fair value of the asset with its carrying value. The fair value is determined using a valuation technique consistent with the technique used to allocate value to assets when they are acquired in a business combination.

E.ON has designated the fourth quarter of its fiscal year for its annual impairment test for goodwill in order to coincide with its medium-term planning process. E.ON believes that this schedule ensures that the most current information available is used and provides consistency in methodology. In 2006, no impairment charges on goodwill and indefinite-lived intangible assets resulted from these impairment tests.

E.ON has goodwill totalling 15,124 million as of December 31, 2006, resulting from various significant acquisitions in recent years. Intangible assets not subject to amortization amounted to 992 million as of December 31, 2006. Future adverse changes in a reporting unit's economic and regulatory environment could adversely affect both estimated future cash flows and discount rates and could result in impairment charges to goodwill and intangible assets not subject to amortization which could materially and adversely affect E.ON's future financial position and net income.

*Property, Plant and Equipment and Intangible Assets Subject to Amortization.* E.ON tests long-lived assets (including intangible assets subject to amortization) in accordance with SFAS 144 for impairment whenever events or changes in circumstances (triggering events) indicate that the carrying amount of the asset may not be recoverable, *i.e.* if the carrying amount exceeds the sum of undiscounted cash flows expected to result from the use and eventual disposition of the asset. If such evaluation indicates a potential impairment and neither quoted market prices in active markets nor prices for similar assets are available, E.ON uses discounted cash flows to measure fair value in determining the amount of these assets to be impaired. In 2006, E.ON recorded impairment charges totalling 409 million on property, plant and equipment and 45 million on intangible assets subject to amortization. A significant portion of the impairment on property, plant and equipment relates to the triggering event identified in connection with the ruling by the Federal Network Agency (BNetzA) on electricity and gas distribution network charges in Germany. This resulted in impairment charges totaling 227 million on long-lived assets within E.ON's gas distribution activities. No impairment charges resulted from the impairment tests E.ON carried out for its electricity distribution operations. For additional information regarding the regulatory developments in 2006, see Item 4. Information on the Company Regulatory Environment.

The assumptions and conditions used to determine recoverability reflect the Company's best estimates and assumptions utilizing data currently available and are consistent with internal planning, but these items involve inherent uncertainties. As a result, the accounting for such items could result in different amounts if management used different assumptions or if different conditions occur in future periods.

*Equity Method Investments, Other Share Investments and Available-for-Sale Securities.* Equity method investments and other share investments, as well as debt and equity securities that are within the scope of SFAS 115 are also subject to impairment review. E.ON records impairment charges in income when management believes such investment has experienced an other-than-temporary decline in fair value. The assessment of timing of when such declines become other than temporary and/or the amount of such impairment is a matter of significant judgment. Such

judgment includes determining whether or not the Company has the ability and intent to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value equal to (or exceeding) the cost of the investment. The regulatory, economic and technological environment of an investee and the general market condition of either the geographic area or the industry in which the investee operates are significant factors and areas of judgment used in making these determinations. Because the estimate for other-than-temporary

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impairment could change from period to period based upon future events that may or may not occur, E.ON considers this to be a critical accounting estimate.

In 2006, E.ON's impairment reviews for equity method investments, other share investments and available-for-sale securities resulted in impairment charges amounting to 374 million, including 335 million in impairment charges on minority shareholdings with network operations due to the new regulation of network charges in Germany. Please also see Notes 11c, Financial Assets, and 15, Current Securities and Fixed-Term Deposits, of the Notes to Consolidated Financial Statements for additional information on unrealized losses attributable to available-for-sale securities.

## **Fair Value of Derivatives**

As quoted market prices for certain derivatives used by E.ON are not readily available, the fair values of these derivatives have been calculated using common market valuation methods and value-influencing market data at the relevant balance sheet date as follows:

Currency, electricity, gas, oil and coal forward contracts, swaps and emission rights derivatives are valued separately at future rates or market prices as of the balance sheet date. The fair values of spot and forward contracts are based on spot prices that consider forward premiums or discounts from quoted prices in the relevant markets.

Market prices for currency, electricity and gas options are obtained using standard option pricing models commonly used in the market. The fair values of caps, floors and collars are determined on the basis of quoted market prices or on calculations based on option pricing models.

The fair values of existing instruments to hedge interest rate risk are determined by discounting future cash flows using market interest rates over the remaining term of the instrument. Discounted cash values are determined for interest rate, cross-currency and cross-currency/interest rate swaps for each individual transaction as of the balance sheet date. Interest income is considered with an effect on current results at the date of payment or accrual.

Equity forwards are valued on the basis of the stock prices of the underlying equities, taking into consideration any financing components.

Exchange-traded energy future and option contracts are valued individually at daily settlement prices determined on the futures markets that are published by their respective clearing houses. Initial margins paid are disclosed under other assets. Variation margins received or paid during the term of such contracts are stated under other liabilities or other assets, respectively, and are accounted for with an impact on earnings at settlement or realization.

Certain long-term commodity contracts are valued by the use of internal models that use fundamental data and take into account individual contract details and variables.

The use of valuation models requires E.ON to make assumptions and estimates regarding the volatility of derivative contracts at the balance sheet date, and actual results could differ significantly due to fluctuations in value-influencing market data. The valuation models for the interest rate and currency derivatives are based on calculations and valuations, generally using a Group-wide financial management system that provides consistent market data and valuation algorithms throughout the Company. The algorithms used to obtain valuations are those which are commonly used in the financial markets. In certain cases the calculated fair value of derivatives is compared with results which are produced by other market participants, including banks, as well as those available through other

internally available systems. The valuations of commodity instruments are delivered by multiple use EDP-based systems in the market units, which also utilize common valuation techniques and models as described above.

The objective of E.ON's financial and commodity risk management is to limit the risk of significant volatility in earnings and cash flows from the underlying operational business. Through internal guidelines (*i.e.*, Group finance guidelines and Group commodity risk guidelines), the Company ensures that derivatives used for risk management purposes, rather than proprietary trading, are only utilized to hedge booked, contracted or planned

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underlying transactions. E.ON's proprietary trading is limited to commodity derivatives and takes place in specified markets within defined limits designed to limit any significant impact of trading activities on earnings. The open positions from the operational business and the hedging and proprietary trading activities are reported and monitored regularly. The Company, in line with international banking standards, calculates and assesses market risks in accordance with the policies outlined in Item 11. Quantitative and Qualitative Disclosures about Market Risk. For additional details on the Group's use of derivative financial instruments, see Note 28 of the Notes to Consolidated Financial Statements.

**Electricity Contracts**

Certain electricity contracts that E.ON has entered into in the ordinary course of business meet all of the required criteria for a derivative as defined under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ), and are marked to market. However, due to the normal purchase normal sales exemption for electricity companies as specified by SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities ( SFAS 149 ), some of these contracts are not accounted for as derivatives under SFAS 133 and therefore are not being marked to market. As a result, any price volatility inherent in these contracts is not reflected in the operating results of E.ON. If this exemption is disallowed through future interpretations or actions of the Financial Accounting Standards Board ( FASB ), the impact on future operating results could be significant.

**Gas Contracts**

The market units enter into gas purchase and sale contracts in connection with their distribution, sale and retail activities, as well as long-term gas purchase contracts for E.ON Ruhrgas gas supplies and for certain subsidiaries of E.ON Energie, E.ON Sverige and the operation of E.ON UK's generation plants. Contracts providing for physical delivery in Germany or Sweden are currently accounted for as contracts outside the scope of SFAS 133, as no functioning natural gas market mechanism or spot market exists in Germany and Sweden which would allow the Company to classify gas as readily convertible to cash. In the future, it is possible that a functioning market mechanism or spot market for natural gas could emerge, resulting in a need to reassess the German and Swedish contracts for derivatives under SFAS 133. If any such reassessment resulted in contracts being accounted for as derivatives under SFAS 133, the impact on future operating results could be significant. Within the U.K. market, a number of non-standard gas contracts at E.ON UK have been marked to market since 2003 following the implementation of Derivatives Implementation Group Issue C-20.

**Deferred Taxes**

E.ON has significant deferred tax assets and liabilities totalling 1,857 million and 7,913 million as of December 31, 2006, respectively, which are expected to be realized through the statement of income over extended periods of time in the future. Based on the Company's past performance and the expectations of similar performance in the future, it is expected that the future taxable income will more likely than not be sufficient to permit recognition of their deferred tax assets. As of December 31, 2006, a valuation allowance has been established totalling 434 million for that portion of the deferred tax assets for which this criterion is not expected to be met. Determining the valuation allowance requires significant management judgments and assumptions. In determining the valuation allowance, E.ON uses historical and forecasted future operating results, based upon approved mid-term plans, including a review of the eligible carryforward periods, tax planning opportunities and other relevant considerations. Each quarter, E.ON reevaluates E.ON's estimate related to the valuation allowance, including E.ON's assumptions about future profitability. In calculating the deferred tax items, E.ON is required to make certain assumptions and estimates regarding the future tax consequences attributable to differences between the carrying amounts of assets and liabilities as recorded in the Consolidated Financial Statements and their tax basis. Significant assumptions made include the expectation that: (1) future operating performance for subsidiaries will be consistent with historical operating results;

(2) recoverability periods for tax credits and net operating loss carryforwards will not change; (3) undistributed earnings of foreign investments have been permanently reinvested; (4) net operating losses for which E.ON has not provided a valuation allowance will more likely than not be recovered through future taxable income; and (5) existing tax laws and rates to which E.ON is subject in various tax

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jurisdictions will remain unchanged into the foreseeable future. E.ON believes that it has used prudent assumptions and feasible tax planning strategies in developing its deferred tax balances; however, any changes to the facts and circumstances underlying its assumptions could cause significant changes in the deferred tax balances and resulting volatility in its net income.

### **Nuclear Waste Management**

*Germany.* German law requires nuclear power plant operators to establish sufficient provisions for financial obligations that arise from the use of nuclear power. The provisions established by E.ON for its German nuclear power plants have been determined based on industry-wide used data prepared by German governmental authorities and qualified parties. Actual results may differ from the assumptions utilized by E.ON to estimate the fair value of the obligation for nuclear waste management if the relevant regulatory requirements or underlying assumptions were to change.

Provisions for nuclear waste management for E.ON's operations in Germany totalling 13,162 million as of December 31, 2006 comprise costs for the decommissioning of nuclear and non-nuclear plant components as well as for the disposal of spent nuclear fuel rods and operating waste.

The provisions are presented net of advance payments of 894 million in 2006. The advance payments are amounts prepaid to nuclear fuel reprocessors and other waste management companies, as well as to governmental authorities relating to the exploration/construction of final storage facilities.

The costs for nuclear plant decommissioning comprise expected costs for run-out operation, dismantling and removal of both the nuclear and non-nuclear portions of the plant and the storage of contaminated decommissioning waste. The expected decommissioning and storage costs are based on studies performed by external specialists and are updated regularly. As of December 31, 2006, E.ON Energie has a provision totalling 8,494 million for nuclear plant decommissioning.

For spent nuclear fuel rods, the provision totalling 4,211 million as of December 31, 2006 covers primarily:

on the one hand, the cost of return transportation and temporary storage of nuclear waste from the reprocessing (including interim storage containers, central temporary storage, conditioning and procurement of final storage containers) based primarily on existing contracts, and

on the other hand, costs of so-called permanent storage of used fuel rods which primarily include:

contractual costs for procuring intermediate containers and intermediate on-site storage on the plant premises, and

costs of transporting spent fuel rods to conditioning facilities, conditioning costs and costs for procuring permanent storage containers as determined by external studies.

The provisions for both nuclear plant decommissioning and for management of spent nuclear fuel rods also comprise the cost of final storage.

Management utilizes certain assumptions and estimates to calculate the fair value of the obligation for nuclear plant decommissioning and nuclear waste management. Any changes in the underlying data, the timing in the future that the corresponding costs will be incurred, as well as changes in regulatory requirements, may adversely affect the Company's financial position and net income.



*Sweden.* In Sweden, nuclear power plant operators are obliged to contribute cash to a fund managed by the governmental authorities. The amount of the contributions, as determined annually by governmental authorities, is based on the volume of electricity produced using nuclear power. Despite these contributions to the fund, nuclear power plant operators in Sweden will still be obligated to make additional contributions if actual costs for nuclear waste management and decommissioning exceed the government's estimates and the amount available in the fund.

E.ON adopted SFAS No. 143, Accounting for Asset Retirement Obligations ( SFAS 143 ) as of January 1, 2003. SFAS 143 requires that asset retirement obligations be recorded at fair value on a company's balance sheet. SFAS 143 changed the methodology for calculating the nuclear decommissioning accrual; however, the underlying

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data and key assumptions used as a basis for establishing the total costs of decommissioning remained consistent with that used in prior years.

### **NEW ACCOUNTING PRONOUNCEMENTS**

The Financial Accounting Standards Board issued the following accounting pronouncements in 2006 and 2007, which became applicable or will become applicable to E.ON in 2006, 2007 and 2008:

SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115;

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);

FIN No. 48, Accounting for Uncertainty in Income Taxes;

SFAS No. 157, Fair Value Measurements; and

Staff Accounting Bulletin ( SAB ) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.

For details of these pronouncements and their impact or expected impact on the Company s results, see Note 2 of the Notes to Consolidated Financial Statements.

### **RESULTS OF OPERATIONS**

E.ON s sales in 2006 increased 24.4 percent to 64,197 million from 51,616 million in 2005 (in each case net of electricity and natural gas taxes). The increase was primarily attributable to 9,232 million higher electricity and gas sales at the Pan-European Gas and Central Europe market units and consolidation effects of 2,900 million. Net income decreased by 31.7 percent to 5,057 million in 2006 from 7,407 million in 2005, primarily reflecting lower income from discontinued operations partially offset by higher income from continuing operations, as described in more detail below. Cash provided by operating activities increased 9.9 percent to 7,194 million in 2006 from 6,544 million in 2005, with the increase being primarily attributable to increases at the Central Europe and U.K. market units, which were offset in part by a decline in the cash generated by Pan-European Gas.

In 2006, 56.1 percent of the Group s total sales were to customers in Germany and 43.9 percent were to customers in other parts of the world, as compared with 59.8 percent and 40.2 percent in 2005, respectively.

E.ON s sales and earnings are influenced by a number of differing economic and other external factors. The energy business is generally not subject to severe fluctuations in its results, but is to some extent affected by seasonality in demand related to weather patterns. Typically, demand is higher for the Central Europe, Pan-European Gas and U.K. market units during the winter months and for the U.S. Midwest market unit during the summer. For a discussion of trends and factors affecting E.ON s businesses, see the market unit descriptions in Item 4. Information on the Company Business Overview and Operating Environment, as well as Item 3. Key Information Risk Factors.

### **BUSINESS SEGMENT INFORMATION**

E.ON s core energy business is divided into five regional market units (Central Europe, Pan-European Gas, U.K., Nordic and U.S. Midwest), plus the Corporate Center. The lead company of each market unit reports directly to E.ON

AG. E.ON's financial reporting mirrors this structure, with each of the five market units and the results of the enhanced Corporate Center (including consolidation effects) constituting a separate segment for financial reporting purposes. E.ON also reports its only remaining telecommunications interest, a 50.1 percent stake in the Austrian mobile telecommunications network operator ONE GmbH ( ONE ), which is accounted for at equity in E.ON's Consolidated Financial Statements, under Corporate Center. For the period between Degussa's deconsolidation and E.ON's disposal of its interest in July 2006, E.ON's proportionate share of Degussa's

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after-tax earnings continued to be presented outside of the core energy business as part of E.ON's Other Activities, which is reported as a separate segment.

E.ON uses adjusted EBIT as the measure pursuant to which the Group evaluates the performance of its segments and allocates resources to them. Adjusted EBIT is an adjusted figure derived from income/(loss) from continuing operations (before intra-Group eliminations when presented on a segment basis) before income taxes and minority interests, excluding interest income. Adjustments include net book gains resulting from disposals, as well as cost-management and restructuring expenses and other non-operating earnings of an exceptional nature. In addition, interest income is adjusted using economic criteria. In particular, the interest portion of additions to provisions for pensions and nuclear waste management is allocated to adjusted interest income. Management believes that adjusted EBIT is the most useful segment performance measure because it better depicts the performance of individual business units independent of changes in interest income and taxes. During the relevant periods, E.ON has used adjusted EBIT as its segment reporting measure in accordance with SFAS 131. However, on a consolidated Group basis, adjusted EBIT is considered a non-GAAP measure that must be reconciled to the most directly comparable GAAP measure. For a reconciliation of Group adjusted EBIT to net income for each of 2006, 2005 and 2004, see the table on page 146 below and the accompanying analyses on pages 148 to 150 and pages 161 to 162. For a reconciliation of adjusted EBIT to income (loss) from continuing operations before income taxes and minority interests for each of the three years, see Note 31 of the Notes to Consolidated Financial Statements. Adjusted EBIT should not be considered in isolation as a measure of E.ON's profitability and should be considered in addition to, rather than as a substitute for the most directly comparable U.S. GAAP measures. In particular, there are material limitations associated with the use of Adjusted EBIT as compared with such U.S. GAAP measures, including the limitations inherent in E.ON's determination of each of the adjustments noted above. E.ON seeks to compensate for those limitations by providing below a detailed reconciliation of adjusted EBIT to income from continuing operations before income taxes and minority interests and net income, the most directly comparable U.S. GAAP measures, as well as the more detailed textual analysis of year-on-year changes in the key components of each of the reconciling items appearing under the caption "E.ON Group Reconciliation of Adjusted EBIT" for each of the relevant periods. As a result of these limitations and other factors, adjusted EBIT as used by E.ON may differ from, and not be comparable to, similarly titled measures used by other companies.

The following table sets forth sales and adjusted EBIT for each of E.ON's business segments for 2006, 2005 and 2004 (in each case excluding the results of discontinued operations):

**E.ON BUSINESS SEGMENT SALES AND ADJUSTED EBIT**

	2006		2005		2004	
	Sales	Adjusted EBIT	Sales	Adjusted EBIT	Sales	Adjusted EBIT
	( in millions)					
Central Europe(1)	28,380	4,168	24,295	3,930	20,752	3,602
Pan-European Gas(2)(3)	24,987	2,106	17,914	1,536	13,227	1,344
U.K.	12,569	1,229	10,176	963	8,490	1,017
Nordic(2)(4)	3,204	619	3,213	766	3,094	661
U.S. Midwest(2)	1,947	391	2,045	365	1,718	354
Corporate Center(2)(5)	(3,328)	(416)	(1,502)	(399)	(792)	(338)
<i>Core Energy Business</i>	<i>67,759</i>	<i>8,097</i>	<i>56,141</i>	<i>7,161</i>	<i>46,489</i>	<i>6,640</i>
<i>Other Activities(2)(6)</i>		<i>53</i>		<i>132</i>		<i>107</i>

Total	67,759	8,150	56,141	7,293	46,489	6,747
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- (1) Sales include energy taxes of 1,124 million in 2006, 1,049 million in 2005 and 1,051 million in 2004.
- (2) Excludes the sales and adjusted EBIT of certain activities now accounted for as discontinued operations. For more details, see Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.
- (3) Sales include natural gas and electricity taxes of 2,061 million in 2006, 3,110 million in 2005 and 2,923 million in 2004.
- (4) Sales include electricity and natural gas taxes of 377 million in 2006, 382 million in 2005 and 376 million in 2004.
- (5) Includes primarily the parent company and effects from consolidation (including the elimination of intersegment sales), as well as the results of its remaining telecommunications interests, as explained above. Sales between companies in the same market unit are eliminated in calculating sales on the market unit level.
- (6) Includes adjusted EBIT of Degussa.

*Reconciliation of Adjusted EBIT.* As noted above, E.ON uses adjusted EBIT as its segment reporting measure in accordance with SFAS 131. On a consolidated Group basis, adjusted EBIT is considered a non-GAAP measure that must be reconciled to the most directly comparable GAAP measure. A reconciliation of Group adjusted EBIT to net income for each of 2006, 2005 and 2004 appears in the table below. The analysis below discusses changes in the principal components of each of the reconciling items to income (loss) from continuing operations before income taxes and minority interests. For additional details, see Note 31 of the Notes to Consolidated Financial Statements and the analyses on pages 148 to 150 and 161 to 162.

	<b>2006</b>	<b>2005</b>	<b>2004</b>
	( in millions)		
<b>Adjusted EBIT</b>	<b>8,150</b>	<b>7,293</b>	<b>6,747</b>
Adjusted interest income, net	(1,081)	(1,027)	(1,032)
Net book gains	1,205	491	589
Cost-management and restructuring expenses		(29)	(100)
Other non-operating results	(3,141)	424	128
<b>Income/(loss) from continuing operations before income taxes and minority interests</b>	<b>5,133</b>	<b>7,152</b>	<b>6,332</b>
Income taxes	323	(2,261)	(1,852)
Minority interests	(526)	(536)	(469)
<b>Income/(loss) from continuing operations</b>	<b>4,930</b>	<b>4,355</b>	<b>4,011</b>
Income/(loss) from discontinued operations	127	3,059	328
Cumulative effect of change in accounting principles		(7)	
<b>Net income</b>	<b>5,057</b>	<b>7,407</b>	<b>4,339</b>

**YEAR ENDED DECEMBER 31, 2006 COMPARED WITH YEAR ENDED DECEMBER 31, 2005**

***E.ON Group***

E.ON's sales in 2006 increased 24.4 percent to 64,197 million from 51,616 million in 2005 (in each case net of electricity and natural gas taxes). As noted above, the increase was primarily attributable to higher electricity and gas sales at the Pan-European Gas and Central Europe market units. As illustrated in the table on the previous page, the overall increase in the Group's sales also reflected an increase in sales at the Central Europe, Pan-European Gas and U.K. market units, which more than offset decreases at the Nordic and U.S. Midwest market units and the Corporate Center.

Sales of the Central Europe market unit increased 16.8 percent in 2006 to 28,380 million (including 1,124 million of electricity taxes) from 24,295 million (including 1,049 million of electricity taxes) in 2005.

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Pan-European Gas sales increased by 39.5 percent to 24,987 million (including 2,061 million of natural gas and electricity taxes) in 2006 from 17,914 million (including 3,110 million of natural gas and electricity taxes) in 2005. Sales of the U.K. market unit increased by 23.5 percent, amounting to 12,569 million in 2006 as compared to 10,176 million in 2005. Nordic sales decreased by 0.3 percent to 3,204 million (including 377 million of electricity and natural gas taxes) from 3,213 million (including 382 million of electricity and natural gas taxes) in 2005. Sales of the U.S. Midwest market unit decreased by 4.8 percent in 2006 to 1,947 million compared with 2,045 million in 2005. The elimination of intersegment sales at the Corporate Center resulted in the segment reporting negative sales of 1,502 million in 2005 and negative sales of 3,328 million in 2006. The sales of each of these segments are discussed in more detail below.

Total cost of goods sold and services provided in 2006 increased 28.8 percent or 11,701 million to 52,304 million compared with 40,603 million in 2005, with increases at the Pan-European Gas market unit ( 7,373 million), primarily reflecting the effect of higher gas prices, and at the Central Europe market unit ( 4,379 million). Purchases of electricity from third parties and the purchase of significantly higher volumes of electricity generated from renewable resources, as well as price-related increased procurement costs for gas increased costs of goods sold at the Central Europe market unit by approximately 2,480 million, while consolidation effects were responsible for approximately 880 million of the increase. The overall increase also reflected higher costs at the U.K. market unit ( 1,766 million). These effects were partially offset by lower cost of goods sold and services provided at the Corporate Center ( 1,836 million), reflecting consolidation effects recorded at the Corporate Center level mainly as a result of higher intergroup sales from the Pan-European Gas market unit to the U.K. market unit. Cost of goods sold as a percentage of revenues (net of electricity and natural gas taxes) increased to 81.5 percent in 2006 from 78.7 percent in 2005, as the rate of increase of cost of goods sold and services provided was greater than that of sales. Gross profit nonetheless increased, rising by 8.0 percent to 11,893 million in 2006 from 11,013 million in 2005.

Selling expenses increased 12.9 percent or 496 million to 4,341 million in 2006, compared with 3,845 million in 2005. The increase reflected an overall increase of 299 million in selling expenses at the U.K. market unit as a result of the expansion of the sales force and impairments of intangible assets due to the rebranding of Powergen, at the Central Europe market unit ( 135 million), primarily attributable to the consolidation effects involving Arena One, E.ON Moldova and the Bulgarian companies Varna and Gorna ( 100 million) and IT-related expenses ( 40 million), as well as at the Pan-European market unit ( 83 million), primarily resulting from the first-time full-year consolidation of E.ON Gaz România.

General and administrative expenses increased by 258 million, amounting to 1,774 million in 2006 compared with 1,516 million in 2005. The 17.0 percent increase reflected increases at the U.K. market unit ( 190 million), primarily due to higher headcount, at the Central Europe market unit ( 126 million) mainly resulting from consolidation effects (approximately 60 million) and an increase in purchased services from third parties (about 20 million), and at the Pan-European Gas market unit ( 80 million), also reflecting the first full year consolidation of several new shareholdings. These effects were partially offset by lower general and administrative expenses at the Corporate Center ( 128 million), reflecting consolidation effects.

Other operating income (expenses), net equalled expenses of 848 million in 2006 as compared to income of 1,674 million in 2005. The significant change in this line item was primarily attributable to net gains/losses on derivative instruments, which generated expenses of 2,748 million in 2006, compared to income of 931 million in 2005, in part reflecting a decrease in the market value of derivatives at E.ON UK. In addition, net income arising from exchange rate differences of 44 million in 2006 was lower than the corresponding net income of 138 million in 2005. These negative effects were partially offset by higher net book gains on the disposal of investments and increased miscellaneous other net operating income. Net book gains on the disposal of investments increased by 545 million year on year, amounting to 579 million in 2006, compared with 34 million in 2005. The 2006 figure primarily included the gain from the forward sale of the stake in Degussa ( 376 million). Miscellaneous other operating income



(expenses), net rose by 733 million, amounting to net income of 1,297 million in 2006, as compared with net income of 564 million in 2005. For 2006, this line item also reflects gains from the derecognition of institutional securities funds as part of the transfer to the Contractual Trust Arrangement ( CTA ) in the amount of 159 million. In 2006, a SAB 51 gain of 7 million related to the sale of shares of E.ON Avacon, compared with 31 million in 2005.

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Financial earnings increased by 377 million, resulting in a gain of 203 million in 2006 compared with a loss of 174 million in 2005. The increase was primarily attributable to higher income from companies accounted for under the equity method of 403 million and lower interest expenses of 49 million, which were partly offset by higher depreciation on securities and share investments ( 90 million). For additional information, see Note 6 of the Notes to Consolidated Financial Statements.

As a result of the factors described above, income (loss) from continuing operations before income taxes and minority interests decreased by 28.2 percent or 2,019 million to 5,133 million in 2006, as compared with 7,152 million in 2005.

In 2006, E.ON recorded an income tax benefit of 323 million, as compared to a tax expense of 2,261 million in 2005. This change was primarily attributable to the change in the German corporate income tax act with regard to corporate tax credits arising from the former corporate imputation system which led to a tax credit of 1.3 billion. In addition, deferred tax income in the amount of approximately 1.2 billion resulted primarily from losses in the market valuation of energy derivatives. For additional information, see Note 7 of the Notes to Consolidated Financial Statements.

Income attributable to minority interests, and therefore deducted in the calculation of net income, was 526 million in 2006, as compared to 536 million in 2005.

Results from discontinued operations increased net income by 127 million in 2006, as compared to a contribution to net income of 3,059 million in 2005. The significant decrease reflected the very significant gains on the disposal of Viterra and Ruhrgas Industries recorded in 2005. For details, see Note 4 of the Notes to Consolidated Financial Statements. The Group's net income decreased 31.7 percent, totaling 5,057 million in 2006, compared with 7,407 million in 2005. Excluding the results of discontinued operations, E.ON would have recorded net income of 4,930 million in 2006, as compared to net income of 4,355 million in 2005.

*Reconciliation of Adjusted EBIT.* As noted above, E.ON uses adjusted EBIT as its segment reporting measure in accordance with SFAS 131. On a consolidated Group basis, adjusted EBIT is considered a non-GAAP measure that must be reconciled to the most directly comparable GAAP measure. A reconciliation of Group adjusted EBIT to net income for each of 2006, 2005 and 2004 appears in the table on page 146. The following paragraphs discuss changes in the principal components of each of the reconciling items to income (loss) from continuing operations before income taxes and minority interests. For additional details, see Note 31 of the Notes to Consolidated Financial Statements.

On a consolidated Group basis, adjusted EBIT increased by 12.0 percent to 8,150 million in 2006, as compared with 7,293 million in 2005.

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As detailed in the table below, adjusted interest income, net, amounted to an expense of 1,081 million in 2006 as compared to an expense of 1,027 million in 2005. The interest portion of long-term provisions deducted in the calculation was 389 million, as compared to 252 million in 2005, reflecting higher interest expenses for nuclear waste management (220 million) that were partially offset by lower interest expenses for pensions at the Central Europe and Pan-European Gas market units, as well as the Corporate Center. Non-operating interest income, net, amounted to income of 5 million in 2006 as compared with income of 39 million in 2005. In 2006, non-operating interest income primarily reflected higher interest charges related to derivatives in the U.K. market unit that were partially offset by higher interest income at the Central Europe market unit and the Corporate Center. In 2005, non-operating interest income primarily reflected the termination of an interest provision (32 million).

	2006	2005
	( in millions)	
<b>Interest income and similar expenses (net) as shown in Note 6 of the Notes to Consolidated Financial Statements</b>	<b>(687)</b>	<b>(736)</b>
(+) Non-operating interest income, net(1)	(5)	(39)
( ) Interest portion of long-term provisions	389	252
<b>Adjusted interest income, net</b>	<b>(1,081)</b>	<b>(1,027)</b>

(1) This net figure is calculated by adding in non-operating interest expense and subtracting non-operating interest income.

Net book gains as used in the reconciliation of adjusted EBIT more than doubled in 2006, increasing by 714 million from 491 million in 2005 to 1,205 million. In 2006, net book gains primarily resulted from the sale of funds invested in securities held by the Central Europe market unit (619 million) and the Degussa transaction (376 million). In 2005, net book gains primarily resulted from the sale of other securities held by the Central Europe market unit (371 million). In addition, the Central Europe market unit realized a gain on disposal of 90 million from the transfer of shares in TEAG. These book gains are calculated on a more inclusive basis than those discussed above in the analysis of other operating income (expenses), net. These gains generally include all gains and losses from the disposal of financial assets and results of deconsolidation, both net of expenses directly linked with the relevant disposal. They also include book gains and losses realized by equity investees, which are included in the income statement as a component of financial earnings.

Cost-management and restructuring expenses did not occur in 2006, compared with 29 million in 2005. In 2005, the principal expenses contributing to this item were restructuring costs of 18 million at the U.K. market unit, mainly attributable to the integration of Midlands Electricity, and restructuring costs of 11 million at the Central Europe market unit, primarily due to the merger of GVT and TEAG into ETE.

The amount reported as other non-operating results amounted to an expense of 3,141 million in 2006, as compared to income of 424 million in 2005. The total of 2006 primarily reflected the fulfilment of derivative gas procurement contracts and the marking to market of derivatives (2,729 million), particularly at the U.K. market unit. The 2006 result also reflected a total of 548 million in impairment charges. Following the BNetzA's reduction of allowable network charges, E.ON conducted impairment tests on E.ON's network assets and shareholdings in municipal distribution network operators. As a result, E.ON recorded impairment charges totaling 374 million in its gas distribution businesses. Of this total, 266 million relate to the Central Europe market unit, with 227 million relating to

its own gas distribution networks and the remaining 39 million to minority shareholdings. The remaining impairment loss of 108 million was recorded on other shareholdings at the Pan-European Gas market unit. Impairment tests on E.ON Energie's electricity transmission and distribution networks did not lead to any impairment losses. Further impairments relate to CHP generation assets at the U.K. market unit (35 million), as well as intangible and tangible assets at the Pan-European Gas, U.K. and Nordic market units (totaling 139 million). The impact of these impairments was partially offset by effects from the first-time consolidation of VKE at the Central Europe market unit, which add up to 83 million. In 2005, other non-operating earnings positively reflected unrealized gains from the required marking to market of derivatives under SFAS 133 (1.2 billion), primarily at the U.K. market unit. This positive effect on this item was partially offset by the impact of an impairment charge that Degussa took as of December 31, 2005. Degussa recorded an impairment

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charge of approximately 836 million (before taxes) in its Fine Chemicals business unit due to significant changes in market conditions. As a result of this impairment, E.ON recorded a loss of approximately 347 million attributable to its direct 42.9 percent shareholding in Degussa. Additional offsetting effects on other non-operating earnings were storm-related costs for rebuilding of the distribution grid and compensating customers of approximately 140 million at the Nordic market unit, impairments recorded at cogeneration facilities in the U.K. market unit ( 129 million), and an adjustment of deferred taxes ( 96 million) made at an equity holding of the Corporate Center.

**Central Europe**

For financial reporting purposes, the Central Europe market unit comprises four business units: Central Europe West Power, Central Europe West Gas, Central Europe East and Other/Consolidation. The Central Europe West Power business unit reflects the results of the conventional (including waste incineration), nuclear and hydroelectric generation businesses, transmission of electricity, the regional distribution of power and the retail electricity business in Germany, as well as its trading business. In addition, Central Europe West Power also includes the results of E.ON Benelux, which operates power generation, district heating and gas and electricity retail businesses in the Netherlands. The Central Europe West Gas business unit reflects the results of the regional distribution of gas and the gas retail business in Germany. The Central Europe East business unit primarily includes the results of the regional distribution companies in Bulgaria, the Czech Republic, Hungary, Romania and Slovakia (with the Slovak activities being valued under the equity method given E.ON Energie's minority interest). Other/Consolidation primarily includes the results of E.ON Energie's business in Italy, other national and international shareholdings, service companies and E.ON Energie AG, as well as intrasegment consolidation effects.

Total sales of the Central Europe market unit increased by 16.8 percent to 28,380 million (including 1,124 million of energy taxes and 686 million in intersegment sales) in 2006, compared with a total of 24,295 million (including 1,049 million of energy taxes and 248 million in intersegment sales) in 2005. The overall increase of 4,085 million reflected higher sales at each of Central Europe's business units, as described in more detail below.

The following table sets forth the sales of each business unit in the Central Europe market unit in each of the last two years, in each case excluding energy taxes:

**SALES OF CENTRAL EUROPE MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	<b>( in millions)</b>		
Central Europe West Power	18,885	16,945	+11.4
Central Europe West Gas	4,371	3,463	+26.2
Central Europe East	3,469	2,618	+32.5
Other/Consolidation	531	220	+141.4
<b>Total</b>	<b>27,256</b>	<b>23,246</b>	<b>+17.3</b>

Sales of the Central Europe West Power business unit increased by 1,940 million or 11.4 percent from 16,945 million in 2005 to 18,885 million in 2006. The rise was primarily attributable to higher electricity prices resulting from the global rise in raw material and energy prices (approximately 1,280 million) as well as to an increase in the sale of electricity produced from renewable resources (approximately 670 million), as the volume of such energy, which

E.ON Energie is required to purchase under regulatory requirements, increased in 2006. An increase in the volume of electricity sold ( 400 million) also contributed to the increase in sales. These positive impacts were offset in part by the negative effect of the new regulations applicable to network charges in Germany (approximately 580 million).

Sales of the Central Europe West Gas business unit rose by 26.2 percent from 3,463 million in 2005 to 4,371 million in 2006, with the increase of 908 million primarily reflecting higher gas prices (approximately

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720 million) as well as the first-time full-year consolidation of GVT (approximately 205 million). These positive factors were offset in part by the negative effect of the new regulation applicable to network charges in Germany (approximately 60 million).

Sales of the Central Europe East business unit increased by 32.5 percent or 851 million, from 2,618 million in 2005 to 3,469 million in 2006, with the increase primarily due to the first-time inclusion of full-year results from Hungarian gas companies which were consolidated as of April 2005, the Bulgarian companies Varna and Gorna Oryahovitza (consolidated as of March 2005), and the Romanian company E.ON Moldova (consolidated as of September 2005), as well as the first-time inclusion of two companies in the Czech Republic and one Hungarian company in 2006 (all of which increased revenues by an aggregate of approximately 560 million). The remainder mainly resulted from higher electricity prices in Hungary and the Czech Republic (approximately 190 million).

Sales of the Other/Consolidation business unit more than doubled, increasing by 311 million to 531 million in 2006, with the increase being primarily attributable to the consolidation effects involving E.ON IS UK (an IT services company), Arena One and Dalmine (an aggregate effect of 240 million).

Total power procured by the Central Europe market unit (excluding physically-settled trading activities) rose 3.6 percent to 281.2 billion kWh in 2006, compared with 271.3 billion kWh in 2005. The increase was primarily attributable to an increase in power procured from third parties and the own production of power. E.ON Energie's own production of power increased by 1.7 percent from 129.1 billion kWh in 2005 to 131.3 billion kWh in 2006. E.ON Energie produced approximately 47 percent of its power requirements in 2006, compared with approximately 48 percent in 2005. Compared with 2005, electricity purchased from jointly operated power stations increased by 2.2 percent from 12.0 billion kWh to 12.3 billion kWh. Purchases of electricity from third parties increased by 5.7 percent, from 130.2 billion kWh in 2005 to 137.6 billion kWh in 2006, largely due to the first-time inclusion of a full year of results from the electricity distribution companies in Bulgaria and Romania (approximately 3.6 TWh), as well as the purchase of significantly higher volumes of electricity generated from renewable resources pursuant to Germany's Renewable Energy Law (approximately 3.4 TWh).

In 2006, the Central Europe market unit contributed adjusted EBIT of 4,168 million, a 6.1 percent increase from a total of 3,930 million in 2005. The following table sets forth the adjusted EBIT of each business unit in the Central Europe market unit in each of the last two years:

**ADJUSTED EBIT OF CENTRAL EUROPE MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	( in millions)		
Central Europe West Power	3,550	3,389	+4.8
Central Europe West Gas	272	307	-11.4
Central Europe East	269	237	+13.5
Other/Consolidation	77	(3)	
<b>Total</b>	<b>4,168</b>	<b>3,930</b>	<b>+6.1</b>

Adjusted EBIT at the Central Europe West Power business unit increased by 161 million from 3,389 million in 2005 to 3,550 million in 2006. This 4.8 percent increase was primarily attributable to higher wholesale electricity prices

which could be passed on to customers (approximately 1,280 million), higher earnings from sale of shareholdings (approximately 130 million) and lower expenses for nuclear fuel management, primarily due to the absence of expenditures for nuclear operations taken in the prior year ( 85 million). The positive effects of these factors on the business unit s adjusted EBIT were partly offset by negative effects from the new regulation of network charges in Germany (approximately 580 million). Higher fuel costs (approximately 160 million), primarily reflecting significantly higher prices for hard coal and higher procurement costs (approximately 400 million) also reduced overall adjusted EBIT. Adjusted EBIT was also negatively affected by increased charges relating to earlier periods (approximately 170 million).



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Adjusted EBIT of the Central Europe West Gas business unit decreased by 11.4 percent to 272 million in 2006, compared with 307 million in 2005. The lower result was a consequence of the impact of new regulation of network charges in Germany (approximately 60 million). The negative impact of the regulation could only partially be offset by the effect of the first-time inclusion of a full year of results from GVT (approximately 30 million).

The Central Europe East business unit contributed adjusted EBIT of 269 million in 2006, a 13.5 percent increase from 237 million in 2005, largely reflecting the inclusion of a full year of earnings from the regional distributors in Bulgaria, Hungary, and Romania acquired in 2005, as well as a positive contribution from the two newly acquired companies in the Czech Republic (together approximately 46 million). Higher procurement costs and weather related lower sales volumes in the Hungarian gas business reduced adjusted EBIT by approximately 10 million.

Central Europe's Other/Consolidation business unit recorded an adjusted EBIT of 77 million in 2006 compared with an adjusted EBIT of negative 3 million in 2005. This positive change primarily resulted from higher income from realized hedging transactions (106 million) and increased earnings from shareholdings (37 million). Mainly intrasegment consolidation effects, re-evaluation of stock options owing to an increase in E.ON's stock price, reduction of the interest rate for pensions and changes in the basis of consolidation reduced adjusted EBIT by an aggregate of 63 million.

***Pan-European Gas***

For financial reporting purposes, the Pan-European Gas market unit is divided into three business units: Up-/Midstream, Downstream Shareholdings and Other/Consolidation. The Up-/Midstream business unit reflects the results of the supply, transmission system, storage and sales businesses, with the midstream operations essentially including all of the supply and sales business other than exploration and production activities. The Downstream Shareholdings business unit reflects the results of ERI and Thüga. Other/Consolidation includes consolidation effects.

The results of the Downstream Shareholdings business unit have included the results of E.ON Gaz România since July 1, 2005 and the results of MOL's gas trading and storage units (now E.ON Földgaz Trade and E.ON Földgaz Storage) since April 1, 2006. The results of the Up-/Midstream business unit include those of Caledonia (now E.ON Ruhrgas North Sea), which has been consolidated since November 1, 2005.

Total sales of the Pan-European Gas market unit increased by 39.5 percent to 24,987 million (including 2,061 million of natural gas and electricity taxes and 2,393 million in intersegment sales) in 2006, compared with a total of 17,914 million (including 3,110 million of natural gas and electricity taxes and 1,079 million in intersegment sales) in 2005. The increase was mainly attributable to higher average sales prices, higher sales volumes outside of Germany and consolidation effects. The decline in natural gas and electricity taxes is related to the new German energy taxation law which came into effect in August 2006 and provides that the tax is paid by distributors of gas rather than the importer.

The following table sets forth the sales of each business unit in the Pan-European Gas market unit (excluding natural gas and electricity taxes) in each of the last two years:

**SALES OF PAN-EUROPEAN GAS MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	( in millions)		

Up-/Midstream	18,868	13,380	+41.0
Downstream	4,773	1,848	+158.3
Other/Consolidation	(715)	(424)	-68.6
<b>Total</b>	<b>22,926</b>	<b>14,804</b>	<b>+54.9</b>

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Sales in the Up-/Midstream business unit increased in 2006 by 5,488 million or 41.0 percent from 13,380 million to 18,868 million, with the increase being primarily attributable to the increase in average sales prices (approximately 4.6 billion) and higher sales volumes (from 690.2 billion kWh to 709.7 billion kWh) in the midstream activities. In the upstream business, sales increased in particular as a result of the first time full year inclusion of E.ON Ruhrgas North Sea (163 million), which was acquired in November 2005, and the increase of sales prices at E.ON Ruhrgas Norge and E.ON Ruhrgas UK (43 million).

In the Downstream Shareholdings business unit, sales more than doubled, increasing by 2,925 million to 4,773 million in 2006 compared with 1,848 million in 2005. The main reason for the change was an increase in sales in ERI's downstream operations (2,801 million), particularly the impact of the first-time consolidation of E.ON Földgaz Trade and E.ON Földgaz Storage following their consolidation in April (1,943 million) and the first time inclusion of a full year of results from E.ON Gaz România (585 million). The overall figure also reflected an increase in sales of 125 million at Thüga's downstream operations, mainly reflecting a rise in gas sales as a consequence of higher average gas prices (161 million), the impact of which was partially offset by the impact of regulatory changes in Italy and Germany (46 million).

The total volume of gas sold by E.ON Ruhrgas' midstream operations increased by 2.8 percent to 709.7 billion kWh in 2006 from 690.2 billion kWh in 2005. Sales to domestic distributors decreased by 1.5 percent from 323.7 billion kWh to 318.7 billion kWh. Sales to domestic municipal utilities increased by 1.4 percent from 160.9 billion kWh to 163.1 billion kWh. E.ON Ruhrgas sold 67.6 billion kWh of gas to domestic industrial customers, a decrease of 4.0 percent from 70.4 billion kWh in 2005. Exports reached 160.3 billion kWh in 2006, a 18.6 percent increase from 135.2 billion kWh in 2005, primarily resulting from increased trading activities in the U.K. E.ON Ruhrgas purchased approximately 84.4 percent of its gas supplies from outside Germany and approximately 15.6 percent from German producers in 2006, compared with 84.5 percent and 15.5 percent, respectively, in 2005. In the Downstream Shareholdings business unit, total gas sales volumes more than doubled, rising from 69.0 billion kWh in 2005 to 175.1 billion kWh in 2006. Thüga increased its sales volumes by 2.7 percent to 23.1 billion kWh from 22.5 billion kWh. Sales volumes at ERI more than tripled to 152.0 billion kWh from 46.5 billion kWh in 2005, largely due to the first time inclusion of a full year of results from E.ON Gaz România and the inclusion of E.ON Földgaz since April 2006.

Adjusted EBIT of the Pan-European Gas market unit increased by 37.1 percent to 2,106 million in 2006 from 1,536 million in 2005. The rise in adjusted EBIT reflected positive results in the Up-/Midstream business unit, which were only partly offset by lower results in the Downstream Shareholdings business unit, as described in more detail below.

The following table sets forth the adjusted EBIT of each business unit in the Pan-European Gas market unit in each of the last two years:

**ADJUSTED EBIT OF PAN-EUROPEAN GAS MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	( in millions)		
Up-/Midstream	1,684	988	+70.4
Downstream Shareholdings	431	551	-21.8
Other/Consolidation	(9)	(3)	-200.0

<b>Total</b>	<b>2,106</b>	<b>1,536</b>	<b>+37.1</b>
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Adjusted EBIT in the Up-/Midstream business unit increased by 696 million or 70.4 percent from 988 million in 2005 to 1,684 million in 2006. The 25 million increase in adjusted EBIT at the upstream activities primarily reflected continued high oil and natural gas prices. These higher oil and gas prices led to improvements in adjusted EBIT of E.ON Ruhrgas UK and E.ON Ruhrgas Norge, whereas the positive effect of the first time inclusion of a full year of results from E.ON Ruhrgas North Sea was more than offset by the impact of reductions in expected production from certain gas fields. Adjusted EBIT in the midstream activities increased by 671 million, primarily due to the positive impact of the time lag effect in adjusting purchase prices, which had a

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negative impact last year ( 699 million). Furthermore, the settlement of proprietary trading transactions at maturity contributed 195 million to the increase. The positive impact of these factors on the adjusted EBIT of the midstream activities was partially offset by a lower contribution from commodity derivatives ( 66 million) as well as the combination of higher transportation fees and the fact that the 2005 result had benefited from the recalculation of fees for the usage of gas pipes ( 87 million).

In the Downstream Shareholdings business unit, adjusted EBIT decreased by 120 million or 21.8 percent to 431 million in 2006 from 551 million in 2005. The decrease in adjusted EBIT was primarily attributable to the new regulation of network charges in Germany which led to impairments of certain Thüga shareholdings totaling 188 million, as well as to the establishment of provisions for the obligation to refund to network customers the difference between network charges originally assessed and those finally approved ( 34 million). Furthermore, E.ON Földgaz Trade, which operates in Hungary's regulated gas market, negatively impacted the Downstream Shareholding's adjusted EBIT due to a delay in the approval of tariffs allowing it to recoup higher procurement costs ( 78 million). These negative effects were partially offset by higher net earnings at other equity investments ( 94 million), the inclusion of the results of E.ON Gaz România for the entire year of 2006 as compared to only six months in 2005 ( 41 million) and the first-time inclusion of the results of E.ON Földgaz Storage ( 31 million).

**U.K.**

From the beginning of 2006, E.ON UK re-allocated costs relating to the business services unit (facilities, IT and other shared services), which had been recorded under Other/Consolidation, to the Non-regulated Business to reflect this unit's use of such services. The Regulated Business already incurred a charge for these services. The 2005 results included below have been recalculated on the same basis to facilitate a comparison. In addition, the Energy Services business, most of which was included in the Regulated Business in prior years, has been included in the Non-regulated Business since the beginning of 2006, reflecting the unit's revised strategic objectives.

Total sales of the U.K. market unit in 2006 increased by 23.5 percent to 12,569 million (including 163 million in intersegment sales) from 10,176 million (including 74 million in intersegment sales) in 2005, primarily as a result of increased sales in the Non-regulated Business, as explained in more detail below.

The following table sets forth the sales of each business unit in the U.K. market unit in each of the last two years:

**SALES OF U.K. MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent</b>
	( in millions)		<b>Change</b>
Non-regulated Business	12,081	9,553	+26.5
Regulated Business	856	813	+5.3
Other/Consolidation	(368)	(190)	-93.7
<b>Total</b>	<b>12,569</b>	<b>10,176</b>	<b>+23.5</b>

Sales in the Non-regulated Business, which is primarily comprised of the energy wholesale (generation and trading), retail and the energy services businesses in the U.K., increased by 2,528 million from 9,553 million in 2005 to 12,081 million in 2006. This 26.5 percent increase was primarily attributable to higher retail prices driven by higher

energy prices, the effects of which were partially offset by lower volumes resulting from warmer weather and changes in consumer behavior ( 1,271 million) and higher sales in the wholesale market reflecting both higher energy prices and increased market sales volumes ( 986 million).

Sales in the Regulated Business, which is primarily comprised of the U.K. distribution operations, increased to 856 million in 2006 from 813 million in 2005. The sales increase of 43 million, or 5.3 percent, was principally attributable to tariff changes.

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Sales attributed to the Other/Consolidation business unit consist almost entirely of the elimination of intrasegment sales and had a negative impact on sales of 368 million in 2006, as compared to a negative impact of 190 million in 2005.

The volume of electricity sold by the U.K. market unit decreased by 1.2 billion kWh or 1.6 percent to 73.8 billion kWh, as compared with 75.0 billion kWh in 2005. Market sales associated with trading operations increased by 2.1 billion kWh or 13.8 percent to 17.5 billion kWh and mass market sales increased by 0.6 billion kWh or 1.6 percent to 37.9 billion kWh, while those to industrial and commercial customers decreased by 3.9 billion kWh or 17.6 percent to 18.4 billion kWh, reflecting the market unit's focus in this segment on securing margins rather than volume. The decrease in sales was reflected in the volume of own production and power purchased from outside sources. Own production decreased by 1.4 billion kWh or 3.7 percent from 37.3 billion kWh in 2005 to 35.9 billion kWh in 2006, primarily due to the unplanned outage at Ratcliffe power station. Power purchased from other suppliers decreased by 1.1 billion kWh or 2.8 percent to 38.1 billion kWh from 39.2 billion kWh, reflecting lower sales to industrial and commercial customers. The volume of power purchased from power stations in which E.ON UK has an interest of 50 percent or less increased by 0.1 billion kWh or 16.6 percent. Gas sales increased by 11.5 billion kWh or 6.3 percent from 182.5 billion kWh in 2005 to 194.0 billion kWh in 2006, with the increase reflecting higher market sales (20.9 billion kWh), offset in part by lower sales to industrial and commercial customers (3.9 billion kWh), lower sales to retail mass market customers (3.8 billion kWh), as well as a decrease in gas used for the market unit's own generation (1.7 billion kWh). E.ON UK satisfied its increased need for gas through an increase of 17.0 billion kWh or 12.7 percent in market purchases, while the volume of gas being sourced under long-term gas supply contracts decreased by 5.5 billion kWh or 11.4 percent from 48.4 billion kWh in 2005 to 42.9 billion kWh in 2006.

Adjusted EBIT at the U.K. market unit increased by 266 million or 27.6 percent from 963 million in 2005 to 1,229 million in 2006, reflecting an increase at each of the Non-regulated Business and the Regulated Business, partially offset by lower results at Other/Consolidation, as described in more detail below.

The following table sets forth the adjusted EBIT of each business unit in the U.K. market unit in each of the last two years:

**ADJUSTED EBIT OF U.K. MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	( in millions)		
Non-regulated Business	869	540	+60.9
Regulated Business	488	452	+8.0
Other/Consolidation	(128)	(29)	-341.4
<b>Total</b>	<b>1,229</b>	<b>963</b>	<b>+27.6</b>

The Non-regulated Business contributed adjusted EBIT of 869 million in 2006. This 329 million or 60.9 percent increase from 540 million in 2005 mainly resulted from the combination of higher margins at the coal fired power stations, higher retail prices and profit and cost saving initiatives implemented after the disappointing results of the first quarter (1,627 million), which were partially offset by higher commodity costs in 2006 (1,127 million) as well as the fact that the 2005 results reflected a benefit of 45 million relating to the integration of previously outsourced customer service activities.

The Regulated Business increased its adjusted EBIT from 452 million in 2005 to 488 million in 2006. The 8.0 percent or 36 million increase was almost entirely attributable to tariff changes and cost improvements.

The contribution of the Other/Consolidation business unit to adjusted EBIT, which is structurally negative due to the combination of intercompany eliminations and costs of the E.ON UK corporate center, was negative 128 million in 2006, as compared with negative 29 million in 2005. The change was primarily attributable to foreign exchange hedging impacts ( 19 million), higher pension costs ( 18 million) and central costs to support a growing business ( 9 million).



**Table of Contents*****Nordic***

Total sales of the Nordic market unit remained essentially stable in 2006, amounting to 3,204 million (including 377 million of electricity and natural gas taxes and 86 million in intersegment sales) compared to 3,213 million (including 382 million of electricity and natural gas taxes and 102 million in intersegment sales) in 2005. Sales decreased in both the Non-regulated Business and the Regulated Business units. This was offset by a positive development in Other/Consolidation, as described in more detail below.

As noted above, the Nordic market unit adopted a new business unit structure following the disposition of E.ON Finland, with its operating units split between the Non-regulated Business and the Regulated Business. In addition, the gas business has been undergoing structural changes since 2005. Following the deregulation of the Swedish gas market, the gas trading and retail businesses were moved from the distribution company to the respective trading and retail companies in the E.ON Sverige group. Since January 2006, the trading and retail businesses are included in the business unit Non-regulated Business, whereas the gas distribution business remains in the business unit Regulated. This re-allocation affects the year-on-year comparison of sales and adjusted EBIT for both the Regulated Business unit and the Non-regulated Business unit.

The following table sets forth the sales of each business unit in the Nordic market unit in each of the last two years, in each case excluding electricity and natural gas taxes:

**SALES OF NORDIC MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	( in millions)		
Non-regulated Business	2,119	2,247	-5.7
Regulated Business	725	850	-14.7
Other/Consolidation	(17)	(266)	+93.6
<b>Total</b>	<b>2,827</b>	<b>2,831</b>	

Sales in the Non-regulated Business unit, which includes power generation, retail, trading, heat and services operations decreased by 128 million or 5.7 percent from 2,247 million to 2,119 million, driven by lower volumes in hydro and nuclear power generation following significantly lower hydro reservoir inflow in the first three quarters of 2006 and the temporary shutdown of several nuclear plants.

Sales in the Regulated Business unit, which includes electricity distribution, as well as gas transmission, distribution and storage, decreased from 850 million to 725 million. This 125 million or 14.7 percent decrease was mainly attributable to the reorganization of gas trading activities from the Regulated Business unit to the Non-regulated Business unit in 2006 noted above.

Sales attributed to the Other/Consolidation business unit consists almost entirely of the elimination of intrasegment sales and had a negative impact on sales of 17 million in 2006, as compared to a negative impact of 266 million in 2005. The significant decrease of intersegment sales in 2006 compared to 2005 primarily reflects the impact of the re-allocation of the gas trading and retail businesses to the Non-regulated Business and the fact that the 2005 results had included a higher volume of maintenance services provided to the Non-regulated Business following the severe

storm in January 2005. Notably, the hydropower assets sold to Statkraft in October 2005 were included in the Other/Consolidation business unit and contributed to the results until their disposal. This partly offset the negative impact on sales coming from the Other/Consolidation business unit in 2005.

Total power supplied by E.ON Nordic (excluding physically settled trading activities) decreased by 11.5 percent to 40.6 billion kWh in 2006, compared with 45.9 billion kWh in 2005. The decrease of 5.3 billion kWh reflected a reduction in the volume of power sold to sales partners/Nord Pool by 19.6 percent from 26.2 billion kWh in 2005 to 21.1 billion kWh in 2006, primarily reflecting lower hydropower production due to the prevailing hydropower situation, the sale of hydropower assets to Statkraft in late 2005, and the unplanned outages of nuclear reactors. Sales to residential customers decreased by 0.4 billion kWh or 5.7 percent from 7.0 billion kWh in 2005 to 6.6 billion kWh in 2006, as a result of unseasonably warm weather in the fourth quarter 2006. Sales to commercial

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customers increased by 1.6 percent to 12.7 billion kWh in 2006 compared with 12.6 billion kWh in 2005, reflecting the impact of new customers. E.ON Nordic's own production decreased by 16.2 percent from 33.3 billion kWh in 2005 to 27.9 billion kWh in 2006, mainly resulting from lower hydropower generation (5.1 billion kWh) and lower nuclear generation (0.8 billion kWh). As a result of lower production volumes from its own sources, E.ON Nordic purchased slightly more power from outside sources (0.5 billion kWh). Purchases from jointly owned power stations remained stable with 10.2 billion kWh. The total volume of gas sold to third parties decreased in 2006 to 5.8 billion kWh from 6.9 billion kWh in 2005, mainly resulting from lower sales to industrial and distribution customers (1.7 billion kWh).

Adjusted EBIT at the Nordic market unit decreased by 147 million or 19.2 percent, from 766 million to 619 million, primarily reflecting lower generation volumes, the disposition of hydropower assets to Statkraft, and increased taxation on hydroelectric assets and nuclear generation, as described in more detail below.

The following table sets forth the adjusted EBIT of each business unit in the Nordic market unit in each of the last two years:

**ADJUSTED EBIT OF NORDIC MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent</b>
	<b>( in millions)</b>		<b>Change</b>
Non-regulated Business	448	541	-17.2
Regulated Business	200	244	-18.0
Other/Consolidation	(29)	(19)	-52.6
<b>Total</b>	<b>619</b>	<b>766</b>	<b>-19.2</b>

Adjusted EBIT in the Non-regulated Business unit decreased by 93 million from 541 million in 2005 to 448 million in 2006. This 17.2 percent decrease primarily reflected increased taxation on hydroelectric assets and nuclear generation ( 63 million), and lower hydro and nuclear generation volumes resulting from the strained hydrological situation during summer and autumn and the unplanned nuclear outages ( 146 million). These effects were partially offset by a positive effect from rising spot electricity prices and successful hedging activities, which enabled Nordic to secure higher average sales prices for its production portfolio ( 174 million).

In the Regulated Business, adjusted EBIT decreased by 44 million from 244 million in 2005 to 200 million in 2006. This 18.0 percent decrease mainly resulted from the re-allocation of gas trading activities from the Regulated Business unit to the Non-regulated Business unit ( 22 million), and increased costs for power losses in the transmission and distribution grid ( 13 million) driven by higher electricity prices during 2006.

The contribution of the Other/Consolidation business unit to adjusted EBIT, which is structurally negative due to the combination of intercompany eliminations and costs of the E.ON Nordic corporate center, decreased from negative 19 million in 2005 to negative 29 million in 2006. The decrease primarily reflects the loss of the contribution from hydropower assets sold to Statkraft in 2005 ( 30 million).

***U.S. Midwest***

Total sales of the U.S. Midwest market unit amounted to 1,947 million in 2006, a decrease of 4.8 percent from 2,045 million in 2005. The decrease was primarily due to lower off-system sales volumes and milder weather in 2006, the impact of which was partially offset by higher recoveries of coal price increases from retail customers and recoveries of environmental capital spending.

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The following table sets forth the sales of each business unit in the U.S. Midwest market unit in each of the last two years:

**SALES OF U.S. MIDWEST MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	( in millions)		
Regulated Business	1,887	1,965	-4.0
Non-regulated Business	60	80	-25.0
<b>Total</b>	<b>1,947</b>	<b>2,045</b>	<b>-4.8</b>

Sales of the Regulated Business, which is comprised of the utility operations of LG&E and KU, decreased by 78 million to 1,887 million in 2006, from 1,965 million in 2005. The 4.0 percent decrease was primarily attributable to lower revenues from off-system electric sales ( 80 million), as well as lower retail electric and gas volumes resulting from milder weather (and associated lower passed-through costs of gas supply) ( 63 million), and lower wholesale gas sales volumes ( 14 million). These negative effects were partially offset by the higher recovery from customers of passed-through costs for fuel (primarily coal) used for generation ( 61 million), and higher recoveries on environmental capital spending ( 17 million).

Sales of the Non-regulated Business, which primarily consists of ECC and its subsidiaries, decreased by 20 million or 25.0 percent from 80 million in 2005 to 60 million in 2006, with the decrease being primarily attributable to new regulations that allowed Argentine industrial customers to purchase gas directly from producers.

Adjusted EBIT at the U.S. Midwest market unit increased by 7.1 percent from 365 million in 2005 to 391 million in 2006.

The following table sets forth the adjusted EBIT of each business unit in the U.S. Midwest market unit in each of the last two years:

**ADJUSTED EBIT OF U.S. MIDWEST MARKET UNIT**

	<b>2006</b>	<b>2005</b>	<b>Percent Change</b>
	( in millions)		
Regulated Business	387	351	+10.3
Non-regulated Business	4	14	-71.4
<b>Total</b>	<b>391</b>	<b>365</b>	<b>+7.1</b>

Adjusted EBIT at the Regulated Business increased by 36 million or 10.3 percent from 351 million in 2005 to 387 million in 2006. The increase was primarily attributable to net cost savings resulting from the exit from MISO in

the third quarter of 2006 ( 24 million) and lower amortization expenses reflecting the completion of certain restructuring activities ( 25 million), as well as recoveries on environmental capital spending ( 17 million) and higher prices realized on off-system electric sales ( 13 million). The impact of these positive effects was partially offset by lower retail electric and gas volumes due to significantly milder weather in 2006 ( 33 million) and higher labor costs ( 15 million).

Adjusted EBIT at E.ON U.S.'s Non-regulated Business decreased from 14 million in 2005 to 4 million in 2006. This 71.4 percent or 10 million decrease primarily reflected the loss of earnings from LPI following its sale in 2006 ( 17 million), partially offset by the improved performance of the Argentine operations ( 5 million).

***Corporate Center***

The Corporate Center reduced Group sales by 3,328 million in 2006, compared with reducing sales by 1,502 million in 2005. The reduction in adjusted EBIT attributable to the segment was 416 million in 2006, compared with 399 million in 2005. The contribution of the Corporate Center to both sales and adjusted EBIT is

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structurally negative due to the elimination of intersegment results and administrative costs that are not matched by revenues.

***Other Activities***

For the period between Degussa's deconsolidation and E.ON's disposal of its interest in July 2006, E.ON's proportionate share of Degussa's after-tax earnings continued to be presented outside of the core energy business as part of E.ON's Other Activities, which is reported as a separate segment. Degussa contributed 53 million to adjusted EBIT in 2006, compared with 132 million in 2005. For information regarding the disposal of E.ON's remaining interest in Degussa, see Overview.

**YEAR ENDED DECEMBER 31, 2005 COMPARED WITH YEAR ENDED DECEMBER 31, 2004*****E.ON Group***

E.ON's sales in 2005 increased 22.5 percent to 51,616 million from 42,150 million in 2004 (in each case net of electricity and natural gas taxes). As noted above, the increase was primarily attributable to higher average prices in the electricity and gas business, higher electricity and gas sales volumes, an increase in sales of electricity generated from renewable resources reflecting regulatory requirements and consolidation effects. As illustrated in the table on page 145, the overall increase in the Group's sales reflected an increase in sales at each of its market units other than the Corporate Center.

Sales of the Central Europe market unit increased 17.1 percent in 2005 to 24,295 million (including 1,049 million of electricity taxes) from 20,752 million (including 1,051 million of electricity taxes) in 2004. Pan-European Gas sales increased by 35.4 percent to 17,914 million (including 3,110 million of natural gas and electricity taxes) in 2005 from 13,227 million (including 2,923 million of natural gas and electricity taxes) in 2004. Sales of the U.K. market unit increased by 19.9 percent, amounting to 10,176 million in 2005 as compared to 8,490 million in 2004. The Nordic market unit grew its 2005 sales by 3.8 percent to 3,213 million (including 382 million of electricity and natural gas taxes) from 3,094 million (including 376 million of electricity and natural gas taxes) in 2004. Sales of the U.S. Midwest market unit increased by 19.0 percent in 2005 to 2,045 million compared with 1,718 million in 2004. The elimination of intersegment sales at the Corporate Center resulted in the segment reporting negative sales of 792 million in 2004 and negative sales of 1,502 million in 2005. The sales of each of these segments are discussed in more detail below.

Total cost of goods sold and services provided in 2005 increased 29.8 percent or 9,333 million to 40,603 million compared with 31,270 million in 2004, with increases at the Pan-European Gas market unit ( 4,571 million), primarily reflecting the effect of higher procurement costs at the gas operations due to increased oil prices, at the Central Europe market unit ( 3,120 million), reflecting higher electricity and gas procurement costs (approximately 1,000 million), higher purchases of energy produced from renewable resources under the Renewable Energy Law (approximately 800 million) and effects from first-time consolidation (approximately 800 million), and at the U.K. market unit ( 1,801 million), primarily attributable to higher gas purchase costs ( 629 million) and increased prices for power purchased ( 566 million). Cost of goods sold as a percentage of revenues (net of electricity and natural gas taxes) increased to 78.7 percent in 2005 from 74.2 percent in 2004, as the rate of increase of cost of goods sold and services provided was greater than that of sales. Gross profit nonetheless increased, rising by 1.2 percent to 11,013 million in 2005 from 10,880 million in 2004.

Selling expenses decreased 9.0 percent or 381 million to 3,845 million in 2005, compared with 4,226 million in 2004. The decline reflected an overall reduction of 180 million in selling expenses at the U.K. market unit, including 62 million in reduced operating costs at Central Networks following the restructuring in 2004 and approximately

60 million from the release of a provision, as well as declines at the U.S. Midwest market unit ( 114 million), primarily resulting from the reclassification of selling expenses to cost of goods sold and services provided, and at the Central Europe market unit ( 59 million), reflecting effects from the first-time consolidation of E.ON IS totaling 190 million, which were partially offset by increased other expenses, in particular those resulting from first-time consolidations.



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General and administrative expenses increased by 182 million, amounting to 1,516 million in 2005 compared with 1,334 million in 2004. The 13.6 percent increase reflected increases at all market units. At the U.K. market unit such costs increased by 70 million, primarily due to additional shared service costs as a result of acquisitions and project costs, and at the Pan-European Gas market unit by 36 million, primarily due to higher project costs and changes in the basis of consolidation. At the U.S. Midwest market unit general and administrative expenses increased by 29 million as a result of the reclassification of cost of goods sold and services provided to such expenses, while at the Corporate Center such costs increased by 26 million.

Other operating income (expenses), net increased to 1,674 million in 2005 from 1,378 million in 2004. This increase of 296 million, or 21.5 percent, reflected higher income from exchange rate differences and higher gains on derivative financial instruments. Net income (expenses) arising from exchange rate differences was equal to income of 138 million in 2005, as compared to expenses of 309 million in 2004, reflecting the results from the recognition of exchange rate movements on foreign currency transactions and net realized losses on foreign currency derivatives. Gains/losses on derivative financial instruments, net amounted to 931 million in 2005, compared with 602 million in 2004. This increase in income of 329 million or 54.7 percent was primarily attributable to the U.K. market unit. These effects were partially offset by lower net book gains on the disposal of investments and decreased miscellaneous other operating income (expenses), net. Net book gains decreased by 363 million year on year, amounting to 34 million in 2005, compared with 397 million in 2004. The 2004 figure primarily included gains from the sale of stakes in EWE Aktiengesellschaft ( EWE ) and VNG ( 317 million), the sale of an additional 3.6 percent of Degussa's share capital to RAG ( 51 million), the sale of shares in Union Fenosa ( 26 million) and the sale of certain shareholdings at the Central Europe market unit ( 57 million). In 2005, a SAB 51 gain of 31 million related to the sale of shares of E.ON Avacon. Miscellaneous other operating income (expenses), net decreased by 143 million, amounting to income of 564 million in 2005, as compared with income of 707 million in 2004. This decrease was primarily attributable to lower income from the reversal of provisions ( 218 million) and the impairment loss recorded at cogeneration facilities at the U.K. market unit ( 129 million). These effects were partially offset by higher gains realized on the sale of securities (approximately 153 million) and the gain from the transfer of the Company's stake in TEAG ( 90 million). For further information, see Note 5 of the Notes to Consolidated Financial Statements.

Financial earnings increased by 192 million, or 52.5 percent, resulting in a loss of 174 million in 2005 compared with a loss of 366 million in 2004. The increase was primarily attributable to a decrease of 327 million in interest and similar expenses, net, a decline of 215 million in income from companies accounted for under the equity method and a decrease of 57 million in write-downs of financial assets and share investments. For additional information, see Note 6 of the Notes to Consolidated Financial Statements.

As a result of the factors described above, income (loss) from continuing operations before income taxes and minority interests increased by 13.0 percent or 820 million to 7,152 million in 2005, as compared with 6,332 million in 2004.

In 2005, E.ON recorded income tax expenses of 2,261 million, as compared to a tax expense of 1,852 million in 2004. This increase of 409 million or 22.1 percent was primarily attributable to an increase of foreign deferred taxes, due in particular to the marking to market of energy derivatives in the U.K. market unit. For additional information, see Note 7 of the Notes to Consolidated Financial Statements.

Income attributable to minority interests, and therefore deducted in the calculation of net income, was 536 million in 2005, as compared to 469 million in 2004, with the increase of 67 million, or 14.3 percent, reflecting improved results at a number of the entities in which the Group holds a minority interest.

Results from discontinued operations increased net income by 3,059 million in 2005, as compared to a contribution to net income of 328 million in 2004. The significant increase reflected the gains on the disposal of Viterra and Ruhrgas Industries. For details, see Note 4 of the Notes to the Consolidated Financial Statements. The Group's net income

increased 70.7 percent, totaling 7,407 million in 2005, compared with 4,339 million in 2004. Excluding the results of discontinued operations, E.ON would have recorded net income of 4,355 million in 2005, as compared to net income of 4,011 million in 2004.

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*Reconciliation of Adjusted EBIT.* As noted above, E.ON uses adjusted EBIT as its segment reporting measure in accordance with SFAS 131. On a consolidated Group basis, adjusted EBIT is considered a non-GAAP measure that must be reconciled to the most directly comparable GAAP measure. A reconciliation of Group adjusted EBIT to net income for each of 2006, 2005 and 2004 appears in the table on page 146. The following paragraphs discuss changes in the principal components of each of the reconciling items to income (loss) from continuing operations before income taxes and minority interests. For additional details, see Note 31 of the Notes to Consolidated Financial Statements.

On a consolidated Group basis, adjusted EBIT increased by 8.1 percent to 7,293 million in 2005, as compared with 6,747 million in 2004.

As detailed in the table below, adjusted interest income, net, remained essentially stable, amounting to an expense of 1,027 million in 2005 as compared to 1,032 million in 2004. The interest portion of long-term provisions deducted in the calculation was 252 million, as compared to 120 million in 2004, reflecting the fact that the 2004 result included a one-off effect related to amendments to Germany's Ordinance on Advance Payments for the Establishment of Federal Facilities for Safe Custody and Final Storage for Radioactive Wastes (*Endlager-Vorausleistungsverordnung*). Non-operating interest income, net, amounted to income of 39 million in 2005 as compared with an expense of 151 million in 2004. In 2005, non-operating interest income primarily reflected the termination of an interest provision (32 million), while in 2004 the largest portion of this item resulted from accruals for interest payments due on taxes for audit periods which are still under review.

	<b>2005</b>	<b>2004</b>
	( in millions)	
<b>Interest income and similar expenses (net) as shown in Note 6 of the Notes to Consolidated Financial Statements</b>	<b>(736)</b>	<b>(1,063)</b>
(+) Non-operating interest income, net(1)	(39)	151
(-) Interest portion of long-term provisions	252	120
<b>Adjusted interest income, net</b>	<b>(1,027)</b>	<b>(1,032)</b>

(1) This net figure is calculated by adding in non-operating interest expense and subtracting non-operating interest income.

Net book gains as used in the reconciliation of adjusted EBIT decreased by 98 million or 16.6 percent in 2005 from 589 million in 2004 to 491 million. In 2005, net book gains primarily resulted from the sale of other securities held by the Central Europe market unit (371 million). In addition, the Central Europe market unit realized a gain on disposal of 90 million from the transfer of shares in TEAG. In 2004, net book gains resulted from the sale of equity interests in EWE and VNG (317 million), the sale of shares of Union Fenosa and other securities held by the Central Europe market unit (221 million) and the sale of an additional 3.6 percent of Degussa's share capital to RAG (51 million). These book gains are calculated on a more inclusive basis than those discussed above in the analysis of other operating income (expenses), net. These gains generally include all gains and losses from the disposal of financial assets and results of deconsolidation, both net of expenses directly linked with the relevant disposal. They also include book gains and losses realized by equity investees, which are included in the income statement as a component of financial earnings.

Cost-management and restructuring expenses decreased by 71.0 percent to 29 million in 2005, compared with 100 million in 2004. In 2005, the principal expenses contributing to this item were restructuring costs of 18 million at the U.K. market unit, mainly attributable to the integration of Midlands Electricity, and restructuring costs of 11 million at the Central Europe market unit, primarily due to the merger of GVT and TEAG into ETE. In 2004, the principal expenses contributing to this item were restructuring costs of 63 million at the U.K. market unit, mainly attributable to the integration of Midlands Electricity, and restructuring costs of 37 million at the Central Europe market unit that were primarily attributable to the merger of a number of its regional distribution companies into E.ON Hanse and E.ON Westfalen Weser.

The income reported as other non-operating results amounted to 424 million in 2005, compared with 128 million in 2004. In 2005, other non-operating earnings positively reflected unrealized gains from the required

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marking to market of derivatives under SFAS 133 ( 1.2 billion), primarily at the U.K. market unit. This positive effect on this item was partially offset by the impact of an impairment charge that Degussa took as of December 31, 2005. Degussa recorded an impairment charge of approximately 836 million (before taxes) in its Fine Chemicals business unit due to significant changes in market conditions. As a result of this impairment, E.ON recorded a loss of approximately 347 million attributable to its direct 42.9 percent shareholding in Degussa. Additional offsetting effects on other non-operating earnings were storm-related costs for rebuilding of the distribution grid and compensating customers of approximately 140 million at the Nordic market unit, impairments recorded at cogeneration facilities in the U.K. market unit ( 129 million), and an adjustment of deferred taxes ( 96 million) made at an equity holding of the Corporate Center. In 2004, positive other non-operating results in the amount of approximately 304 million were attributable to unrealized gains from the required marking to market of derivatives under SFAS 133, primarily at the U.K. market unit, which were partially offset by unusual charges on investments at the Central Europe and U.K. market units ( 110 million) and by impairment charges on real estate and short-term securities at the Central Europe market unit ( 84 million).

**Central Europe**

For financial reporting purposes, the Central Europe market unit comprises four business units: Central Europe West Power, Central Europe West Gas, Central Europe East and Other/Consolidation. The Central Europe West Power business unit reflects the results of the conventional, nuclear and hydroelectric generation businesses, transmission, the regional distribution of power and the retail electricity business in Germany, as well as its trading business. In addition, Central Europe West Power also includes the results of E.ON Benelux, which operates power generation, district heating and gas and electricity retail businesses in the Netherlands. The Central Europe West Gas business unit reflects the results of the regional distribution of gas and the gas retail business in Germany. The Central Europe East business unit primarily includes the results of the regional distribution companies in Bulgaria, the Czech Republic, Hungary, Romania and Slovakia (with the Slovak activities being valued under the equity method given E.ON Energie's minority interest). Other/Consolidation primarily includes the results of other international shareholdings, service companies and E.ON Energie AG, as well as intrasegment consolidation effects.

Total sales of the Central Europe market unit increased by 17.1 percent to 24,295 million (including 1,049 million of electricity taxes and 248 million in intersegment sales) in 2005, compared with a total of 20,752 million (including 1,051 million of electricity taxes and 212 million in intersegment sales) in 2004. The overall increase of 3,543 million reflected higher sales at each of Central Europe's business units other than its Other/Consolidation business unit, as described in more detail below.

The following table sets forth the sales of each business unit in the Central Europe market unit in each of the last two years, in each case excluding electricity taxes:

**SALES OF CENTRAL EUROPE MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	<b>( in millions)</b>		
Central Europe West Power	16,945	14,597	+16.1
Central Europe West Gas	3,463	2,979	+16.2
Central Europe East	2,618	1,877	+39.5
Other/Consolidation	220	248	-11.3

<b>Total</b>	<b>23,246</b>	<b>19,701</b>	<b>+18.0</b>
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Sales of the Central Europe West Power business unit increased by 2.348 billion or 16.1 percent from 14,597 million in 2004 to 16,945 million in 2005. The increase was primarily attributable to higher electricity prices and higher grid access fees (approximately 750 million) as well as to an increase in the sale of electricity produced from renewable resources (approximately 570 million), as the volume of such energy, which E.ON Energie is required to purchase under regulatory requirements, increased in 2005. Increased trading revenues

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contributed approximately 480 million to the overall increase, with the remainder reflecting increases in sales volumes and in other revenues.

Sales of the Central Europe West Gas business unit increased by 16.2 percent from 2,979 million in 2004 to 3,463 million in 2005, with the increase of 484 million primarily reflecting higher gas prices (approximately 425 million) as well as the first-time consolidation of two gas companies at E.ON Bayern and of GVT (approximately 205 million). These positive factors were partly offset by lower sales volumes, with the decrease reflecting weather-related effects as well as increased competition.

Sales of the Central Europe East business unit increased by 39.5 percent or 741 million, from 1,877 million in 2004 to 2,618 million in 2005, with the increase primarily due to the first-time inclusion of results from the Hungarian gas companies which were consolidated as of April 2005, the Bulgarian companies Varna and Gorna Oryahovitza, (consolidated as of March 2005) and the Romanian E.ON Moldova (consolidated as of September 2005) (together approximately 530 million). Higher electricity prices in Hungary and the Czech Republic also contributed to the increase.

Total power procured by the Central Europe market unit (excluding physically-settled trading activities) rose 6.7 percent to 271.3 billion kWh in 2005, compared with 254.3 billion kWh in 2004, primarily reflecting an increase in power procured from third parties. E.ON Energie's own production of power declined by 1.7 percent from 131.3 billion kWh in 2004 to 129.1 billion kWh in 2005. E.ON Energie produced approximately 48 percent of its power requirements in 2005, compared with approximately 52 percent in 2004. Compared with 2004, electricity purchased from jointly operated power stations increased by 7.1 percent from 11.2 billion kWh to 12.0 billion kWh. Purchases of electricity from third parties increased by 16.4 percent, from 111.8 billion kWh in 2004 to 130.2 billion kWh in 2005, largely due to the first-time consolidation of the electricity distribution companies in Bulgaria and Romania (approximately 6 TWh), as well as the purchase of significant higher volumes of renewable source electricity produced from renewable resources, which is regulated under Germany's Renewable Energy Law (approximately 6 TWh). The residual rise was mainly related to an increase in short- and midterm trading volumes.

In 2005, the Central Europe market unit contributed adjusted EBIT of 3,930 million, a 9.1 percent increase from a total of 3,602 million in 2004. The following table sets forth the adjusted EBIT of each business unit in the Central Europe market unit in each of the last two years:

**ADJUSTED EBIT OF CENTRAL EUROPE MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	( in millions)		
Central Europe West Power	3,389	2,996	+13.1
Central Europe West Gas	307	315	-2.5
Central Europe East	237	235	+0.9
Other/Consolidation	(3)	56	
<b>Total</b>	<b>3,930</b>	<b>3,602</b>	<b>+9.1</b>

Adjusted EBIT at the Central Europe West Power business unit increased by 393 million from 2,996 million in 2004 to 3,389 million in 2005. This 13.1 percent increase was primarily attributable to higher wholesale electricity prices

which could be passed on to customers (approximately 610 million) as well as operational improvements (approximately 80 million). The positive effects of these factors on the business unit's adjusted EBIT were partly offset by higher fuel costs (approximately 210 million), primarily reflecting significantly higher prices for hard coal. Costs for the purchase of electricity from jointly owned power plants and from third parties increased by approximately 90 million. Procurement of CO<sub>2</sub> emission certificates also reduced overall adjusted EBIT at Central Europe West Power by a net amount of 46 million.

Adjusted EBIT of the Central Europe West Gas business unit declined by 2.5 percent to 307 million in 2005, compared with 315 million in 2004. The decrease of 8 million was primarily the result of lower sales volumes due to weather related effects as well as increased competition (approximately 30 million). This effect was partially



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offset by the first time consolidation effect of two gas companies at E.ON Bayern and of GVT ( 15 million), as well as increased gas transport revenues.

The Central Europe East business unit contributed adjusted EBIT of 237 million in 2005, a 0.9 percent increase from 235 million in 2004. As expected, the first time consolidation of the Bulgarian, Romanian and Hungarian companies did not have a material impact on the business unit's adjusted EBIT in 2005.

Central Europe's Other/Consolidation business unit recorded a 59 million decline in adjusted EBIT, from adjusted EBIT of 56 million in 2004 to adjusted EBIT of negative 3 million in 2005. The 2004 result had reflected the release of provisions relating to E.ON Energie in 2004.

***Pan-European Gas***

For financial reporting purposes, the Pan-European Gas market unit is divided into three business units: Up-/Midstream, Downstream Shareholdings and Other/Consolidation. The Up-/Midstream business unit reflects the results of the supply, transmission system, storage and sales businesses, with the midstream operations essentially including all of the supply and sales business other than exploration and production activities. The Downstream Shareholdings business unit reflects the results of ERI and Thüga. Other/Consolidation includes consolidation effects.

The results of the Downstream Shareholdings business unit have included the results of Distrigaz Nord since July 1, 2005. The results of the Up-/Midstream business unit included those of Caledonia (now E.ON Ruhrgas North Sea), which has been consolidated since November 1, 2005.

Total sales of the Pan-European Gas market unit increased by 35.4 percent to 17,914 million (including 3,110 million of natural gas and electricity taxes and 1,079 million in intersegment sales) in 2005, compared with a total of 13,227 million (including 2,923 million of natural gas and electricity taxes and 556 million in intersegment sales) in 2004. The increase was mainly attributable to higher sales volumes, as well as higher average sales prices.

The following table sets forth the sales of each business unit in the Pan-European Gas market unit (excluding natural gas and electricity taxes) in each of the last two years:

**SALES OF PAN-EUROPEAN GAS MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	( in millions)		
Up-/Midstream	13,380	9,274	+44.3
Downstream	1,848	1,358	+36.1
Other/Consolidation	(424)	(328)	-29.3
<b>Total</b>	<b>14,804</b>	<b>10,304</b>	<b>+43.7</b>

Sales in the Up-/Midstream business unit increased in 2005 by 4,106 million or 44.3 percent from 9,274 million to 13,380 million, with the increase being primarily attributable to the increase of average sales prices in the midstream activities (approximately 2.4 billion) as well as a rise in sales volumes (from 641.4 billion kWh to 690.2 billion kWh). The business unit's overall sales figure also benefited from the increase of sales prices ( 102 million) and higher sales

volumes ( 31 million), primarily resulting from higher production of the Njord oil and gas field and of the Scoter gas field, as well as the first-time inclusion of E.ON Ruhrgas North Sea ( 35 million) within the exploration and production activities.

In the Downstream Shareholdings business unit, sales increased by 490 million or 36.1 percent to 1,848 million in 2005 compared with 1,358 million in 2004. The main reason for the change was an increase in sales in ERI s downstream operations ( 347 million), particularly Distrigaz Nord ( 199 million) and Ferngas Nordbayern ( 144 million). The overall figure also reflected an increase in sales of 143 million at Thüga s

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downstream operations, reflecting changes in the basis of consolidation at Thüga Italia ( 50 million) and higher average gas prices at Thüga in Germany ( 45 million).

The total volume of gas sold by E.ON Ruhrgas' midstream operations increased by 7.6 percent to 690.2 billion kWh in 2005 from 641.4 billion kWh in 2004. Sales to domestic distributors decreased by 1.5 percent from 328.7 billion kWh to 323.7 billion kWh. Sales to domestic municipal utilities increased by 3.1 percent from 156.1 billion kWh to 160.9 billion kWh. E.ON Ruhrgas sold 70.4 billion kWh of gas to domestic industrial customers, an increase of 2.0 percent from 69.0 billion kWh in 2004. Exports reached 135.2 billion kWh in 2005, a 54.3 percent increase from 87.6 billion kWh in 2004. E.ON Ruhrgas purchased approximately 84.5 percent of its gas supplies from outside Germany and approximately 15.5 percent from German producers in 2005, compared with 83.2 percent and 16.8 percent, respectively, in 2004. In the Downstream Shareholdings business unit, total gas sales volumes increased by 35.3 percent from 51.0 billion kWh in 2004 to 69.0 billion kWh in 2005. Thüga increased its sales volumes by 7.7 percent to 22.5 billion kWh from 20.9 billion kWh, primarily due to changes in the basis of consolidation at Thüga Italia. Sales volumes at ERI rose by 54.5 percent to 46.5 billion kWh, largely due to the first time inclusion of Distrigaz Nord in the second half of 2005.

Adjusted EBIT of the Pan-European Gas market unit increased by 14.3 percent to 1,536 million in 2005 from 1,344 million in 2004. The rise in adjusted EBIT reflected positive results in the Up-/Midstream business unit as well as in the Downstream Shareholdings business unit, as described in more detail below.

The following table sets forth the adjusted EBIT of each business unit in the Pan-European Gas market unit in each of the last two years:

**ADJUSTED EBIT OF PAN-EUROPEAN GAS MARKET UNIT**

	2005	2004	Percent Change
	( in millions)		
Up-/Midstream	988	862	+14.6
Downstream Shareholdings	551	486	+13.4
Other/Consolidation	(3)	(4)	+25.0
<b>Total</b>	<b>1,536</b>	<b>1,344</b>	<b>+14.3</b>

Adjusted EBIT in the Up-/Midstream business unit increased by 126 million or 14.6 percent from 862 million in 2004 to 988 million in 2005. The 104 million increase in adjusted EBIT at the upstream activities primarily reflected higher production volumes, as well as higher average sales prices. Adjusted EBIT in the midstream activities increased by 22 million. Contributing to the increase were positive effects from hedging activities ( 103 million), the recalculation of fees for the use of natural gas pipelines ( 61 million), higher income from share investments ( 44 million), the impact of increased sales volumes as well as changes in the sales portfolio structure ( 44 million), higher results from capacity charges mainly due to the impact of higher temperature spikes ( 35 million) and higher transportation volumes ( 31 million). These positive effects were partially offset by negative impacts derived from price effects ( 255 million) (e.g., reflecting higher procurement costs attributable to the sharp increase in heating oil prices and the underlying linkage between these prices and natural gas prices), as well as negative results from trading derivatives ( 39 million).

In the Downstream Shareholdings business unit, adjusted EBIT increased by 65 million or 13.4 percent to 551 million in 2005 from 486 million in 2004. This increase reflected positive developments at Thüga (95 million), that were attributable to changes in the basis of consolidation at Thüga Italia, higher equity earnings and lower writedowns. ERI's adjusted EBIT decreased by 30 million, largely due to the inclusion of the results of Distrigaz Nord for the second half of the year 2005.

***U.K.***

Total sales of the U.K. market unit in 2005 increased by 19.9 percent to 10,176 million (including 74 million in intersegment sales) from 8,490 million (including 10 million in intersegment sales) in 2004, primarily as a

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result of significantly increased sales in the Non-regulated Business business unit, as explained in more detail below.

The following table sets forth the sales of each business unit in the U.K. market unit in each of the last two years:

**SALES OF U.K. MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	( in millions)		
Non-regulated Business	9,553	7,788	+22.7
Regulated Business	813	941	-13.6
Other/Consolidation	(190)	(239)	+20.5
<b>Total</b>	<b>10,176</b>	<b>8,490</b>	<b>+19.9</b>

Sales in the Non-regulated Business, which is primarily comprised of the energy wholesale (generation and trading) and retail businesses in the U.K., increased by 1,765 million from 7,788 million in 2004 to 9,553 million in 2005. This 22.7 percent increase was primarily attributable to higher retail prices ( 1,222 million) and higher market commodity gas and power sales (approximately 752 million), the effects of which were offset in part by a reduction in retail sales volumes ( 209 million) primarily arising in the industrial and commercial business.

Sales in the Regulated Business, which is primarily comprised of the U.K. distribution operations, decreased to 813 million in 2005 from 941 million in 2004. The sales decrease of 128 million, or 13.6 percent, was attributable to the reallocation of new business income from turnover to below gross margin ( 72 million), the disposal of non-core businesses acquired in the Midlands acquisition and other items ( 38 million) and tariff changes ( 18 million).

Sales attributed to the Other/Consolidation business unit consist almost entirely of the elimination of intrasegment sales and had a negative impact on sales of 190 million in 2005, as compared to a negative impact of 239 million in 2004.

The volume of electricity sold by the U.K. market unit decreased by 7.1 billion kWh or 8.6 percent to 75.0 billion kWh, as compared with 82.1 billion kWh in 2004. Mass market sales increased by 1.1 billion kWh or 3.1 percent to 37.3 billion kWh, while those to industrial and commercial customers decreased by 4.2 billion kWh or 15.9 percent to 22.3 billion kWh, reflecting the market unit's focus in this segment on securing margins rather than volume. The decrease in sales was reflected in the volume of power purchased from outside sources. Own production increased by 2.4 billion kWh or 7.0 percent from 34.9 billion kWh in 2004 to 37.3 billion kWh in 2005. Power purchased from other suppliers decreased by 7.9 billion kWh or 17.0 percent to 39.2 billion kWh from 47.1 billion kWh. In addition, the volume of power purchased from power stations in which E.ON UK has an interest of 50 percent or less decreased by 1.4 billion kWh or 69.4 percent as a result of the acquisition of remaining shares in the CDC power station. Gas sales increased by 6.6 billion kWh or 3.7 percent from 175.9 billion kWh in 2004 to 182.5 billion kWh in 2005, with the increase reflecting higher market sales (7.2 billion kWh), offset in part by lower sales to industrial and commercial customers (3.4 billion kWh), as well as an increase in gas used for the market unit's own generation (1.3 billion kWh). E.ON UK satisfied its increased need for gas mainly through an increase of 7.6 billion kWh or 6.0 percent in market purchases, while the volume of gas being sourced under long-term gas supply contracts decreased by 1.1 billion kWh or 2.1 percent from 49.5 billion kWh in 2004 to 48.4 billion kWh in 2005.

Adjusted EBIT at the U.K. market unit decreased by 54 million or 5.3 percent from 1,017 million in 2004 to 963 million in 2005, reflecting a decrease at Other/Consolidation, which more than offset higher results of the Non-regulated Business and the Regulated Business, as described in more detail below.

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The following table sets forth the adjusted EBIT of each business unit in the U.K. market unit in each of the last two years:

**ADJUSTED EBIT OF U.K. MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	( in millions)		
Non-regulated Business	661	626	+5.6
Regulated Business	452	446	+1.4
Other/Consolidation	(150)	(55)	-172.7
<b>Total</b>	<b>963</b>	<b>1,017</b>	<b>-5.3</b>

The Non-regulated Business contributed adjusted EBIT of 661 million in 2005. This 35 million or 5.6 percent increase from 626 million in 2004 mainly resulted from higher retail prices and the realization of additional cost savings from the integration of the former TXU retail business ( 1,282 million), which were partially offset by increased commodity input costs which include the new CO<sub>2</sub> emission certificates and other items ( 1,247 million).

The Regulated Business increased its adjusted EBIT from 446 million in 2004 to 452 million in 2005. The 1.4 percent increase was almost entirely attributable to the first-time full-year inclusion of Midlands Electricity, which was acquired on January 16, 2004.

The contribution of the Other/Consolidation business unit to adjusted EBIT, which is structurally negative due to the combination of intercompany eliminations and costs of the E.ON UK corporate center, was negative 150 million in 2005, as compared with negative 55 million in 2004. The change was primarily attributable to additional project expenditure and service costs associated with acquisitions ( 40 million), the absence of earnings from Asian Asset Management activities following the divestment of that business ( 32 million) and an expiry of deferred warranty income from previous asset sales ( 18 million).

***Nordic***

Total sales of the Nordic market unit increased from 3,094 million in 2004 (including 376 million of electricity and natural gas taxes and 66 million in intersegment sales) to 3,213 million (including 382 million of electricity and natural gas taxes and 102 million in intersegment sales) in 2005. This 3.8 percent increase was primarily attributable to higher average spot prices in conjunction with successful hedging activities.

The following table sets forth the sales of each business unit in the Nordic market unit in each of the last two years, in each case excluding electricity and natural gas taxes:

**SALES OF NORDIC MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	( in millions)		

Non-regulated Business	2,247	2,107	+6.6
Regulated Business	850	828	+2.7
Other/Consolidation	(266)	(217)	-22.6
<b>Total</b>	<b>2,831</b>	<b>2,718</b>	<b>+4.2</b>

Sales in the Non-regulated Business unit increased by 140 million or 6.6 percent from 2,107 million in 2004 to 2,247 million in 2005, primarily due to higher average spot prices in conjunction with successful hedging activities.



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Sales in the Regulated Business unit increased from 828 million in 2004 to 850 million in 2005. This 22 million, or 2.7 percent, increase mainly reflects increased sales volumes via the Baltic Cable. This positive effect was partially offset by lower sales due to the severe storm that hit southern Sweden in January 2005, causing extensive damage to electricity distribution networks.

Sales attributable to the Other/Consolidation business unit, almost entirely consisting of the elimination of intrasegment sales, had a negative impact on sales of 266 million in 2005, as compared to a negative impact of 217 million in 2004.

Total power supplied by E.ON Nordic (excluding physically settled trading activities) decreased by 2.1 percent to 45.9 billion kWh in 2005, compared with 46.9 billion kWh in 2004. The decrease of one billion kWh reflected a reduction in the volume of power sold to residential customers by 4.1 percent from 7.3 billion kWh in 2004 to 7.0 billion kWh in 2005, primarily reflecting the effects of the January storm. Sales to commercial customers decreased by 7.3 percent to 12.7 billion kWh in 2005 compared with 13.7 billion kWh in 2004, also reflecting the impact of the January storm. Sales to sales partners and Nord Pool increased slightly by 1.2 percent from 25.9 billion kWh in 2004 to 26.2 billion kWh in 2005, primarily resulting from increased generation in owned power plants. E.ON Nordic's own production rose by 3.7 percent from 32.1 billion kWh in 2004 to 33.3 billion kWh in 2005, mainly resulting from increased hydropower generation (2.1 billion kWh). This was partially offset by a decline in nuclear power production (0.9 billion kWh) that primarily reflected the fact that the availability of Swedish nuclear power plants in 2004 had been unusually high. E.ON Nordic purchased less power, primarily from outside sources (1.6 billion kWh) mostly reflecting lower imports from Germany. Purchases from jointly owned power stations declined (0.6 billion kWh) due to a lower availability in these plants. The total volume of gas sold to third parties decreased slightly in 2005 to 6.9 billion kWh from 7.1 billion kWh in 2004, mainly resulting from slightly lower sales to industrial customers (0.2 billion kWh).

Adjusted EBIT at the Nordic market unit increased by 105 million or 15.9 percent from 661 million to 766 million, primarily reflecting higher effective prices from its electricity production portfolio, as described in more detail below.

The following table sets forth the adjusted EBIT of each business unit in the Nordic market unit in each of the last two years:

**ADJUSTED EBIT OF NORDIC MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent</b>
	<b>( in millions)</b>		<b>Change</b>
Non-regulated Business	541	444	+21.8
Regulated Business	244	215	+13.5
Other/Consolidation	(19)	2	
<b>Total</b>	<b>766</b>	<b>661</b>	<b>+15.9</b>

Adjusted EBIT in the Non-regulated Business unit increased by 97 million from 444 million in 2004 to 541 million in 2005. This 21.8 percent increase reflected the rising electricity wholesale prices in conjunction with successful hedging activities, which enabled E.ON Nordic to record higher effective prices per unit for energy generated from its electricity production portfolio ( 96 million), as well as increased electricity generation volumes ( 27 million) primarily

resulting from higher hydropower production availability. These positive effects were partially offset by rebranding costs ( 15 million) and losses on currency derivatives ( 13 million).

In the Regulated Business, adjusted EBIT increased by 29 million from 215 million in 2004 to 244 million in 2005. This 13.5 percent increase mainly resulted from improvements at the gas operations, due to a favorable spread between gas oil and fuel oil prices ( 10 million).

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Total sales of the U.S. Midwest market unit amounted to 2,045 million in 2005, an increase of 19.0 percent from 1,718 million in 2004. The increase primarily reflected higher retail sales due to higher electric and gas rates effective July 1, 2004, higher off-system sales due to both higher volumes and higher prices, as well as higher retail electric volumes resulting from warmer summer and fall weather.

The following table sets forth the sales of each business unit in the U.S. Midwest market unit in each of the last two years:

**SALES OF U.S. MIDWEST MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	( in millions)		
Regulated Business	1,965	1,643	+19.6
Non-regulated Business	80	75	+6.7
<b>Total</b>	<b>2,045</b>	<b>1,718</b>	<b>+19.0</b>

Sales of the Regulated Business, which is comprised of the utility operations of LG&E and KU, increased by 322 million to 1,965 million in 2005, from 1,643 million in 2004. The 19.6 percent increase was attributable to higher recovery from customers of passed-through costs of fuel used for generation ( 91 million) and of gas supply costs ( 54 million), higher revenues from off-system electric sales reflecting higher wholesale electric prices driven by higher gas prices and higher volumes ( 49 million), an increase in retail volumes resulting from warmer summer and fall weather ( 49 million), higher retail prices following the rate increases that took effect in mid-2004 ( 43 million), MISO revenue sufficiency guarantee payments ( 35 million), higher wholesale natural gas sales ( 10 million) and higher environmental cost recoveries ( 9 million). These positive effects were partially offset by the impact of the expiration of the ESM ( 11 million).

Sales of the Non-regulated Business, which primarily consists of ECC and its subsidiaries, increased by 5 million or 6.7 percent from 75 million in 2004 to 80 million in 2005, with the increase being primarily due to higher revenues in the Argentina operations due to higher summer gas volumes.

Adjusted EBIT at the U.S. Midwest market unit increased by 3.1 percent from 354 million in 2004 to 365 million in 2005.

The following table sets forth the adjusted EBIT of each business unit in the U.S. Midwest market unit in each of the last two years:

**ADJUSTED EBIT OF U.S. MIDWEST MARKET UNIT**

	<b>2005</b>	<b>2004</b>	<b>Percent Change</b>
	( in millions)		

Regulated Business	351	339	+3.5
Non-regulated Business	14	15	-6.7
<b>Total</b>	<b>365</b>	<b>354</b>	<b>+3.1</b>

Adjusted EBIT at the Regulated Business increased by 12 million or 3.5 percent from 339 million in 2004 to 351 million in 2005. The increase was primarily attributable to the increase in sales resulting from increased retail electric and gas rates that went into effect July 1, 2004 ( 43 million), higher retail electric volumes due to warmer summer and fall weather ( 38 million) and the contribution from off-system sales ( 38 million), reflecting higher wholesale electric prices driven by higher gas prices and higher volumes. These positive effects were partially offset by costs associated with participation in MISO ( 49 million), higher purchased power costs due to unit outages ( 31 million), higher operating expenses ( 14 million), the impact of the expiration of the ESM ( 11 million) and higher depreciation on newly installed assets ( 11 million).

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Adjusted EBIT at E.ON U.S.'s Non-regulated Business was generally consistent with 2004, decreasing by 1 million or 6.7 percent, from 15 million in 2004 to 14 million in 2005.

### ***Corporate Center***

The Corporate Center reduced Group sales by 1,502 million in 2005, compared with reducing sales by 792 million in 2004. The reduction in adjusted EBIT attributable to the segment was 399 million in 2005, compared with 338 million in 2004. The contribution of the Corporate Center to both sales and adjusted EBIT is structurally negative, due to the elimination of intersegment results and administrative costs that are not matched by revenues.

### ***Other Activities***

Effective February 1, 2004, Degussa has been accounted for using the equity method in line with E.ON's minority shareholding in the company. Under the equity method, Degussa's sales are not included in E.ON's consolidated sales. From February 1, 2004, a percentage of Degussa's earnings after taxes and minority interests equal to E.ON's proportionate interest is recorded in E.ON's financial earnings. After selling a further 3.6 percent interest, E.ON has owned 42.9 percent of Degussa since June 1, 2005 and 42.9 percent of Degussa's earnings after taxes and minority interests are recorded in E.ON's financial earnings. Degussa contributed 132 million to adjusted EBIT in 2005, compared with 107 million in 2004. For information of the framework agreement regarding the disposal of E.ON's remaining interest in Degussa, see Overview.

As of December 31, 2005, Degussa took an impairment charge of 836 million (before taxes) in its Fine Chemicals business unit due to significant changes in market conditions. For more information on the impact on E.ON, see the discussion of other non-operating results in the reconciliation of adjusted EBIT for the E.ON Group above.

## **INFLATION**

The rates of inflation in Germany during 2006, 2005 and 2004 were 1.7 percent, 2.0 percent and 1.6 percent, respectively on chained prices base. The effects of inflation on E.ON's operations have not been significant in recent years.

## **EXCHANGE RATE EXPOSURE AND CURRENCY RISK MANAGEMENT**

Certain business activities within the E.ON Group result in foreign exchange rate exposures. Of the Group's consolidated revenues in 2006, 2005 and 2004, 38 percent, 35 percent and 34 percent, respectively, were attributable to customers located outside of member states participating in the EMU.

To manage the Group's exposure to exchange rate fluctuations, E.ON continually monitors its exposures to currency risks and pursues a systematic and Group-wide foreign exchange risk management policy. At the end of 2006, the Group's consolidated foreign exchange rate exposure, which is calculated as its netted transaction risk exposure derived from booked and forecasted transactions excluding any foreign exchange translation exposure from net investments in entities with a functional currency other than the euro, was approximately 2.0 billion, compared with approximately 2.2 billion at year-end 2005. The Group's foreign exchange rate exposure is principally attributable to the Central Europe and U.K. market units (which have short positions in U.S. dollars) and Pan-European Gas (which has a short position in U.S. dollars and long positions in British pounds and Hungarian forint). Due to the acquisition of the Powergen Group and E.ON Sverige, the E.ON Group also has a net investment in assets denominated in British pounds, U.S. dollars and Swedish krona, which is continually monitored and partly hedged with foreign exchange instruments in accordance with the financial guidelines of the E.ON Group.

The principal derivative financial instruments used by E.ON to cover foreign currency exposures are foreign exchange forward contracts, cross currency swaps, interest rate cross currency swaps and currency options. As of December 31, 2006, the E.ON Group had entered into foreign exchange forward contracts with a nominal value of 11.5 billion, cross currency swaps with a nominal value of 18.5 billion, interest rate cross currency swaps with a

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nominal value of 0.3 billion and currency options with a nominal value of zero. The currencies in which the Group's derivative financial instruments are denominated reflect the currencies in which it is subject to transaction and translation risks. For further information, see Item 11. Quantitative and Qualitative Disclosures about Market Risk and Note 28 of the Notes to Consolidated Financial Statements.

**LIQUIDITY AND CAPITAL RESOURCES**

The major source of liquidity for E.ON in 2006 was again cash provided by operating activities. Cash provided by operating activities amounted to 7,194 million in 2006, 6,544 million in 2005 and 5,776 million in 2004. The 9.9 percent increase in cash provided by operating activities in 2006 was primarily attributable to operational improvements and the first-time consolidation of the VKE German energy industry pension fund at the Central Europe market unit, as well as the fact that the 2005 result had been reduced by payments to the pension funds at the U.K. market unit. Other positive effects were a decrease in accounts receivable at the U.S. Midwest market unit and tax effects at the Corporate Center. These improvements were partially offset by the seasonally negative cash flow effects related to gas storage due to the first-time inclusion of results from E.ON Földgáz Trade. Time shifts in payments and higher prices for gas storage also reduced cash flow.

Proceeds from divestments, which are reported in the Consolidated Statements of Cash Flows as the sum of payments received on the disposition of equity investments and intangible and fixed assets, amounted to 3,954 million in 2006, 6,294 million in 2005 and 1,888 million in 2004. In 2006, divestment proceeds were primarily attributable to the sales of interests in Degussa ( 2,776 million) and E.ON Finland ( 393 million).

E.ON's major liquidity requirement in recent years has been for purchases of financial assets (including equity investments) and other fixed assets. Capital expenditures in 2006, 2005 and 2004 amounted to 5,161 million, 3,941 million and 4,777 million, respectively, and are reported in the Consolidated Statements of Cash Flows as the sum of purchases of equity investments, and intangible and fixed assets. In 2006, in 2005 and in 2004, investments in fixed and intangible assets exceeded purchases of equity investments. The relative decrease in capital expenditures in 2006 and 2005 reflected the relative absence of major acquisitions. For additional information on these acquisitions, see Acquisitions and Dispositions above and Note 4 of the Notes to Consolidated Financial Statements. As described in more detail in the segment analysis below, the most significant capital expenditures in 2006 were for fixed and intangible assets at a number of the market units, particularly Central Europe and U.K., as well as for payments related to the acquisition of MOL at the Pan-European Gas market unit. Funds used for the above-mentioned acquisitions and contributions to the CTA model in 2006 were the primary reasons for the change in E.ON's cash flow used for investing activities, which totaled 442 million cash provided in 2005 and 4,501 million cash used in 2006 ( 359 million cash used in 2004).

Cash used for financing activities totaled 5,849 million, with the decrease from 6,458 million in 2005 primarily reflecting the smaller net reduction of financial liabilities, partly offset by higher dividend distributions. In 2004, cash used for financing activities had totaled 4,749 million.

As of December 31, 2006, the Group had cash and cash equivalents from continuing operations of 1,152 million, as compared with 4,346 million at December 31, 2005 ( 4,113 million at year-end 2004).

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The following table shows the cash provided by operating activities and used for capital expenditures for each of the Group's segments in 2006, 2005 and 2004 (in each case excluding the cash flows of discontinued operations, see Results of Operations Business Segment Information above).

**E.ON BUSINESS SEGMENT CASH FLOW AND CAPITAL EXPENDITURES(1)(2)**

	2006		2005		2004	
	Cash from Operations	Capital Expenditures	Cash from Operations	Capital Expenditures	Cash from Operations	Capital Expenditures
	( in millions)					
Central Europe	3,825	2,416	3,020	1,981	2,938	2,273
Pan-European Gas(3)	589	880	1,999	523	903	610
U.K.	749	863	101	926	633	503
Nordic(3)	715	631	689	394	893	666
U.S. Midwest(3)	381	398	214	227	152	247
Corporate Center(3)	935	(27)	521	(110)	257	478
Total	7,194	5,161	6,544	3,941	5,776	4,777

- (1) For a detailed description of capital expenditures by purchases of financial assets and purchases of other fixed assets, see Note 27 of the Notes to Consolidated Financial Statements.
- (2) Excludes investments in other financial assets.
- (3) Excludes the cash from operations and capital expenditures of certain activities now accounted for as discontinued operations. For more details, see Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.

*Capital Expenditures*

The Central Europe market unit continued to account for the largest portion of the Group's capital expenditures over the most recent three-year period, primarily as a result of acquisitions of equity interests in energy companies and other share investments, as well as additions to property, plant and equipment and intangible assets. Capital expenditures at the Central Europe market unit increased by 22.0 percent from 1,981 million in 2005 to 2,416 million in 2006. Investments in property, plant and equipment and intangible assets amounted to 1,883 million, mainly consisting of assets used in conventional and renewable power generation, waste incineration and the distribution of energy. The Central Europe market unit invested 533 million in share investments, of which 100 million were due to the acquisitions of JCP and Teplárna Otrokovice in the Czech Republic and Dalmine in Italy. Furthermore, investments in companies which are constructing conventional generation and waste incineration plants and the investment in the waste incineration company SOTEC amounted to 130 million. Investments in real estate funds amounted to approximately 135 million. In 2005, investments in property, plant and equipment and intangible assets amounted to 1,519 million, mainly consisting of assets used in conventional, waste disposal and renewable power generation and in distribution. The Central Europe market unit invested 462 million in share investments, of which 126 million were due to the acquisitions of interests in the Dutch NRE ( 67 million) and the Romanian Electrica



Moldova (now E.ON Moldova) ( 59 million). Capital expenditures of the Central Europe market unit amounted to 2,273 million in 2004, with 1,388 million invested in property, plant and equipment and intangible assets primarily used in power generation and distribution. Investments in share investments amounted to 885 million, with the largest single category being intra-Group acquisitions from the Pan-European Gas market unit in connection with the new market unit structure ( 404 million), the largest of which was the acquisition of additional interests in Ferngas Salzgitter ( 230 million). The investment in share investments also included advance payments in connection with the acquisition of interests in Varna and Gorna Oryahovitza ( 141 million), and the purchase of additional shares in Ferngas Salzgitter from third parties ( 133 million) and increased stakes in a number of companies in the Czech Republic and Hungary ( 106 million).

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The Pan-European Gas market unit's level of capital expenditures increased by 68.3 percent from 523 million in 2005 compared with 880 million in 2006. In 2006, the Pan-European Gas market unit invested 506 million in share investments with the largest single investment being the approximately 400 million spent acquiring the MOL activities. Investments in property, plant and equipment and intangible assets, mainly in the transmission system and the upstream activities, amounted to 374 million. In 2005, the Pan-European Gas market unit invested 523 million, of which 263 million was spent on property, plant and equipment and intangible assets, primarily in the transmission system and upstream activities. The remaining 260 million in capital expenditures was used for share investments, with the largest single item being the 90 million spent acquiring the 51.0 percent stake in the Romanian gas distribution company Distrigaz Nord (now E.ON Gaz România). In 2004, the Pan-European Gas market unit invested 610 million, of which 105 million was spent on property, plant and equipment and intangible assets, primarily in the transmission system. The majority of the remaining 505 million in capital expenditures was for share investments, with the largest single item being the 223 million spent acquiring the remaining 3.4 percent stake in Thüga in the squeeze-out process.

Investments in the U.K. market unit decreased by 6.8 percent to 863 million in 2006 compared with 926 million in 2005. In 2006, the U.K. market unit invested 860 million in property, plant and equipment and intangible assets, primarily for generation assets, including the development of new renewables capacity at Lockerbie, Scotland, and in existing conventional power plants, as well as investments in the regulated distribution business. Investments in share investments amounted to 3 million. In 2005, investments in property, plant and equipment and intangible assets amounted to 565 million, mainly in renewable generation, conventional power stations, and the regulated distribution business. The U.K. market unit invested 361 million in share investments, primarily due to the acquisitions of Enfield and HGSL. In 2004, the U.K. market unit spent 511 million on fixed and intangible assets and negative 8 million was attributable to share investments. The majority of the investments in fixed assets was attributable to expenditures in the distribution business (320 million), and the maintenance of the generation portfolio (185 million).

The Nordic market unit invested 631 million in 2006, an increase of 60.2 percent, with 581 million dedicated to property, plant and equipment and intangible assets, mainly to maintain existing production plants, particularly nuclear power plants, and to upgrade and extend E.ON Nordic's distribution network. Investments in share investments amounted to 50 million. In 2005, investments at the Nordic market unit amounted to 394 million, with 373 million dedicated to property, plant and equipment and intangible assets primarily used to maintain production plants and to upgrade and expand its distribution network. Investments in share investments amounted to 21 million with the largest single investment being the acquisition of district heating activities from the Danish utility Nesa A/S. In 2004, the Nordic market unit's capital expenditures amounted to 666 million. Of this amount, 354 million was attributable to investments in share investments. The largest equity investment was the acquisition of additional Graninge shares (307 million). The Nordic market unit also invested 312 million in property, plant and equipment and intangible assets in order to maintain its existing production facilities, as well as to upgrade and enhance the distribution network.

Capital expenditures in the U.S. Midwest market unit increased by 75.3 percent to 398 million in 2006. The total amount was invested in property, plant and equipment and intangible assets, primarily reflecting increased spending for SO<sub>2</sub> emissions equipment and the construction of a new 750 MW baseload unit at the Trimble County 2 plant. In 2005, investments amounted to 227 million, all of which was invested in property, plant and equipment and intangible assets. In 2004, the total amount of 247 million was invested in property, plant and equipment and intangible assets, primarily in the regulated business.

In the Corporate Center, capital expenditures amounted to negative 27 million in 2006, with investments of negative 14 million in share investments and negative 13 million in property, plant and equipment and intangible assets. In 2005, capital expenditure at the Corporate Center amounted to negative 110 million. The Corporate Center invested negative 119 million in share investments. The Corporate Center segment's level of capital expenditures in 2004 amounted to 478 million. The majority of this amount was invested in share investments, primarily payments to

holders of outstanding bonds of Midlands Electricity as part of its acquisition ( 881 million) and in the Thüga squeeze-out ( 223 million), with the impact of these investments on the segment s total partially offset by the elimination of intersegment transactions.

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*Financial Liabilities.* The financial liabilities of E.ON decreased to 13,399 million at year-end 2006 from 14,362 million at year-end 2005. The decrease of 963 million or 6.7 percent primarily resulted from reductions in other financial liabilities ( 555 million), bonds outstanding ( 535 million) and the outstanding amount of bank loans ( 293 million), the overall effects of which were partially offset by an increase in commercial paper outstanding ( 366 million). Bank loans decreased from 1,530 million at year-end 2005 to 1,237 million at year-end 2006. Of the amounts payable under bank loans at year-end 2006, 353 million (28.5 percent) are due in 2007, 80 million (6.5 percent) due in 2008, 62 million (5.0 percent) due in 2009, 45 million (3.6 percent) due in 2010, 504 million (40.8 percent) due in 2011 and 193 million (15.6 percent) due after 2011. Up to December 31, 2004, non-interest-bearing and low-interest liabilities of Viterra were reported net of the interest portion in the Consolidated Balance Sheet. Due to the disposal of Viterra in 2005, no deduction of the interest portion was reported as of December 31, 2006.

E.ON follows a centralized financing policy. Most of the financing transactions of E.ON's market units have been centralized and netted at the Group level to reduce the Group's overall debt and interest expense. As a general rule, external financings will be undertaken at the E.ON AG level (or via finance subsidiaries under its guarantee) and on-lent as needed within the Group. In certain limited circumstances, future financings may also take place at the subsidiary level, e.g. for reasons of tax efficiency or regulatory compliance.

To support E.ON's centralized financing policy, E.ON AG has a Commercial Paper program and a Medium Term Note program with aggregate authorized amounts of 10 billion and 20 billion, respectively. E.ON also has a Syndicated Multi-Currency Revolving Credit Facility that permits borrowings in various currencies in an aggregate amount of up to 10 billion. For additional information on these programs, including amounts outstanding and available as of year end 2006, see Note 24 of the Notes to Consolidated Financial Statements.

E.ON's financing arrangements contain affirmative and negative covenants and provide for various events of default that are generally in line with industry standard terms for similar borrowings. In general, E.ON's most significant financial arrangements do not include financial covenants such as ratio compliance tests, though a number do include restrictions on certain types of transactions and negative pledges. E.ON and its subsidiaries were in compliance with all such covenants as of December 31, 2006 and 2005, and no cross-default clauses had been triggered as of such dates.

Neither E.ON AG's Medium Term Note program nor any of the bonds outstanding under the program contain any financial covenants. Documentation is customary and both the program and the bonds contain the same cross-default language, under which a cross default would be triggered if the issuer or the guarantor fails to pay indebtedness for borrowed money in an amount above a specified threshold or any amount payable under any guarantee in respect of such indebtedness or if a creditor is entitled to declare that any such indebtedness is payable before its stated maturity by reason of an event of default.

E.ON AG's Commercial Paper program does not contain any financial covenants. The cross default language is in line with the above-mentioned language for the Medium Term Note program and bonds.

E.ON AG's syndicated credit facility contains no financial covenants, nor does it provide for a rating trigger. A cross default would be triggered by the declaration of financial indebtedness (with the exception of guarantees and indemnities) of any material subsidiary or any of the borrowers in an aggregate amount of more than 500 million to be due and payable prior to its specified maturity pursuant to the occurrence of an event of default (cross acceleration default) or by non-payment of any financial indebtedness of any material subsidiary or any of the borrowers in an aggregate amount of more than 100 million within five business days after having fallen due or after any applicable grace period (cross payment default).

In the context of the offer for Endesa, E.ON entered into a syndicated term loan and guarantee facility agreement for a total amount of up to 37.1 billion on October 16, 2006 (Facility Agreement), and a supplemental term and guarantee facility of up to 5.3 billion (immediately reduced to 3.9 billion) on February 2, 2007 (Supplemental Facility Agreement). The Facility Agreement and the Supplemental Facility Agreement do not require the borrower to comply with any financial covenants. The cross default provision is identical to the provision in the 10 billion syndicated credit facility. For additional details on these facilities, see Item 4. Information on the Company History and Development of the Company Proposed Endesa Acquisition.

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In addition to these centralized financing arrangements described above, there are numerous additional financing arrangements in the E.ON Group that are not individually significant. These other arrangements also include affirmative and negative covenants and provide for various events of default that are generally in line with industry standard terms for similar borrowings. Certain of these arrangements also include financial covenants, including requirements to maintain certain ratios. Certain arrangements also include material adverse change clauses, as well as restrictions on certain types of transactions and negative pledges. E.ON and its subsidiaries were in compliance with all such covenants as of December 31, 2006 and 2005, and no cross-default clauses had been triggered as of such dates.

Bonds outstanding at the U.K. market unit totaling 408 million as of December 31, 2006, include covenants providing for a negative pledge and restrictions on sale and lease-back transactions. Each also includes a cross-default clause that would be triggered by a non-payment of principal, premium or interest on any obligation of the issuer, E.ON UK plc or any of its subsidiaries, with the threshold amounts ranging from GBP10 million to GBP50 million. In addition, the E.ON Sverige Medium Term Note Program with an outstanding amount of 631 million as of December 31, 2006, does not include any financial covenants but does contain a cross-default clause which would be triggered by a default of E.ON Sverige or any of its subsidiaries on financial indebtedness in the amount of SEK 10 million or more. Also, LG&E has five revolving lines of credit with banks totaling 140 million at year-end 2006. These revolving lines of credit include financial covenants, in particular that LG&E's debt/total capitalization ratio must be less than 70 percent and that E.ON AG must own at least two thirds of voting stock of LG&E directly or indirectly. Furthermore, the corporate credit rating of LG&E must be at or above BBB- and Baa3 and LG&E may not dispose of assets aggregating more than 15 percent of its total assets. Each of the credit lines contains a cross-default provision that causes the LG&E bilateral line of credit to be in default if LG&E is in default on other debt in excess of \$25 million.

For more detailed information on interest rates, maturities and other details of the Group's financial liabilities, including the credit facilities and Commercial Paper and Medium Term Note programs, see Note 24 of the Notes to Consolidated Financial Statements.

The failure of E.ON or the relevant borrower to comply with any of the identified covenants or the triggering of any cross-default clauses could result in any and all of the following:

- the repayment of the affected financing arrangement
- the declaration that a liability becomes due and payable before its stated maturity
- the triggering of cross defaults in other financing arrangements

E.ON's access to additional financing on favorable terms being severely curtailed or even eliminated.

At year-end 2006, Standard & Poor's Ratings Group (S&P) and Moody's Investors Service (Moody's) rated E.ON's Commercial Paper program with a short-term rating of A-1+ and Prime-1, respectively. On February 22, 2006, Moody's placed its Aa3 long-term rating for E.ON bonds on review for a possible downgrade, following the announcement by E.ON that it has made an offer to acquire 100 percent of the shares of Endesa. On September 28, 2006, Moody's commented that E.ON's long-term rating remains on review for a possible downgrade and that it has also decided to place the short-term P-1 rating on review for a possible downgrade. On February 21, 2006, S&P placed its AA- long-term rating and its A-1+ short-term rating for E.ON on creditwatch with negative implications, following the announcement by E.ON that it has made an offer to acquire 100 percent of the shares of Endesa. On August 21, 2006, S&P confirmed E.ON's long-term and short-term credit ratings. On September 27, 2006, S&P said that its long-term and short-term credit ratings for E.ON remain on creditwatch with negative implications following E.ON's announcement that it intended to increase its bid for Endesa to 35 per share.

*Expected Investment Activity.* E.ON currently plans to invest a total of approximately 25.3 billion over the three years from 2007 to 2009. This total, and the more detailed description of E.ON's expected investments below, excludes any amounts relating to E.ON's proposed acquisition of Endesa or any investments that may be undertaken with respect to any of the activities that may be acquired from Endesa. For more information on the proposed

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transaction, see Item 4. Information on the Company History and Development of the Company Proposed Endesa Acquisition.

These capital expenditures are targeted, above all, at reinforcing the security of supply in E.ON's existing markets, as well as developing E.ON's position in new markets. A majority of these capital expenditures (approximately 22.4 billion) is earmarked for property, plant and equipment, with approximately 12.3 billion intended for the maintenance, renewal or replacement of existing power stations and grids, and 10.1 billion being budgeted for investments in new capacity, mainly in power generation. Of this 10.1 billion, investments in energy production from renewable sources are expected to account for approximately 0.9 billion. The remaining approximately 2.9 billion of the overall total is expected to consist of financial investments, particularly the planned expansion of E.ON's shareholdings in the upstream gas business, as well as that of E.ON's shareholdings in Eastern Europe and Turkey.

The Central Europe market unit expects to make a total of approximately 11.5 billion in capital expenditures between 2007 and 2009. Of this amount, approximately 88 percent is budgeted for property, plant and equipment, primarily for the modernization of existing generation facilities and power and gas networks, as well as for the construction of new facilities (most of which are expected to come on-line after 2009). As described in more detail in the description of the market unit's activities in Item 4, the construction of new power stations at Datteln and Irsching has already begun, while E.ON is committed to building a new coal-fired power station at Staudinger if and when the necessary regulatory approvals are obtained. The market unit's plans also call for the construction of a coal-fired test facility capable of operating with an efficiency of more than 50 percent. Outside of Germany, E.ON has started to build a modern gas-fired power station at Livorno Ferraris in Italy, and plans to build a coal-fired power station at Maasvlakte in the Netherlands and various power stations in Eastern Europe. A total of approximately 3.6 billion has been budgeted for investments in power and gas networks in Central Europe, of which approximately 2.4 billion is intended for the maintenance of existing networks. The market unit's budgeted financial investments of approximately 1.4 billion are mainly earmarked for the development of E.ON's market position in Eastern Europe and Turkey.

The Pan-European Gas market unit plans to invest approximately 4.7 billion during the three-year period, of which 3.4 billion is budgeted for investments in property, plant and equipment. These investments are mainly targeted towards enhancing the security and flexibility of gas supplies by improving and expanding the gas transmission pipelines and storage facilities, as well as the construction of a new LNG terminal at Wilhelmshaven that is currently scheduled to begin operation in 2010. In addition, approximately 0.8 billion is budgeted for investments in the development of upstream facilities, while the market unit's budgeted financial investments of approximately 1.3 billion essentially relate to its planned acquisition of a minority interest in the Severnftgazprom joint venture, which holds the exploration and production license for the Yushno Russkoje gas field in Russia. For additional information on this venture, see Item 4. Information on the Company Business Overview Pan-European Gas Supply Exploration and Production.

Investments at the U.K. market unit are expected to total approximately 4.3 billion through 2009 and are almost entirely focused on property, plant and equipment, primarily the modernization of generation facilities and network infrastructure. The market unit's plans include the replacement of some of its existing generation capacity with a new gas-fired power station and a new coal-fired facility that are currently scheduled to begin operation in 2009 and 2012/13, respectively. Of this 4.3 billion, approximately 0.2 billion has been budgeted for financial investments in companies operating wind power facilities.

The Nordic market unit is expected to invest approximately 2.7 billion in property, plant and equipment over the three-year period, while not having budgeted any amounts for financial investments. Nordic's investments are mainly earmarked for the improvement of power distribution networks and the modernization and upgrade of existing generation facilities, as well as the construction of a new CHP power station and the development of wind power projects.



Capital expenditures totalling approximately 2.1 billion through 2009 are budgeted at the U.S. Midwest market unit. All of these investments are earmarked for property, plant and equipment. The market unit's most important investment project is the construction of Trimble County 2, a 750 MW coal-fired power station, while

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investments will also be made in environmental measures at existing power stations and the improvement of power and gas networks.

The investment plan summarized above only contains projects that E.ON believes are sufficiently probable from today's perspective.

The proposed offer for Endesa is the only material transaction expected to have a significant impact on E.ON's cash flows in 2007.

Upon approval of the Supervisory Board on August 10, 2005, E.ON Pension Trust e.V. and Pensionsabwicklungstrust e.V. were formed, each with registered offices in Grünwald, Germany. The purpose of these trusts is the fiduciary administration of funds to provide for future pension benefit payments to employees of German group companies (the so-called CTA model). The board resolution allows for a maximum contribution of 5.4 billion. In 2006, E.ON made a contribution of 5.2 billion.

In January 2005, E.ON AG agreed to make a payment of GBP431 million (approximately 629 million) into the pension schemes for existing employees of the U.K. market unit. The payment, which was made in April 2005, improved the funding level of the plans (which had a funding deficit of GBP728 million ( 1.1 billion) at the time of the last actuarial valuation in March 2004) and allowed for the merger of four previously autonomous sections covering Powergen, EME, Midlands Electricity and TXU into a single pool.

E.ON expects that cash flow from operations will continue to be the primary source of funds for capital expenditures in its ongoing business (*i.e.*, excluding Endesa) and working capital requirements in 2007. E.ON believes that its cash flow and available liquid funds and credit lines will be sufficient to meet the anticipated cash needs of its ongoing business operations. In addition, various means of raising share capital (see Item 10. Additional Information Memorandum and Articles of Association Changes in Capital and Note 17 of the Notes to Consolidated Financial Statements) and debt are available to E.ON.

*Fair Value of Derivatives.* E.ON has established risk management policies that allow the use of foreign currency, interest rate, equity, and commodity derivative instruments and other instruments and agreements to manage its exposure to market, currency, interest rate, commodity price, share price and counterparty risk. E.ON uses derivatives for both trading and non-trading purposes. Proprietary trading is conducted with the goal of improving operating results within defined limits in specified markets.

The estimated fair value of commodity contracts used in the Group's trading activities for the year ended December 31, 2006 is presented below:

**FAIR VALUE RECONCILIATION TABLE**  
( in millions)

Fair value of contracts outstanding at the beginning of the period	1,474.3
Change to scope of consolidation	(8.4)
Contracts realized or otherwise settled during the period	(609.7)
Fair value of new contracts entered into during the period	(646.8)
Changes in fair values attributable to changes in valuation techniques and assumptions	
Other changes in fair values	(1,605.2)

Fair value of contracts outstanding at the end of the period (1,395.8)

For information regarding E.ON's trading activities, risk management and market factors impacting the fair values of contracts, see the respective market unit descriptions in Item 4. Information on the Company Business Overview, Risk Management, Item 11. Quantitative and Qualitative Disclosures about Market Risk and Notes 28 and 29 of the Notes to Consolidated Financial Statements.

E.ON estimated the gross mark-to-market value of its commodity contracts as of December 31, 2006 using quoted market values where available and other valuation techniques where market data is not available. In such

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instances, E.ON uses alternative pricing methodologies, including, but not limited to, fundamental data models, spot prices adjusted for forward premiums/discounts and option pricing models. Fair value contemplates the effects of credit risk, liquidity risk and the time value of money on gross mark-to-market positions.

The following table shows the sources of prices used to calculate the fair value of commodity contracts at December 31, 2006. In many cases these prices are fed into option models that calculate a gross mark-to-market value from which fair value is derived after considering reserves for liquidity, credit, time value and model confidence.

**SOURCE OF FAIR VALUE TABLE**

Source of Fair Value	Fair Value of Contracts at Period-End				Total Fair Value
	Maturity less than 1 Year	Maturity 1-3 Years	Maturity 4-5 Years ( in millions)	Maturity in Excess of 5 Years	
Prices actively quoted	(786.7)	(148.0)	(16.5)	12.7	(938.5)
Prices provided by other external sources	(1.2)	(0.1)			(1.3)
Prices based on models and other valuation methods	(341.2)	(195.8)	70.5	10.5	(456.0)

The amounts disclosed above are not indicative of likely future cash flows, as these positions may be changed by new transactions in the trading portfolio at any time in response to changing market conditions, market liquidity and E.ON's risk management portfolio needs and strategies.

**RESEARCH AND DEVELOPMENT**

E.ON only performs minimal research and development ( R&D ) activities. In 2006, E.ON spent approximately 27 million on R&D, compared with 24 million in 2005 and 19 million in 2004. In each of 2006, 2005 and 2004, E.ON's R&D expenditures as a percentage of sales were below one percent. E.ON does not anticipate any significant changes in its R&D expenditures in the near term. The 2006 expenditures were attributable to the Nordic, Pan-European and U.K. market units. The E.ON Group employs 175 R&D employees.

**TREND INFORMATION**

For information on the principal trends and uncertainties affecting the Company's results of operations and financial condition, see Item 3. Key Information Risk Factors, the respective market unit descriptions in Item 4. Information on the Company Business Overview and Operating Environment, and Results of Operations and Liquidity and Resources above.

**PROCESS OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS**

In July 2002, the European Parliament and Council passed Regulation No. 1606/2002 on the adoption of International Financial Reporting Standards ( IFRS ) by European companies. In accordance with the Regulation, companies whose securities are publicly traded on a regulated market in an EU country are generally required to prepare their

consolidated financial statements in accordance with IFRS, as adopted by the EU, for fiscal years commencing on or after January 1, 2005. The Regulation allowed individual EU member states to defer the deadline for adopting IFRS until 2007 in certain circumstances, particularly with respect to those companies that apply internationally accepted standards other than IFRS due to the fact that their securities are listed on a market outside of the EU. Germany adopted this deferral option in implementing the regulation. E.ON currently prepares its consolidated financial statements in accordance with U.S. GAAP. Accordingly, it qualifies for the German deferral option and is therefore required to prepare its consolidated financial statements for the fiscal year ending December 31, 2007 in accordance with IFRS as adopted by the EU. E.ON expects to meet this statutory deadline and to prepare an opening balance sheet in accordance with IFRS as of January 1, 2006 as part of its transition

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process. Even after E.ON has adopted IFRS as its primary accounting principles, it will be required to present a reconciliation of net income and stockholders' equity in accordance with U.S. GAAP in its Annual Report on Form 20-F.

In order to prepare for the transition, E.ON has undertaken a project to determine the relevant differences between IFRS and U.S. GAAP and to evaluate the impact on the Company's financial reporting. However, it is currently not possible to determine exactly the impact on the Company's financial reporting of the conversion to IFRS. In addition to the fact that the transition project has yet to be completed, the IFRS principles that E.ON will adopt for the fiscal year ending December 31, 2007 will be those then in effect. As a result, new pronouncements from the International Accounting Standards Board (IASB) and the required endorsement process by the EU prior to such date could have an impact on E.ON's consolidated financial statements.

**OFF-BALANCE SHEET ARRANGEMENTS**

E.ON uses certain off-balance sheet arrangements in the ordinary course of business, including financial guarantees, lines of credit, indemnification agreements and other guarantees. E.ON's arrangements in each of these categories are described in more detail below. For additional information, see Notes 24 and 25 of the Notes to Consolidated Financial Statements.

*Financial Guarantees.* E.ON's financial guarantees require the guarantor to make contingent payments upon the occurrence of certain events or changes in an underlying instrument that is related to an asset, a liability, or the equity of the guaranteed party. These guarantees include arrangements that are characterized as direct and indirect obligations under FASB Interpretation No. (FIN) 45 Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Direct obligations are those that give the party receiving the guarantee a direct claim against E.ON; indirect obligations are those under which E.ON has agreed to provide the funds necessary for another party to satisfy an obligation, such as pursuant to a keepwell arrangement.

The Company's financial guarantees as of December 31, 2006 included certain direct obligations relating to E.ON's generation of electricity from nuclear power plants in Germany and Sweden, primarily those arising from solidarity agreements in connection with the requirement that German nuclear power plant operators provide nuclear accident liability coverage of up to 2.5 billion per accident. These obligations are described in more detail in Item 4. Information on the Company's Environmental Matters Germany: Electricity and Note 25 of the Notes to Consolidated Financial Statements. E.ON's direct obligations also include direct financial guarantees issued in favor of the creditors of related parties and third parties. The Company's obligations under these direct financial guarantees with specified terms extend as far as 2023, and the maximum undiscounted amounts potentially payable in the future under these direct guarantees totaled 370 million at December 31, 2006, compared with 427 million at year-end 2005. Of these amounts, 284 million and 304 million, respectively, involved guarantees issued on behalf of related parties (including financing arrangements for the Interconnector undersea gas pipeline). E.ON's indirect financial guarantees include, *inter alia*, obligations in connection with cross-border leasing transactions entered into by E.ON Benelux, mainly obligations to provide financial support, primarily to related parties. E.ON's obligations under indirect financial guarantees with specified terms extend as far as 2030. The maximum undiscounted amounts potentially payable in the future under these indirect guarantees totaled 582 million at year-end 2006, compared with 431 million at December 31, 2005. Of these amounts, 262 million and 67 million, respectively, involved guarantees issued on behalf of related parties. As of December 31, 2006 and 2005, the Company had recorded provisions in accordance with U.S. GAAP of 5 million and 25 million, respectively, with respect to its obligations under all of these non-nuclear financial guarantees.

*Indemnification Agreements.* A number of the agreements governing E.ON's divestiture of former subsidiaries and operations include indemnification clauses (*Freistellungen*) and other guarantees, certain of which are required by

applicable local law. These arrangements generally comprise customary guarantees relating to the accuracy of representations and warranties, as well as indemnification provisions relating to contingent future environmental and tax liabilities. The Company's obligations under these arrangements with specified terms extend as far as 2041 in accordance with contractual arrangements and local legal requirements, unless shorter terms were contractually agreed. The maximum undiscounted amount potentially payable in respect of the circumstances

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expressly set forth in these agreements was 6,865 million as of December 31, 2006, as compared with 6,623 million at year-end 2005. In a number of cases, it is not possible to reliably estimate a maximum obligation because there is no maximum liability specified in the contract. A number of the contracts also require the buyer to either share costs or cover a certain amount of costs before the Company is required to make any payments. Certain of E.ON's obligations under these arrangements are also covered by insurance and/or provisions established at the relevant divested companies. As of December 31, 2006 and 2005, the Company had recorded provisions in accordance with U.S. GAAP of 270 million and 296 million, respectively, with respect to all indemnities and other guarantees included in the relevant agreements. Guarantees issued by companies that were later sold by E.ON AG (or VEBA AG and VIAG AG before their merger) have generally been assumed by the buyers of the relevant businesses in the final sales contracts in the form of indemnities, and are therefore no longer obligations of E.ON.

*Other Guarantees.* E.ON's obligations under other guarantees primarily include those relating to market value guarantees and warranties. These warranty obligations primarily relate to E.ON Energie's business, while those for market value guarantees primarily arise from assurances as to the future value of securities pledged in connection with cross-border leasing transactions. As of December 31, 2006, the maximum potential undiscounted future payments potentially payable in respect of these warranties and market value guarantees amounted to 104 million, as compared with 130 million at year-end 2005.

*Variable Interest Entities.* The Company holds variable interests in various Variable Interest Entities (VIEs), which are not significant either individually or in the aggregate. As of December 31, 2004, the VIEs consolidated in the Consolidated Financial Statements comprised two jointly managed electricity companies, two real estate leasing companies, one company for the management and disposal of real estate and one company managing investments. Following the termination of all contractual relationships with the VIE for the management and disposal of real estate in August 2005, which was presented as a discontinued operation as of December 31, 2005, FIN 46R no longer applies to this company. During the second quarter of 2006, E.ON acquired additional interests in one of the two real estate leasing companies. This company is now consolidated under the general consolidation rules as opposed to under the rules of FIN 46R. As of December 31, 2006, the VIEs consolidated within the E.ON Group had total assets of 710 million and recorded earnings for 2006 of 27 million before consolidation. At December 31, 2006, 132 million in non-current assets of these entities served as collateral for financial leasing and bank credits. The recourse of creditors of the consolidated VIEs to the assets of the primary beneficiary is generally limited. One VIE has no such limitation of recourse. The primary beneficiary was liable for 75 million in respect of this entity as of December 31, 2006.

In addition, E.ON has had contractual relationships with one leasing company in the energy sector since July 1, 2000. The Company is not the primary beneficiary of this VIE. The entity is currently in liquidation pursuant to a shareholder resolution. This entity had no significant assets and no liabilities at year end 2005 and 2006. Neither the relationship to this entity nor its liquidation is expected to result in the realization of losses by E.ON.

The extent of E.ON's interest in another VIE, which has been in existence since 2001 and was expected to terminate in 2005, cannot be assessed in accordance with the FIN 46R criteria due to insufficient information. The significant transactions between this entity and the E.ON Group took place in the fourth quarter of 2005, with no activities thereafter. However, the entity's liquidation remains outstanding. The entity handled the liquidation of assets from operations that had already been sold. Originally, its total assets amounted to 127 million. The termination of the relationship with this entity is not expected to result in any significant effects on E.ON's earnings.

For additional information, see Note 3 of the Notes to Consolidated Financial Statements.



Table of Contents**CONTRACTUAL OBLIGATIONS**

The following table summarizes E.ON's contractual obligations as of December 31, 2006 and the related amounts falling due in each of the periods presented:

<b>Contractual Obligations</b>	<b>Total</b>	<b>Payments Due by Period</b>			<b>More than 5 Years</b>
		<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	
		<b>( in millions)</b>			
Financial Liabilities(1)(2)	17,753	3,978	5,446	1,862	6,467
Capital Lease Obligations	175	46	56	20	53
Operating Leases	645	159	175	127	184
Purchase Obligations	241,443	28,473	43,575	41,214	128,181
Asset Retirement Obligations	9,948	460	312	253	8,923
Pension Payments	9,790	883	1,847	1,943	5,117
Other Long-Term Obligations	3,888	2,726	992	5	165
<b>Total Contractual Obligations</b>	<b>283,642</b>	<b>36,725</b>	<b>52,403</b>	<b>45,424</b>	<b>149,090</b>

(1) Excludes capital lease obligations.

(2) Includes estimated interest payment obligations for these liabilities.

As of December 31, 2006, the majority of the Company's contractual obligations arose under long-term purchase contracts in its core energy business, primarily for natural gas and electricity. For additional details on E.ON's financial liabilities and lease obligations, see Notes 24 and 25 of the Notes to Consolidated Financial Statements. For information on pension obligations, see Note 22 of the Notes to Consolidated Financial Statements.

*Purchase Obligations.* E.ON's purchase obligations primarily relate to the procurement of gas ( 221 billion) and electricity ( 8 billion). E.ON Ruhrgas purchases nearly all of its natural gas under long-term supply contracts with international and German gas producers. For more detailed information, see Item 4. Information on the Company Business Overview Pan-European Gas. As is standard in the industry, the price E.ON Ruhrgas pays for gas under these contracts is calculated on the basis of complex formulas incorporating variables based upon current market prices for fuel oil, gas oil, coal and/or other competing fuels, with prices being automatically re-calculated periodically. The contracts also generally provide for formal revisions and adjustments of the price and other business terms to reflect changes in the market environment (in many cases expressly including changes in the retail market for natural gas and competing fuels), generally providing that such revisions may only be made once every few years unless the parties agree otherwise. Claims for revision are subject to binding arbitration in the event the parties cannot agree on the necessary adjustments. The contracts also require E.ON Ruhrgas to pay for specified minimum quantities of gas even if it does not take delivery of such quantities, a standard gas industry practice known as take or pay. Certain of the Company's other energy businesses also procure gas under similar arrangements. E.ON calculates the financial obligations arising from these contracts using the same principles that govern its internal budgeting process, as well as taking into account the specific take-or-pay obligations in the individual contracts.

Contractual obligations for the purchase of electricity primarily arise in connection with E.ON Energie's interest in jointly operated power plants. The price E.ON pays for electricity generated by these jointly operated power plants is determined on the basis of production cost plus a profit margin that is generally calculated on the basis of an agreed return on capital.

E.ON Energie has also entered into long-term contractual obligations for the procurement of services in the area of reprocessing and storage of spent nuclear fuel elements delivered through June 30, 2005. For additional details on these obligations, see Item 4. Information on the Company Business Overview Central Europe Power Generation.

*Asset Retirement Obligations.* In accordance with SFAS 143, E.ON's asset retirement obligations are reported at the fair value of both legal and contractual obligations. These obligations primarily relate to retirement costs for decommissioning of nuclear power plants in Germany and Sweden, environmental remediation related to

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non-nuclear power plants, including removal of electricity transmission and distribution equipment, environmental remediation at gas storage and opencast mining facilities and the decommissioning of oil and gas field infrastructure. For additional details on E.ON's asset retirement obligations, see Note 23 of the Notes to Consolidated Financial Statements.

*Other Long-Term Obligations.* E.ON's Other Long-Term Obligations consist primarily of obligations arising out of option agreements that would require the Company to purchase shares from third parties.

As of December 31, 2006, E.ON is a party to put option agreements related to certain of its acquisitions, including one that allows the minority shareholder in E.ON Sverige to sell its remaining stake in that company to E.ON at any time through December 15, 2007 at an agreed price, and others that allow minority shareholders in other companies controlled by E.ON Energie to exercise similar rights. As of December 31, 2006, the total amount potentially payable in connection with such obligations was approximately 2.6 billion.

Other Long-Term Obligations in the table above do not include E.ON's contingent obligation to acquire up to 100.0 percent of shares in Endesa pursuant to the terms of its proposed tender offer. For more information with regard to the offer and this contingent obligation, see Item 4. Information on the Company History and Development of the Company Proposed Endesa Acquisition and Note 33 of the Notes to Consolidated Financial Statements.

For more information with regard to E.ON's contractual obligations, see Notes 24 and 25 of the Notes to Consolidated Financial Statements.

## **Item 6. Directors, Senior Management and Employees.**

### **DIRECTORS AND SENIOR MANAGEMENT**

#### **GENERAL**

In accordance with the Stock Corporation Act, E.ON has a Supervisory Board and a Board of Management. The two Boards are separate and no individual may simultaneously be a member of both Boards.

The Board of Management is responsible for managing the day-to-day business of E.ON in accordance with the Stock Corporation Act and E.ON's Articles of Association. The Board of Management is authorized to represent E.ON and to enter into binding agreements with third parties on behalf of it.

The principal function of the Supervisory Board is to supervise the Board of Management. It is also responsible for appointing and removing the members of the Board of Management. The Supervisory Board may not make management decisions, but may determine that certain types of transactions require its prior consent.

In carrying out their duties, the individual Board members must exercise the standard of care of a diligent and prudent businessperson. In complying with such standard of care, the Boards must take into account a broad range of considerations including the interests of E.ON and its shareholders, employees and creditors. In addition, the members of the Board of Management are personally liable for certain violations of the Stock Corporation Act by the Company. For information on differences between E.ON's corporate governance standards and those applicable to U.S. companies listed on the NYSE, see Item 10. Additional Information Memorandum and Articles of Association Significant Differences in Corporate Governance Practices for Purposes of Section 303A.11 of the New York Stock Exchange Listed Company Manual (the NYSE Manual).

#### **SUPERVISORY BOARD (AUFSICHTSRAT)**

The present Supervisory Board of E.ON consists of twenty members, ten of whom were elected by the shareholders by a simple majority of the votes cast at a shareholder meeting in accordance with the provisions of the Stock Corporation Act, and ten of whom were elected by the employees in accordance with the German Co-determination Act (*Mitbestimmungsgesetz*).

A member of the Supervisory Board elected by the shareholders may be removed by the shareholders by a majority of the votes cast at a meeting of shareholders. A member of the Supervisory Board elected by the

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employees may be removed by three-quarters of the votes cast by the relevant class of employees. The Supervisory Board appoints a Chairman and a Deputy Chairman of the Supervisory Board from amongst its members. At least half the total required number of members of the Supervisory Board must be present or participate in the decision making to constitute a quorum. Unless otherwise provided for by law, resolutions are passed by a simple majority of the votes cast. In the event of a tie, another vote is held and the Chairman (who is, in practice, a representative of the shareholders because the representatives of the shareholders have the right to elect the Chairman if two-thirds of the total required number of members of the Supervisory Board fail to agree on a candidate) then casts the tie-breaking vote.

The members of the Supervisory Board are each elected for the same fixed term of approximately five years. The term expires at the end of the annual general shareholders meeting after the fourth fiscal year following the year in which the Supervisory Board was elected. Reelection is possible. The remuneration of the members of the Supervisory Board is determined by E.ON's Articles of Association.

Because all members of the Supervisory Board are elected at the same time, their terms expire simultaneously. The term of a substitute member of the Supervisory Board elected or appointed by a court to fill a vacancy ends at the time when the term of the original member would have ended. The incumbent members of E.ON's Supervisory Board, their respective ages and their principal occupation and experience, each as of December 31, 2006, as well as the year in which they were first elected or appointed to the Supervisory Board are as follows:

<b>Name and Position Held</b>	<b>Age</b>	<b>Principal Occupation</b>	<b>Year First Elected</b>
Ulrich Hartmann(1)(2)*(3)* Chairman of the Supervisory Board	68	Retired Co-Chief Executive Officer of E.ON AG; formerly Chairman of the Board of Management and Chief Executive Officer of VEBA AG	2003
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Deutsche Bank AG, Deutsche Lufthansa AG, Hochtief AG, IKB Deutsche Industriebank AG (Chairman), Münchener Rückversicherungs-Gesellschaft AG, Henkel KGaA(4)	
Hubertus Schmoldt(2)(3)(5) Deputy Chairman of the Supervisory Board	61	Chairman of the Board of Management of Industriegewerkschaft Bergbau, Chemie, Energie	1996
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Bayer AG, DOW Olefinverbund GmbH, Deutsche BP AG, RAG Aktiengesellschaft, RAG Beteiligungs-AG	

Dr. Karl-Hermann Baumann(1)* Member of the Supervisory Board	71	Formerly Chairman of the Supervisory Board of Siemens AG; formerly member of the Board of Management of Siemens AG	2000
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Linde AG, Schering AG	
Dr. Rolf-E. Breuer Member of the Supervisory Board	69	Formerly Chairman of the Supervisory Board of Deutsche Bank AG; formerly Spokesman of the Board of Management of Deutsche Bank AG	1997
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Landwirtschaftliche Rentenbank(4)	
Dr. Gerhard Cromme(3) Member of the Supervisory Board	63	Chairman of the Supervisory Board of ThyssenKrupp AG	1993
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Allianz SE, Axel Springer AG, Deutsche Lufthansa AG, Siemens AG, Suez S.A.(4), BNP Paribas S.A.(4), Compagnie de Saint-Gobain(4)	

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<b>Name and Position Held</b>	<b>Age</b>	<b>Principal Occupation</b>	<b>Year First Elected</b>
Gabriele Gratz(5)(6) Member of the Supervisory Board	58	Chairwoman of the Works Council of E.ON Ruhrgas AG  <u>Supervisory Board</u> <u>Memberships/Directorships:</u> E.ON Ruhrgas AG	2005
Wolf-Rüdiger Hinrichsen(2)(3)(5) Member of the Supervisory Board	51	Vice-Chairman of the Group Workers Council of E.ON AG	1998
Ulrich Hocker Member of the Supervisory Board	56	General Manager of the German Investor Protection Association  <u>Supervisory Board</u> <u>Memberships/Directorships:</u> Feri Finance AG, Karstadt Quelle AG, ThyssenKrupp Stainless AG, Gartmore SICAV(4), Phoenix Mecano AG(4) (Chairman)	1998
Eva Kirchhof(5) Member of the Supervisory Board	49	Diploma-Physicist, E.ON Sales and Trading GmbH	2002
Seppel Kraus(5) Member of the Supervisory Board	53	Secretary of Labor Union  <u>Supervisory Board</u> <u>Memberships/Directorships:</u> Wacker-Chemie AG, Novartis Deutschland GmbH, Hexal AG	2003
Prof. Dr. Ulrich Lehner Member of the Supervisory Board	60	President and Chief Executive Officer, Henkel KGaA  <u>Supervisory Board</u> <u>Memberships/Directorships:</u> HSBC Trinkaus & Burkhardt KGaA, Ecolab Inc.(4), Novartis AG(4), The DIAL Corporation(4) (Chairman)	2003
Dr. Klaus Liesen Member of the Supervisory Board	75	Honorary Chairman of the Supervisory Board of E.ON Ruhrgas AG and of Volkswagen AG; formerly Chairman of the Supervisory Board of E.ON Ruhrgas AG	1991
	53		2005

Erhard Ott(5) Member of the Supervisory Board		Member of the Board of Management, Unified Services Sector Union (ver.di)	
Ulrich Otte(1)(5)(6) Member of the Supervisory Board	57	Chairman of the Central Works Council, E.ON Energie AG	2001
Hans Prüfer(5)(7) Member of the Supervisory Board	57	Chairman of the Group Works Council, E.ON AG	2006
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> E.ON Energie AG	
Klaus-Dieter Raschke(1)(5) Member of the Supervisory Board	53	Chairman of the Combined Works Council, E.ON Energie AG	2002
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> E.ON Energie AG, E.ON Kernkraft GmbH	
Dr. Henning Schulte-Noelle(2) Member of the Supervisory Board	64	Chairman of the Supervisory Board of Allianz SE; formerly Chairman of the Board of Management of Allianz SE	1993
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Siemens AG, ThyssenKrupp AG	



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<b>Name and Position Held</b>	<b>Age</b>	<b>Principal Occupation</b>	<b>Year First Elected</b>
Prof. Dr. Wilhelm Simson Member of the Supervisory Board	68	Retired Co-Chief Executive Officer of E.ON AG; formerly Chairman of the Board of Management and Chief Executive Officer of VIAG AG	2003
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Frankfurter Allgemeine Zeitung GmbH, Merck KGaA(4) (Chairman), Freudenberg KG (4), Jungbunzlauer Holding AG(4), E. Merck OHG(4), Hochtief AG	
Gerhard Skupke(5) Member of the Supervisory Board	57	Chairman of the Central Works Council, E.ON edis AG	2003
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> E.ON edis AG	
Dr. Georg Freiherr von Waldenfels Member of the Supervisory Board	62	Former Minister of Finance of the State of Bavaria; Attorney	2003
		<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Georgsmarienhütte Holding GmbH, GI Ventures AG (Chairman)	

\* Chairman of the respective Supervisory Board committee.

- (1) Member of E.ON AG's Audit Committee. For more information, see Item 10. Additional Information Memorandum and Articles of Association Corporate Governance The Supervisory Board Committees.
- (2) Member of E.ON AG's Executive Committee, which covers the functions of a remuneration committee. For more information, see Item 10. Additional Information Memorandum and Articles of Association Corporate Governance The Supervisory Board Committees.
- (3) Member of E.ON AG's Finance and Investment Committee. For more information, see Item 10. Additional Information Memorandum and Articles of Association Corporate Governance The Supervisory Board Committees.
- (4) Membership in comparable domestic or foreign supervisory body of a commercial enterprise.
- (5) Elected by the employees.

- (6) Ulrich Otte was a member of E.ON AG's Supervisory Board until December 31, 2006. He was elected by the employees and a member of E.ON AG's Audit Committee. On January 4, 2007, Hans Wollitzer, Chairman of the Central Works Council of E.ON Energie AG, was publicly appointed as his successor. On March 6, 2007, Gabriele Gratz was elected as a new member of E.ON AG's Audit Committee, replacing Ulrich Otte.
- (7) Member since July 25, 2006. Hans Prüfer was elected to the position held prior to that date by Günter Adam.

The current members of the Supervisory Board are subject to reelection in 2008.

#### **BOARD OF MANAGEMENT (VORSTAND)**

As of December 31, 2006, the Board of Management of E.ON consisted of seven members (the total number is determined by the Supervisory Board) who are appointed by the Supervisory Board in accordance with the Stock Corporation Act.

Pursuant to E.ON's Articles of Association, any two members of the Board of Management, or one member of the Board of Management and the holder of a special power of attorney (*Prokura*), may bind E.ON. According to E.ON's Articles of Association, Prokura is granted by the Board of Management.

The Board of Management must report regularly to the Supervisory Board, in particular on proposed business policy and strategy, on profitability, on the current business of E.ON and on business transactions that may affect the profitability or liquidity of E.ON, as well as on any exceptional matters which may arise from time to time. The

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Supervisory Board is also entitled to request special reports at any time. For more information, see Item 10. Additional Information Memorandum and Articles of Association Corporate Governance.

The members of the Board of Management are appointed by the Supervisory Board for a maximum term of five years. They may be re-appointed or have their term extended for additional five-year terms, subject to certain limitations depending upon the age of the member. Under certain circumstances, such as a serious breach of duty or a bona fide vote of no confidence by the shareholders at a shareholders meeting, a member of the Board of Management may be removed by the Supervisory Board prior to the expiration of such term.

In 2006, E.ON introduced a new Board structure to prepare for an even stronger market focus and for the Group's future growth. In October 2006, the Supervisory Board of E.ON AG decided that the future Board of Management will include not only the Chief Executive Officer (CEO), the Chief Financial Officer (CFO) and the Chief Human Resources Officer but also a Chief Operating Officer (COO) and a Board member in charge of Corporate Development/New Markets. The new Board of Management structure will be effective as of April 1, 2007.

The members of the Board of Management, their respective ages and their positions and experience, each as of December 31, 2006, as well as the year in which they were first appointed to the Board and the years in which their terms expire, respectively, are as follows:

<b>Name and Title</b>	<b>Age</b>	<b>Business Activities and Experience</b>	<b>Year First Appointed</b>	<b>Year Current Term Expires</b>
Dr. Wulf H. Bernotat Chairman of the Board of Management	58	Chief Executive Officer; Corporate Communications, Corporate and Public Affairs, Investor Relations, Supervisory Board Relations, Strategy, Executive Development, Audit; formerly Chairman of the Board of Management of Stinnes AG	2003	2008
<b><u>Supervisory Board</u></b>				
<b><u>Memberships/Directorships:</u></b>				
E.ON Energie AG(1) (Chairman), E.ON Ruhrgas AG(1) (Chairman), Allianz SE, Metro AG, Bertelsmann AG, RAG Aktiengesellschaft (Chairman), RAG Beteiligungs-AG (Chairman), E.ON Nordic AB(2)(3) (Chairman), E.ON UK plc(2)(3) (Chairman), E.ON US Investments Corp.(2)(3) (Chairman), E.ON Sverige AB(2)(3) (Chairman)				
Dr. Burckhard Bergmann Member of the Board of Management	63	Upstream Business, Market Management, Group Regulatory Management; Chairman of the Board of Management and Chief Executive Officer of E.ON Ruhrgas AG	2003	2008

Supervisory Board

Memberships/Directorships:

Thüga AG(1) (Chairman), Allianz  
 Lebensversicherungs-AG, MAN Ferrostaal  
 AG, Jaeger Akustik GmbH & Co.(2)  
 (Chairman), Accumulatorenwerke Hoppecke  
 Carl Zoellner & Sohn GmbH(2), OAO  
 Gazprom(2), E.ON Ruhrgas E & P  
 GmbH(2)(3) (Chairman), Nord Stream AG(2),  
 E.ON Gastransport AG & Co. KG(2)(3)  
 (Chairman), E.ON UK plc(2)(3), ZAO  
 Gerosgaz(2)(3) (Chairman; in alternation with  
 a representative of the foreign partner)

Christoph Dänzer-Vanotti(4) Member of the Board of Management	51	Chief Human Resources Officer; Labor Relations, Personnel, Infrastructure and Services, Procurement, Organization; formerly Member of the Board of Management of E.ON Ruhrgas AG	2006	2009
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<b>Name and Title</b>	<b>Age</b>	<b>Business Activities and Experience</b>	<b>Year First Appointed</b>	<b>Year Current Term Expires</b>
Lutz Feldmann(5) Member of the Board of Management	49	Corporate Development/New Markets; formerly Group Vice President Marketing of BP p.l.c.	2006	2009
Dr. Hans Michael Gaul(6) Member of the Board of Management	64	Controlling/Corporate Planning, M&A, Legal Affairs; formerly Member of the Board of Management of VEBA AG	1990	2007
<u>Supervisory Board</u> <u>Memberships/Directorships:</u> Degussa AG, E.ON Energie AG(1), E.ON Ruhrgas AG(1), Allianz Versicherungs-AG, DKV AG, RAG Aktiengesellschaft, STEAG AG, RAG Beteiligungs-AG, Volkswagen AG, E.ON Nordic AB(2)(3), E.ON Sverige AB(2)(3)				
Dr. Marcus Schenck(4) Member of the Board of Management	41	Chief Financial Officer; Finance, Accounting, Taxes, IT; formerly Managing Director and Partner of Goldman Sachs & Co. oHG	2006	2009
Dr. Johannes Teysen Member of the Board of Management(7)	47	Downstream Business, Market Management, Group Regulatory Management; Chairman of the Board of Management and Chief Executive Officer of E.ON Energie AG <u>Supervisory Board</u> <u>Memberships/Directorships:</u> E.ON Bayern AG(1) (Chairman), E.ON Hanse AG(1) (Chairman), Salzgitter AG, E.ON Nordic AB(2)(3), E.ON Sverige AB(2)(3)	2004	2008

(1) Group mandate.

(2) Membership in comparable domestic or foreign supervisory body of a commercial enterprise.

(3) Other Group mandate (membership in comparable domestic or foreign supervisory body of a commercial enterprise).

- (4) Member since December 1, 2006. Dr. Marcus Schenck was appointed to the position held prior to that date by Dr. Erhard Schipporeit; Christoph Dänzer-Vanotti was appointed to that formerly held by Dr. Manfred Krüper.
- (5) Member since December 1, 2006. Lutz Feldmann was appointed to the new position.
- (6) On April 1, 2007, Dr. Hans Michael Gaul will retire from the Board.
- (7) Dr. Johannes Teyssen will become Chief Operating Officer as of April 1, 2007.

The members of the Supervisory Board and Board of Management hold, in aggregate, less than 1 percent of E.ON's outstanding Ordinary Shares.

## COMPENSATION

### SUPERVISORY BOARD

#### *Compensation System for Members of the Supervisory Board*

The compensation of Supervisory Board members is governed by E.ON AG's Articles of Association. In accordance with German law and the recommendations set forth in the German Corporate Governance Code (*Deutscher Corporate Governance Kodex*, the Code), the current compensation system, which has been in effect since 2005, takes into consideration the responsibility and the scope of duties of the members of the Supervisory Board as well as the Company's financial situation and business performance. In accordance with the Code, Supervisory Board members receive fixed annual compensation as well as two variable, performance-based

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compensation components: a short-term component linked to dividends and a long-term component linked to the three-year average of the E.ON Group's consolidated net income per share. More specifically:

*Fixed compensation:* in addition to being reimbursed for their expenses (including the value-added tax due on their compensation), Supervisory Board members receive a fixed amount of 55,000 for each fiscal year.

*Short-term variable compensation:* in addition, members of the Supervisory Board receive variable compensation of 115.00 for each 0.01 of the per share annual dividend paid out to shareholders with respect to the prior fiscal year, to the extent such dividend is in excess of 0.10 per Ordinary Share.

*Long-term variable compensation:* furthermore, members of the Supervisory Board receive variable compensation of 70.00 for each 0.01 of any positive difference between the three-year average of the E.ON Group's consolidated net income per share and 2.30.

Individuals who were members of the Supervisory Board or any of its committees for less than the entire fiscal year receive pro rata compensation for each full or partial month of membership. Fixed compensation is payable after the end of the financial year. Variable compensation components are payable after the annual general meeting of shareholders, which votes to formally approve the acts of the members of the Supervisory Board in the previous financial year.

The Chairman of the Supervisory Board receives a total of three times the above-mentioned compensation; the Deputy Chairman and every chairman of a Supervisory Board committee receive a total of twice the above-mentioned amount; and each committee member receives a total of one-and-a-half times the above-mentioned compensation. For more information about the Supervisory Board committees, see Item 10. Additional Information Memorandum and Articles of Association Corporate Governance The Supervisory Board Committees.

Supervisory Board members are paid an attendance fee of 1,000 per day for meetings of the Supervisory Board or its committees. Finally, the Company has taken out liability insurance for the benefit of Supervisory Board members to cover the statutory liability related to their Supervisory Board duties. If an insurance claim is granted, this insurance includes a deductible equal to 50 percent of a Supervisory Board member's annual fixed compensation.

The fixed annual compensation of 55,000 is intended to take into account the independence of the Supervisory Board required to fulfill the supervisory function. In addition, there are a number of duties that Supervisory Board members need to perform irrespective of the Company's financial performance. For this reason, the Company believes that a minimum level of compensation should be guaranteed even during times that are difficult for the Company, when the work of the Supervisory Board is usually particularly challenging. On the other hand, dividend-based compensation is designed to ensure that the Supervisory Board's compensation interests are, to some extent, aligned with shareholders' return expectations. Finally, since another part of variable compensation is linked to the three-year average of consolidated net income, the Supervisory Board's compensation also contains a component that is related to the Company's long-term performance.

***Compensation of the Members of the Supervisory Board***

Provided that E.ON's annual shareholders' meeting on May 3, 2007 approves the proposed dividend, the total compensation of the members of the Supervisory Board for 2006 will amount to 4.1 million (2005: 3.8 million).

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The following table sets forth details of the compensation of each member of E.ON's Supervisory Board (in the capacities indicated) in 2006, presented in accordance with the recommendations of the German Corporate Governance Code:

Name	<b>Fixed Compensation for Service on E.ON's Supervisory Board</b>	<b>Variable Short-Term Compensation for Service on E.ON's Supervisory Board</b>	<b>Variable Long-Term Compensation for Service on E.ON's Supervisory Board ( )</b>	<b>Compensation for Supervisory Board Memberships at Affiliated Companies</b>	<b>Total</b>
Ulrich Hartmann	165,000	112,125	130,410	0	<b>407,535</b>
Hubertus Schmoldt	110,000	74,750	86,940	0	<b>271,690</b>
Günter Adam (until June 30, 2006)	27,500	18,687	21,735	0	<b>67,922</b>
Dr. Karl-Hermann Baumann	110,000	74,750	86,940	0	<b>271,690</b>
Dr. Rolf-E. Breuer	55,000	37,375	43,470	0	<b>135,845</b>
Dr. Gerhard Cromme	82,500	56,063	65,205	33,288	<b>237,056</b>
Gabriele Gratz	55,000	37,375	43,470	102,000	<b>237,845</b>
Wolf-Rüdiger Hinrichsen	82,500	56,063	65,205	0	<b>203,768</b>
Ulrich Hocker	55,000	37,375	43,470	0	<b>135,845</b>
Eva Kirchhof	55,000	37,375	43,470	0	<b>135,845</b>
Seppel Kraus	55,000	37,375	43,470	0	<b>135,845</b>
Prof. Dr. Ulrich Lehner	55,000	37,375	43,470	0	<b>135,845</b>
Dr. Klaus Liesen	55,000	37,375	43,470	0	<b>135,845</b>
Erhard Ott	55,000	37,375	43,470	0	<b>135,845</b>
Ulrich Otte	82,500	56,063	65,205	57,074	<b>260,842</b>
Hans Prüfer (from July 25, 2006)	27,500	18,687	21,735	18,000	<b>85,922</b>
Klaus-Dieter Raschke	82,500	56,063	65,205	53,230	<b>256,998</b>
Dr. Henning Schulte-Noelle	82,500	56,063	65,205	0	<b>203,768</b>
Prof. Dr. Wilhelm Simson	55,000	37,375	43,470	0	<b>135,845</b>
Gerhard Skupke	55,000	37,375	43,470	16,300	<b>152,145</b>
Dr. Georg Freiherr von Waldenfels	55,000	37,375	43,470	0	<b>135,845</b>
<b>Subtotal</b>	<b>1,457,500</b>	<b>990,439</b>	<b>1,151,955</b>	<b>279,892</b>	<b>3,879,786</b>
Attendance fees and meeting-related reimbursements(1)					<b>172,768</b>
<b>Total</b>	<b>1,457,500</b>	<b>990,439</b>	<b>1,151,955</b>	<b>279,892</b>	<b>4,052,554</b>

(1)



Attendance fees and meeting-related reimbursements are given as an aggregate for all Supervisory Board members.

No loans were outstanding or granted to members of the Supervisory Board in 2006. For details of the members of the Supervisory Board, see the table under Directors and Senior Management Supervisory Board (Aufsichtsrat) above.

## **BOARD OF MANAGEMENT**

### *Compensation System for Members of the Board of Management*

The compensation of the members of the Board of Management is currently composed of a fixed annual base salary, an annual bonus, and a long-term variable component.

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The base salary is paid on a monthly basis and is reviewed regularly to determine whether it is in line with market salaries and whether it is fair and reasonable. The last date on which salaries were adjusted was July 1, 2006.

The amount of the bonus is determined by the degree to which certain corporate and personal performance targets are achieved under a target-setting system, 70 percent of which is related to corporate performance targets and 30 percent to personal targets. The corporate performance targets reflect, in equal shares, operating performance (as measured by adjusted EBIT) and return on capital employed ( ROCE ). Board of Management members who fully achieve their performance target receive the target bonus agreed to in their contracts. The maximum bonus that can be achieved is 200 percent of the target bonus. Any compensation received for work done in the Company's interest (other directorships at Group companies) is set off against the bonus or transferred to the Company.

The long-term variable compensation component that Board of Management members receive is stock-based compensation. This compensation is designed to reward Board of Management members (and other key executives) for their contributions to increasing the Company's shareholder value and to promote E.ON's long-term business performance. The Company believes that this variable pay component, which combines incentives for long-term growth with a risk component, effectively aligns management's and shareholders' interests.

In 2006, the E.ON Share Performance Plan, a new uniform Group-wide stock-based compensation system, was introduced. The amount of compensation beneficiaries receive from the E.ON Share Performance Plan depends on the performance of E.ON's stock price, both in absolute terms and relative to an industry index.

Through the end of 2005, E.ON awarded annual stock appreciation rights (each, a SAR) as part of its stock option program. SARs already granted may still be exercised in accordance with the program's terms and conditions. Both programs are described in Note 9 of the Notes to Consolidated Financial Statements.

In line with the Code's recommendations, the total compensation paid to Board of Management members therefore includes both fixed and variable components. Criteria applied to determine the amount of compensation include in particular a Board of Management member's duties, his or her personal performance and the performance of the Board of Management as a whole, as well as the Company's financial situation, its business performance, and its future prospects, each relative to a market-based benchmark.

The variable compensation components contain an element of risk and consequently are not guaranteed compensation. The stock-based compensation program is based on demanding, relevant benchmark parameters. Under the program's terms, performance targets or benchmark parameters cannot be changed at a later stage.

The Supervisory Board's Executive Committee is responsible for decisions on compensation. The Supervisory Board last discussed the compensation system for the Board of Management at its meeting on December 13, 2006.

In the event of a premature loss of a Board of Management position due to a change-in-control event, the service agreements of Board of Management members entitle them to severance and settlement payments.

With the exception of those members who joined the Board of Management in 2006, during the reporting year change-in-control agreements existed with all members of the Board of Management which reflect the hitherto standard terms and conditions of such agreements for members of the E.ON AG Board of Management. Under these agreements, a change-in-control occurs if a single shareholder acquires 25 percent or more of the voting rights in the Company; if a third party acquires a share of the Company's voting rights that has led or would lead to this party having a share of the voting rights of at least half of the Company's share capital with voting rights at an annual shareholders' meeting; or if the Company, as a dependent entity, concludes a corporate agreement, becomes part of another company through subordination, takes on a different legal form, or is merged with another company. If, within

12 months of any such change-in-control, the service agreement of a Board of Management member is terminated by mutual consent, expires, or is terminated by the member of the Board of Management because his or her position on the Board is materially altered by the change-in-control, he or she is entitled to severance pay equal to the capitalized amount of his or her total annual compensation (annual base salary, annual target bonus, and other compensation) for the remaining term of the service agreement. If the remaining term of the service agreement exceeds three years, severance pay for the period beyond three years will be reduced by 25 percent to reflect discounting and a set off for services rendered to other companies or organizations. In addition, he or she will

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receive a settlement payment equal to at least three times his or her total annual compensation or, if he or she has been a Board of Management member for more than ten years, four times such compensation. Together, severance and settlement payments may not exceed five times the Board of Management member's total annual compensation.

On December 13, 2006, the Executive Committee of the Supervisory Board made changes to the terms of the change-in-control agreements. In February 2007, change-in-control agreements that incorporate these new terms were concluded with the members who joined the Board of Management in 2006: Mr. Dänzer-Vanotti, Dr. Schenck and Mr. Feldmann. Under the new agreements, a change-in-control only occurs upon the occurrence of one of the following three events: if a third party acquires at least 30 percent of the Company's voting rights, thus triggering the automatic requirement to make an offer for the Company pursuant to Germany's Stock Corporation Takeover Law; if the Company, as a dependent entity, concludes a corporate agreement; or if the Company is merged with another company. The severance and settlement payments based on such a change-in-control have also been modified for those members of the Board that joined in 2006. Board of Management members now are entitled to severance pay equal to the capitalized amount of their total annual compensation (annual base salary, annual target bonus, and other compensation) for the remaining term of their service agreement or for at least three years. They are not entitled to any settlement payments beyond this. To reflect discounting and a set off for services rendered to other companies or organizations, payments will be reduced by 20 percent. If a Board of Management member is above the age of 53, this 20 percent reduction is diminished according to an age-related schedule.

Following the end of their service for the Company, Board of Management members are entitled to receive pension payments in any of three cases: if they reach the standard retirement age (currently 60 years), if they are permanently incapacitated, or if their service agreement is terminated prematurely or not extended. Depending on the length of their service, Board of Management members are generally entitled to annual pension payments equal to between 50 percent and 75 percent of their last annual base salary. The annual pension of one member of the Board of Management is a fixed amount. If Board of Management members are entitled to pension payments stemming from earlier employment, these payments will be set off against their pension payments from the Company. If their service agreement is terminated prematurely or not extended, and if such termination or non-extension is not due to misconduct or rejection of an offer of extension that is at least on a par with the existing service agreement, Board of Management members who have been in a Top Management position in the E.ON Group for more than five years will receive a reduced pension as a bridge payment until they reach the age of 60. The amount of the bridge payment will be calculated based on the ratio between the actual and potential length of service to the Company until the age of 60 is reached. The pension arrangements granted by the Company to Board of Management members prior to 2006 do not include limitations on pension entitlements relating to premature termination or non-extension of service agreements.

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The following table shows the current pension obligations to persons who served on the Board of Management in 2006. In line with the Code's recommendations, the table also includes for each member the additions to provisions for pensions for each member calculated according to U.S. GAAP.

Name	Current pension entitlement at December 31, 2006		Additions to provisions for pensions in 2006	
	As a percentage of annual base salary (%)	( )	( )	Thereof interest cost ( )
Dr. Wulf H. Bernotat	70	868,000	1,462,762	381,956
Dr. Burckhard Bergmann		728,500	918,961	539,536
Christoph Dänzer-Vanotti (from December 1, 2006)(1)	50	300,000	69,563	231
Lutz Feldmann (from December 1, 2006)(1)	50	300,000	20,846	69
Dr. Hans Michael Gaul	75	562,500	669,008	397,514
Dr. Manfred Krüper (until November 30, 2006)(2)			691,085	355,312
Dr. Marcus Schenck (from December 1, 2006)(1)	50	300,000	34,245	114
Dr. Erhard Schipporeit (until November 30, 2006)(3)	75	562,500	1,042,739	332,170
Dr. Johannes Teysen	70	525,000	617,863	245,552

(1) Pension entitlement not yet vested.

(2) Entered retirement on December 1, 2006.

(3) Will enter retirement in February 2009.

Pension payments are adjusted on an annual basis to reflect changes in the German consumer price index. In the case of pensions granted before 2003, the Executive Committee of the Supervisory Board may, under certain circumstances, make additional adjustments that it deems appropriate. The annual pension of one member of the Board of Management is a fixed amount that is also adjusted on an annual basis to reflect changes in the consumer price index plus an additional 0.7 percent per year.

Following the death of an active or former member of the Board of Management, a reduced amount of his or her pension is paid as a survivor's pension to the family. Widows and widowers are entitled to lifelong payment of 60 percent of the pension the Board of Management member received on the date of his or her death or would have received had he or she entered retirement on this date. This payment is terminated if a widow or widower remarries. The survivor's pensions for the widows of two Board of Management members deviate from this model and are equal to 75 percent and 49.5 percent of the members' respective pensions. The children or dependents of a Board of Management member who have not reached the age of 18 are entitled, for the duration of their education or professional training until they reach a maximum age of 25, to an annual payment equal to 20 percent of the pension

the member of the Board of Management received or would have received on the date of his or her death. Surviving children benefits granted before 2006 deviate from this model and are equal to 15 percent of a Board of Management member's pension. If, taken together, the survivor's pensions of the widow or widower and children exceed 100 percent of a Board of Management member's pension, the pensions paid to the children are reduced proportionally so as to eliminate the excess amount.

***Compensation of the Members of the Board of Management***

The composition of the Board of Management changed in 2006. Dr. Manfred Krüper and Dr. Erhard Schipporeit ended their service on the Board of Management effective November 30, 2006. Christoph Dänzer-Vanotti, Lutz Feldmann and Dr. Marcus Schenck were appointed to the Board of Management effective December 1, 2006.

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The total compensation of the members of the Board of Management in 2006 amounted to 21.7 million (2005: 22.5 million). The following table sets forth the details of the compensation of each member of E.ON's Board of Management in 2006, presented in accordance with the regulations of the German Commercial Code, as amended to reflect the Management Board Compensation Disclosure Law, as well as the recommendations of the German Corporate Governance Code:

Name	Fixed Annual Compensation ( )	Annual Bonus ( )	Other Compensation(1) ( )	Fair Value of Performance Rights granted in	Total ( )	Performance Rights Granted in 1st Tranche in 2006 (No. of Performance Rights)
				1st Tranche in 2006 ( )		
Dr. Wulf H. Bernotat	1,195,000	2,400,000	63,913	1,273,133	4,932,046	17,041
Dr. Burckhard Bergmann	725,000	1,500,000	27,325	754,422	3,006,747	10,098
Christoph Dänzer-Vanotti (from December 1, 2006)	50,000	100,000	1,273	50,280	201,553	673
Lutz Feldmann (from December 1, 2006)	50,000	100,000	3,371	50,280	203,651	673
Dr. Hans Michael Gaul	725,000	1,500,000	28,708	754,422	3,008,130	10,098
Dr. Manfred Krüper (until November 30, 2006)	662,500	1,375,000	27,245	754,422	2,819,167	10,098
Dr. Marcus Schenck (from December 1, 2006)	50,000	100,000	1,500,000	50,280	1,700,280	673
Dr. Erhard Schipporeit (until November 30, 2006)	662,500	1,375,000	38,423	754,422	2,830,345	10,098
Dr. Johannes Teysen	725,000	1,500,000	54,098	754,422	3,033,520	10,098
<b>Total</b>	<b>4,845,000</b>	<b>9,950,000</b>	<b>1,744,356</b>	<b>5,196,083</b>	<b>21,735,439</b>	<b>69,550</b>

- (1) Dr. Schenck received other compensation of 1.5 million as a one-time reimbursement for parts of his long-term compensation from his previous employer that he forfeited when he joined E.ON. The remaining other compensation of the members of the Board of Management consists primarily of benefits in kind from the personal use of company cars.

The performance rights granted in 2006 as the first tranche of the E.ON Share Performance Plan were granted on the basis of their fair value of 74.71 per right on the date of their issuance and were included in the total compensation of the members of the Board of Management.

The fair value of performance rights under the new plan is determined by means of a recognized option pricing model. The model, called a Monte Carlo simulation, simulates a large number of different scenarios for E.ON Ordinary Shares and its benchmark index, the Dow Jones STOXX Utilities Index (Return EUR). According to the terms and conditions of the E.ON Share Performance Plan, the intrinsic value of the performance rights is determined for each scenario based on E.ON's stock outperformance or underperformance of its benchmark index and the stock's corresponding payout value. The fair value is equal to the discounted average of these intrinsic values.

Instead of the fair value, the target value is used in internal communications between the Supervisory Board and the Board of Management. The target value is equal to the cash payout amount of each performance right if at the end of the maturity period E.ON's stock maintains its price and its performance equals the performance of the benchmark index. The target value for the first tranche is 79.22 per right and equals the average E.ON stock price during the 60 trading days prior to the issuance of the rights on January 2, 2006. The Executive Committee of the Supervisory Board used the target value to determine the number of rights to be issued. These correspond to a target value of 1.35 million for the Chairman of the Board of Management, 0.8 million for members of the Board of Management and 80 percent of this amount on a pro rata basis for newly-appointed members of the Board of Management.



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During 2006, members of the Board of Management exercised SARs granted to them in previous years under the terms of the former program. Additional detailed information about E.ON AG's stock-based compensation programs can be found in Note 9 of the Notes to Consolidated Financial Statements.

No loans were outstanding or granted to members of the Board of Management in 2006.

For additional information about the members of the Board of Management, see the table under **Directors and Senior Management Board of Management (Vorstand)** above.

**Payments Made to Former Members of the Board of Management**

Total payments made to former Board of Management members and to their beneficiaries amounted to 11.7 million in 2006 (2005: 5.4 million).

Provisions of 99.9 million (2005: 89.0 million) have been provided for pension obligations to former Board of Management members and their beneficiaries.

**EMPLOYEES**

As of December 31, 2006, E.ON had 80,612 employees. This increase of 1.3 percent from year-end 2005 is mainly due to further additions in customer service staff and increased hiring of technical personnel at the electricity distribution and metering businesses at the U.K. market unit. Of the total number of employees, 42.2 percent were based in Germany. The following table sets forth information about the number of employees of E.ON as of December 31, 2006, 2005 and 2004, not including apprentices and managing directors or board members:

	<b>Employees at December 31, 2006</b>			<b>Employees at December 31, 2005</b>			<b>Employees at December 31, 2004</b>		
	<b>Total</b>	<b>Germany</b>	<b>Foreign</b>	<b>Total</b>	<b>Germany</b>	<b>Foreign</b>	<b>Total</b>	<b>Germany</b>	<b>Foreign</b>
Central Europe	43,546	30,199	13,347	44,476	30,307	14,169	36,811	29,208	7,603
Pan-European Gas	12,417	3,371	9,046	13,366	3,411	9,955	4,001	3,432	569
U.K.	15,621	13	15,608	12,891	10	12,881	10,397	6	10,391
Nordic	5,693	3	5,690	5,424	2	5,422	5,106	2	5,104
U.S. Midwest	2,890	2	2,888	3,002	2	3,000	2,997	1	2,996
Corporate Center	445	426	19	411	395	16	420	403	17
<b>Total</b>	<b>80,612</b>	<b>34,014</b>	<b>46,598</b>	<b>79,570</b>	<b>34,127</b>	<b>45,443</b>	<b>59,732</b>	<b>33,052</b>	<b>26,680</b>

In addition, E.ON employed 2,574, 2,471 and 2,289 apprentices with limited contracts in Germany at year-end 2006, 2005 and 2004, respectively.

Personnel expenses totaled 4.6 billion in 2006 compared with 4.2 billion in 2005.

Many of the Group's employees are members of labor unions. Almost all of the union members in Germany belong to the national chemicals/mining/energy and the united services unions. None of E.ON's facilities in Germany is operated on a closed shop basis. In Germany, employment agreements for blue collar workers and for white collar employees below management level are generally collectively negotiated between the association of the companies within a

particular industry and the respective unions. In addition, under German law, works councils comprised of both blue collar and white collar employees participate in determining company policy with regard to certain compensation matters, work hours and hiring policy. Management believes its relations with the German trade unions may be characterized as constructive and cooperative.

E.ON U.K.'s organizational structure comprises a number of businesses which are supported by a common services business and central functional teams, including finance, legal and human resources services. E.ON U.K. has in place a company level framework for collective bargaining that has been jointly agreed with the five recognized trade unions. This framework provides for arrangements for negotiation and consultation at the company level and the individual business level. At company level, a range of common standards is negotiated with the trade unions for company-wide application. At the individual business level, detailed negotiation of pay and other business-specific terms and conditions is negotiated by business level employee forums. These forums consist

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of representatives from management, trade unions and employees and fulfill a consultative, as well as a negotiating role. Since privatization, E.ON U.K. believes it has maintained constructive relationships with its recognized unions.

In Sweden, approximately 80 percent of E.ON Sverige's employees are members of various trade unions. E.ON Sverige adheres to two main central collective labor agreements at the national level, on the basis of which E.ON Sverige's corporate human resources department and representatives from the different trade unions have negotiated a framework for E.ON Sverige. Local human resources departments and local trade union representatives negotiate at the local level. Pursuant to Swedish law, representatives of the unions are members of E.ON Sverige's board of directors. According to Swedish law, all issues that have an impact on the employees' working conditions must be negotiated with the trade unions. Management believes its relations with the Swedish trade unions may be characterized as constructive and cooperative.

The level of trade union participation is very high in the eastern European countries in which the Company has operations. Almost all of the Company's employees in Romania, Hungary, Bulgaria and the Czech Republic are members of the trade unions in the energy and gas sector or at least participate in the collective bargaining agreements that are used in the energy and gas industries. These collective bargaining agreements, which are negotiated between the association of the companies within a particular industry or the individual employer and the respective unions, stipulate compensation levels and most other working conditions for employees. Management believes that its relations with the relevant trade unions may be characterized as constructive and cooperative, and that the continuation of a constructive and cooperative relationship is of great importance for the successful integration of the Company's recently-acquired operations in Eastern Europe.

The employees of E.ON U.S. who are members of labor unions belong to local units of the International Brotherhood of Electrical Workers (IBEW) and The United Steelworkers of America. Most of these union employees are involved in operational and maintenance work in power generation and distribution operations. The majority of E.ON U.S.'s employees are not union members. In the United States, Collective Bargaining Agreements (CBA) are negotiated between the local management (*i.e.*, LG&E and KU) and local union representatives. Each CBA generally has a term of three to four years and includes no strike or lock out clauses during the term of the agreement. While E.ON U.S. had an adversarial relationship in the past with the IBEW, its primary union, management believes relations have significantly improved and may now be characterized as cooperative.

Pursuant to EU requirements, E.ON also established a European works council in 1996 that is responsible for cross-border issues. The Company believes that it has satisfactory relations with its works councils and unions and therefore anticipates reaching new agreements with its labor unions on satisfactory terms as the existing agreements expire. There can be no assurance, however, that new agreements will be reached without a work stoppage or strike or on terms satisfactory to the Company. A prolonged work stoppage or strike at any of its major facilities could have a material adverse effect on the Company's results of operations. The Group has not experienced any material strikes during the last ten years.

Since 1984, E.ON has had an employee share purchase program under which employees in Germany may purchase Ordinary Shares at a discount to the extent provided under German tax laws (according to Section 19a of the German Income Tax Law, in 2006 employees were eligible for a total discount per employee of 135). Since 2005, E.ON provides an additional discount per employee of up to 320, which is subject to income tax and depends on the Company's performance. In 2006, this additional discount amounted to 320 per employee. In 2006, 19,955 employees purchased 443,290 Ordinary Shares under this program.

Under HM Revenue and Customs-approved share incentive plans, E.ON's employees in the United Kingdom can buy Ordinary Shares of E.ON AG out of their pre-tax salary (partnership shares) and receive additional shares for every partnership share purchased (matching shares). As of December 31, 2006, 4,849 employees were participating in the

plans. In 2006, participants purchased 86,352 partnership shares and received approximately 106,902 matching shares under the plans.

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**STOCK INCENTIVE PLANS**

From 1999 through 2005, E.ON AG ran a SAR plan for key executives of the Group (including the members of the Board of Management) that was based on the performance of E.ON AG's Ordinary Shares. Approximately 3.3 million SARs granted in previous years remain outstanding under this program; such SARs may be exercised in the future in accordance with their respective terms. In 2006, E.ON adopted the E.ON Share Performance Plan, a new long-term incentive program for senior executives (including the members of the Board of Management) to replace the SAR program. The new program, the specific terms of which were set during 2006, is based on annual grants of performance rights, with the grantee being entitled to receive a cash payment based on a formula linked to the price of E.ON Ordinary Shares and the performance of a benchmark index. E.ON AG granted approximately 0.5 million share performance rights to 396 senior executives worldwide in 2006. For more information about these plans, see Compensation above and Note 9 of the Notes to Consolidated Financial Statements.

**Item 7. Major Shareholders and Related Party Transactions.**

**MAJOR SHAREHOLDERS**

As of December 31, 2006, E.ON AG had an aggregate number of 659,597,269 Ordinary Shares with no par value outstanding. Under the Articles of Association, each Ordinary Share represents one vote.

Based on information available to E.ON, including filings with the SEC, there were no shareholders who beneficially owned more than five percent of the Ordinary Shares as of December 31, 2006. Holders of voting securities of listed German corporations (including E.ON) whose shareholding reaches, passes or falls below certain thresholds are subject to certain notification requirements under German law. These thresholds are 5, 10, 25, 50 and 75 percent of a company's voting rights; as from the beginning of 2007, additional thresholds are 3, 15, 20 and 30 percent of a company's voting rights. For more information, see Item 10. Additional Information Memorandum and Articles of Association Disclosure of Shareholdings and Note 17 of the Notes to Consolidated Financial Statements.

In addition, as of December 31, 2006 E.ON directly and indirectly held a total of 32,402,731 of its own Ordinary Shares in treasury stock, representing 4.7 percent of its share capital. E.ON cannot vote these shares. For more information, see Note 17 of the Notes to Consolidated Financial Statements.

According to amendments to the German Securities Trading Act (*Wertpapierhandelsgesetz*, or Securities Trading Act ) which became effective as of January 20, 2007, listed German corporations have to publish the total number of voting rights at the end of each month in which the total number has either decreased or increased, and to notify BAFin. Further, a listed corporation acquiring or disposing of its own shares must publish, as well as notify BAFin of, the proportion of its own shares held by it promptly, but not later than within four trading days, following such acquisition or disposal if the proportion reaches, passes or falls below the thresholds of 3 percent, 5 percent or 10 percent of the voting rights. This applies to corporations acquiring or disposing of shares directly or through an entity acting in its own name but on behalf of the corporation.

Although E.ON is unable to determine the exact number of its Ordinary Shares held in the United States, it believes that as of December 31, 2006, approximately 20.1 percent of its outstanding share capital was held by shareholders in the United States, and approximately 2.3 percent was held in the form of ADSs. For more information, see Item 9. The Offer and Listing General.

**RELATED PARTY TRANSACTIONS**

In the ordinary course of its business, E.ON enters into transactions with numerous businesses, including firms in which the Group holds ownership interests and those with which some of E.ON's Supervisory Board members hold positions of significant responsibility.

Allianz AG was a major shareholder of E.ON in 2002 and prior years. Allianz AG provides the Group with insurance coverage in the ordinary course of business for which it was paid reasonable and customary fees. E.ON

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also has ongoing banking relations with Deutsche Bank AG, previously a major shareholder, in the ordinary course of business.

E.ON directly and indirectly holds a 39.2 percent interest in RAG. In February 2003, E.ON sold 37.2 million of its shares in Degussa (approximately 18 percent of Degussa's outstanding shares) to RAG for 1.4 billion. Subsequent to this transaction, both E.ON and RAG held a 46.5 percent interest in Degussa. In the second step of the transaction, E.ON sold a further 3.6 percent of Degussa's stock to RAG, with effect from June 1, 2004, giving RAG a 50.1 percent interest in Degussa. Total proceeds from the sale of this 3.6 percent stake amounted to 283 million. In December 2005, E.ON and RAG signed a framework agreement on the sale of E.ON's remaining 42.9 percent stake in Degussa to RAG. As part of the implementation of that framework agreement, E.ON transferred its stake in Degussa to RAG Projektgesellschaft in March 2006 and agreed on the forward sale of that entity to RAG for a purchase price of approximately 2.8 billion (equal to 31.50 per Degussa share). The transaction closed in July 2006. As a result, E.ON no longer holds any equity interest in Degussa. For more information on these transactions, see Item 4. Information on the Company History and Development of the Company Ruhrgas Acquisition and Item 5. Operating and Financial Review and Prospects Overview and Acquisitions and Dispositions.

From time to time E.ON may make loans to companies in which the Group holds ownership interests. At year-end 2006, E.ON had aggregate outstanding loans to companies in which the Group holds ownership interests amounting to 447 million, with one of the largest single such loans being to ONE (122 million). For information, see Note 30 of the Notes to Consolidated Financial Statements.

For a discussion of off-balance sheet arrangements, see Item 5. Operating and Financial Review and Prospects Off-Balance Sheet Arrangements.

## **Item 8. Financial Information.**

### **CONSOLIDATED FINANCIAL STATEMENTS**

See Item 18. Financial Statements and pages F-1 to F-82.

### **LEGAL PROCEEDINGS**

Various legal actions, including lawsuits for product liability or for alleged price fixing agreements, governmental investigations, proceedings and claims are pending or may be instituted or asserted in the future against the Company. These include lawsuits pending in the United States and Germany against E.ON and certain subsidiaries in connection with the sale of VEBA Electronics in 2000, as well as various arbitration proceedings in which E.ON Ruhrgas is involved in connection with the terms on which it buys or sells natural gas and the acquisition of shares in Europagas a.s. Since such litigation or claims are subject to numerous uncertainties, their outcome cannot be ascertained; however, in the opinion of management, the outcome of these matters and those discussed in this section will not have a material adverse effect upon the financial condition, results of operations or cash flows of the Company.

The U.S. Securities and Exchange Commission has requested that the Company provide them with information for an investigation focusing in particular on the preparation of its Annual Reports on Form 20-F and financial statements for the years from 2000 through 2003, including, with respect to all or a portion of such period, the accounting treatment and depreciation of its power plant assets, its accounting for and consolidation of certain former subsidiaries (Degussa and Viterra) and their shareholdings, the nature of the services performed by its auditors, disclosures with regard to its long-term commitments (including fuel procurement contracts), and the process of such documents' preparation and conformity with U.S. GAAP. The Company is in close contact with the SEC and has been cooperating fully with the investigation. A similar request that also covers additional items has been made to the Company's independent public

accountants.

For information about the conditions and obligations imposed on E.ON in connection with the ministerial approval for E.ON's acquisition of E.ON Ruhrgas, see Item 4. Information on the Company History and Development of the Company Ruhrgas Acquisition.



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For information about proceedings instituted by German or European antitrust authorities affecting E.ON Ruhrgas, E.ON Energie and certain of their subsidiaries, see Item 3. Key Information Risk Factors.

For information about proceedings in connection with the proposed takeover of Endesa, see Item 4. Information on the Company History and Development of the Company Proposed Endesa Acquisition.

E.ON maintains general liability insurance covering claims on a worldwide basis with coverage limits and retention amounts which management believes to be adequate and appropriate in light of E.ON's businesses and the risks to which they are subject. For a discussion of E.ON Energie's and E.ON Sverige's nuclear accident protection, see Item 4. Information on the Company Environmental Matters.

## **DIVIDEND POLICY**

The Supervisory Board and the Board of Management jointly propose the Company's dividends based on E.ON AG's unconsolidated financial statements. The dividends are officially declared at the annual general meeting of shareholders which is usually convened during the second quarter of each year. The shareholders approve the dividends. Holders of E.ON's Ordinary Shares on the date of the annual general meeting of shareholders are entitled to receive the dividend, less any amounts required to be withheld on account of taxes or other governmental charges. See also Item 10. Additional Information Taxation. Cash dividends payable to holders of Ordinary Shares are distributed by HypoVereinsbank as paying agent. In Germany, the payment will be made to the holder's custodian bank or other institution holding the shares for the shareholder which will credit the payment to the shareholder's account. For purposes of distribution in the United States, the dividend will be paid to JPMorgan Chase Bank N.A. as U.S. transfer agent. For ADS holders in the United States, the payment will be converted from euros to U.S. dollars unless the ADS holder instructs otherwise. The U.S. dollar amounts of dividends may be affected by fluctuations in exchange rates. See Item 3. Key Information Exchange Rates.

E.ON AG expects to continue to pay dividends, although there can be no assurance as to the particular amounts that may be paid from year to year. The payment of future dividends will depend upon E.ON's earnings, financial condition (including its cash needs), future earnings prospects and other factors. In March 2005, E.ON AG announced that it is committed to achieving a payout ratio of between 50 and 60 percent of net income excluding exceptional items by 2007. For information about the annual dividends paid per Ordinary Share of E.ON AG, see Item 3. Key Information Dividends.

## **SIGNIFICANT CHANGES**

For information about significant changes following December 31, 2006, see Item 4. Information on the Company History and Development of the Company.

## **Item 9. The Offer and Listing.**

### **GENERAL**

The principal trading market for the Ordinary Shares is the Frankfurt Stock Exchange together with XETRA, as described below. The Ordinary Shares are also traded on the other German stock exchanges in Berlin-Bremen, Düsseldorf, Hamburg, Hanover, Munich and Stuttgart. Options on Ordinary Shares are traded on the German derivatives exchange (*Eurex Deutschland*). E.ON believes that as of December 31, 2006, it had approximately 480,000 stockholders worldwide.

E.ON shares are listed on the NYSE in the form of ADSs and are traded under the symbol EON. In the past, the exchange ratio between E.ON ADSs and E.ON shares was 1:1. E.ON decided to change this ratio to 3:1 effective March 29, 2005. As of this date, three times as many ADSs are tradable on the NYSE, with three ADSs representing one Ordinary Share with a pro rata amount of the registered capital of E.ON AG calculated on a 2.60 share-equivalent basis. The depositary for the ADSs is JPMorgan Chase Bank N.A.

**Table of Contents****TRADING ON THE NEW YORK STOCK EXCHANGE**

The table below sets forth, for the periods indicated, the high and low closing sales prices for the ADSs on the NYSE, as reported on the NYSE Composite Tape.

	Price per ADS \$(1)	
	High	Low
<b>2002</b>	58.02	39.80
<b>2003</b>	65.44	38.52
<b>2004</b>	91.15	61.72
<b>2005</b>	35.01	27.67
First Quarter	31.01	28.21
Second Quarter	29.97	27.67
Third Quarter	33.73	29.14
Fourth Quarter	35.01	29.15
<b>2006</b>	45.36	34.30
First Quarter	38.39	35.60
Second Quarter	40.79	34.30
Third Quarter	42.92	36.10
Fourth Quarter	45.36	38.58
September	42.88	39.35
October	40.13	38.58
November	42.90	38.93
December	45.36	42.02
<b>2007</b>		
January	45.40	41.91
February	48.52	43.62

(1) One E.ON ADS equaled one Ordinary Share until March 28, 2005.

On March 2, 2007, the closing sale price per ADS on the NYSE as reported on the NYSE Composite Tape was \$42.04.

**TRADING ON THE FRANKFURT STOCK EXCHANGE**

The Frankfurt Stock Exchange is by far the most significant of the seven German stock exchanges. By the end of December 2006, the Frankfurt Stock Exchange together with XETRA accounted for approximately 90 percent of the total securities orderbook turnover in Germany. As of the end of 2006, the equity securities of 8,032 corporations, including 7,054 foreign corporations, were traded on the Frankfurt Stock Exchange.

The structure of the Frankfurt Stock Exchange (*Frankfurter Wertpapierbörse*) consists of the Prime Standard segment and the General Standard segment. The Prime Standard segment is designed for companies that wish to target international investors. Accordingly, Prime Standard companies are required to meet transparency criteria over and above those required for General Standard companies. E.ON's Ordinary Shares have been admitted to the Prime Standard segment.

Prices are continuously quoted on the Frankfurt Stock Exchange floor each business day between 9:00 a.m. and 8:00 p.m. Central European Time ( CET ) and on XETRA between 9:00 a.m. and 5:30 p.m. CET for E.ON Ordinary Shares, as well as for other actively traded shares. The Frankfurt Stock Exchange publishes a daily official list (*Orderbuchstatistik*) which includes the volume of recorded transactions in the shares comprising the *Deutsche Aktienindex* or DAX 30 Index (a performance index comprising the shares of the 30 largest German companies

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included in the Prime Standard, of which E.ON is one, and the key benchmark of trading on the Frankfurt Stock Exchange), together with the prices of the highest and lowest recorded trades of the day.

XETRA (*Exchange Electronic Trading System*) is a computerized trading platform that can be accessed by all market participants regardless of their geographical location. It is administered by Deutsche Börse AG and integrated into the Frankfurt Stock Exchange, and is subject to the Exchange's rules and regulations. Almost all of the equity securities listed on the Frankfurt Stock Exchange are traded on XETRA.

The table below sets forth, for the periods indicated, the high and low closing sales prices (*Schlusskurse*) for the Ordinary Shares on XETRA, as reported by the Frankfurt Stock Exchange, together with the highs and lows of the DAX 30 Index.

See the discussion under Item 3. Key Information – Exchange Rates for rates of exchange between the dollar and the euro applicable during the periods set forth below.

	Price Per		DAX 30 Index(1)	
	High	Low	High	Low
	( )		( in thousands)	
<b>2002</b>	59.97	38.16	5,462.55	2,597.88
<b>2003</b>	51.74	34.67	3,965.16	2,202.96
<b>2004</b>	67.06	49.27	4,261.79	3,646.99
<b>2005</b>	88.92	64.50	5,458.58	4,178.10
First Quarter	71.70	64.50	4,428.09	4,201.81
Second Quarter	73.68	69.60	4,627.48	4,178.10
Third Quarter	80.80	72.59	5,048.74	4,530.18
Fourth Quarter	88.92	72.25	5,458.58	4,806.05
<b>2006</b>	104.40	82.12	6,611.81	5,292.14
First Quarter	96.10	87.07	5,984.18	5,334.30
Second Quarter	100.35	82.12	6,140.72	5,292.14
Third Quarter	100.94	85.52	6,004.33	5,396.85
Fourth Quarter	104.40	91.50	6,611.81	5,992.22
September	100.94	92.65	6,004.33	5,773.72
October	94.96	91.50	6,284.19	5,992.22
November	98.25	91.73	6,476.13	6,223.33
December	104.40	94.52	6,611.81	6,241.13
<b>2007</b>				
January	104.24	96.59	6,789.11	6,566.56
February	111.65	99.14	7,027.59	6,715.44

(1) The DAX 30 Index is a continuously updated, capital-weighted performance index of 30 German blue chip companies. E.ON represented approximately 9.23 percent of the DAX 30 Index as of March 2, 2007. In principle, the shares included in the DAX 30 Index were selected on the basis of their stock exchange turnover and their market capitalization. Adjustments of the DAX 30 Index are made for capital changes, subscription rights and dividends.

On March 2, 2007, the closing sale price per Ordinary Share on XETRA, as reported by the Frankfurt Stock Exchange, was 96.40, equivalent to \$126.87 per Ordinary Share, translated at the euro Foreign Exchange Rate as published on Reuters page EUROFX/1 on such date.

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**Item 10. Additional Information.**

**MEMORANDUM AND ARTICLES OF ASSOCIATION**

***Organization, Register and Entry Number***

E.ON AG is a stock corporation organized under the laws of the Federal Republic of Germany. It is entered in the Commercial Register maintained by the local court of Düsseldorf, Germany, under the entry number HRB 22315.

***Objects and Purposes***

The purposes of the Company, described in Section 2 of E.ON AG's Articles of Association (*Satzung*), are the supply of energy (primarily electricity and gas) and water as well as the provision of disposal services. The Company's activities may encompass generation and/or production, transmission and/or transport, purchasing, selling and trading. Plants of all kinds may be built, purchased and operated; services and cooperations of all kinds may be performed.

Furthermore, the Company is entitled to run businesses in the chemicals sector, primarily in the special and constructional chemistry areas, as well as in the real estate industry and telecommunications sector.

Further, its Articles of Association authorize E.ON AG to conduct business itself or through subsidiaries or associated companies in these or related areas. The Company is entitled to take all actions and measures related to its purpose or suited to serve its purpose, directly or indirectly.

E.ON may also establish and purchase other companies, and may acquire shareholdings in other companies, particularly companies active, in whole or in part, in the business areas set forth above. The Articles of Association further authorize E.ON to acquire interests in companies of all kinds with the primary objective of investing financial resources, regardless of whether the company operates within one of E.ON's stated business sectors.

***Corporate Governance***

German stock corporations are governed by three separate bodies: the annual general meeting of shareholders, the supervisory board and the board of management. Their roles are defined by German law and by the corporation's articles of association, and may be described generally as follows:

*The annual general meeting of shareholders* ratifies the actions of the corporation's supervisory board and board of management. It decides, among other things, on the amount of the annual dividend, the appointment of an independent auditor and certain significant corporate transactions. In corporations with more than 2,000 employees, shareholders and employees elect or appoint an equal number of representatives to the supervisory board. The annual general meeting must be held within the first eight months of each fiscal year.

*The supervisory board* appoints and removes the members of the board of management and oversees the management of the corporation. Although prior approval of the supervisory board may be required in connection with certain significant matters, the law prohibits the supervisory board from making management decisions.

*The board of management* manages the corporation's business and represents it in dealings with third parties. The board of management submits regular reports to the supervisory board about the corporation's operations

and business strategies, and prepares special reports upon request. A person may not serve on the board of management and the supervisory board of a corporation at the same time.

In February 2002, a government commission appointed by the German Minister of Justice presented the new German Corporate Governance Code, which is described in more detail below. A new Transparency and Publicity Act (*Transparenz- und Publizitätsgesetz*) came into effect in July 2002. A new Article 161 was also added to the Stock Corporation Act, stipulating that the board of management and supervisory board of German listed companies shall declare once a year that the recommendations of the Code have been and are being complied with, or identify which of the Code's recommendations have not been or are not being applied. E.ON has submitted



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this declaration each year since 2002 as required. For more information, see Significant Differences in Corporate Governance Practices for Purposes of Section 303A.11 of the New York Stock Exchange Listed Company Manual (the NYSE Manual ) below.

E.ON has always welcomed the creation of uniform corporate governance standards. E.ON believes that the Code will make the German system of corporate governance more transparent and promote the trust of international and national investors and the general public in the management and supervision of German listed companies. Taking the Code as a basis, in 2002 E.ON reviewed its internal rules and procedures relating to shareholders' meetings, the interaction between the Board of Management and the Supervisory Board and the transparency of its financial reporting, as well as the Company's procedures for accounting and auditing. E.ON concluded from this review that the Company had already been following a majority of the Code's recommendations for some time before the Code was published, reflecting E.ON's value-oriented corporate governance principles and capital markets-oriented accounting and reporting policies. In order to promote the transparency and efficiency of the Supervisory Board's activities, rules of procedure for the Supervisory Board were adopted on December 19, 2002 and it was decided to set up an audit committee, as well as a finance and investment committee, in addition to the already existing committees.

*Cooperation between the Board of Management and the Supervisory Board.* The E.ON Board of Management manages the business of the Company, with all its members bearing joint responsibility for its decisions, in accordance with German law. The Board of Management establishes the Company's objectives, sets its fundamental strategic direction, and is responsible for corporate policy and group organization. This includes, in particular, the management of the Group and its financial resources, the development of its human resources strategy, the appointment of persons to management posts within the Group and the development of its managerial staff, as well as the presentation of the Group to the capital markets and to the public at large. In addition, the Board of Management is responsible for coordinating and supervising the Group's market units in accordance with the Group's established strategy.

The Board of Management regularly reports to the Supervisory Board on a timely and comprehensive basis on all issues of corporate planning, business development, risk assessment and risk management. It also submits the Group's investment, finance and personnel plan for the coming fiscal year (as well as the medium-term plan) to the Supervisory Board for its approval at the last meeting of each fiscal year.

The Chairperson of the Board of Management informs the Chairperson of the Supervisory Board of important events that are of fundamental significance in assessing the condition, development and management of the Company and of any defects that have arisen in the Company's monitoring systems without undue delay. Transactions and measures requiring the approval of the Supervisory Board are also submitted to the Supervisory Board without delay.

*Conflicts of Interest.* In order to ensure that the Supervisory Board's advice and oversight functions are conducted on an independent basis, no more than two former members of the Board of Management may be members of the Supervisory Board. Supervisory Board members may also not hold a corporate office or perform any advisory services for key competitors of the Company. Supervisory Board members are required to disclose any information concerning conflicts of interest to the full Supervisory Board, particularly if the conflict arises from their advising or holding a corporate office with one of E.ON's customers, suppliers, creditors or other business partners. The Supervisory Board is required to report any conflicts of interest to the annual shareholders' meeting and to describe how the conflicts have been handled. Any material conflict of interest of a non-temporary nature will result in the termination of the member's appointment to the Supervisory Board. No conflicts of interest involving any members of the Supervisory Board were reported during 2006. In addition, any consulting or other service agreements between the Company and a member of the Supervisory Board require the prior consent of the full Supervisory Board. No such agreements existed during 2006.

Members of the Board of Management are also required to promptly report conflicts of interest to the Executive Committee of the Supervisory Board and to the full Board of Management. Members of the Board of Management may only assume other corporate positions, particularly appointments to the supervisory boards of non-Group companies, with the consent of the Executive Committee. Any material transactions between the Company and members of the Board of Management, their relatives or entities with which they have close personal

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ties require the consent of the Executive Committee, and all transactions must be conducted on an arm's-length basis. No such transactions took place during 2006.

*The Supervisory Board Committees.* The Supervisory Board has 20 members and, in accordance with the German Co-determination Act (*Mitbestimmungsgesetz*), is composed of an equal number of shareholder and employee representatives. It supervises the management of the Company and advises the Board of Management. The Supervisory Board has formed the following committees from among its members.

The Executive Committee consists of four members. It prepares meetings of the Supervisory Board and advises the Board of Management on matters of general policy relating to the strategic development of the Company. In urgent cases (*i.e.*, if waiting for the prior approval of the Supervisory Board would materially prejudice the Company), the Executive Committee decides on business transactions requiring prior approval by the Supervisory Board. The Executive Committee also performs the functions of a remuneration committee.

In particular, the Executive Committee prepares the Supervisory Board's personnel decisions and deals with issues of corporate governance. It reports to the Supervisory Board at least once a year on the status, effectiveness and possible ways of improving the Company's corporate governance and on new requirements and developments in this field.

The Audit Committee consists of four members who have special knowledge in the field of accounting or business administration. The Company believes that two of the Audit Committee's members—Dr. Karl-Hermann Baumann and Ulrich Hartmann—meet all of the requirements for being considered an audit committee financial expert within the meaning of Section 407 of Sarbanes-Oxley and the rules enacted thereunder, given their extensive experience in accounting and auditing matters, including the application of U.S. GAAP. E.ON relies on the exemption afforded by Rule 10A-3(b)(1)(iv)(C) under the Securities Exchange Act with respect to the independence of two of its members, Gabriele Gratz and Klaus-Dieter Raschke. The Company believes that such reliance does not materially adversely affect the ability of the Audit Committee to act independently or to satisfy the other requirements of Rule 10A-3.

The Audit Committee deals in particular with issues relating to the Company's accounting policies and risk management, issues regarding the independence of the Company's external auditors, the establishment of auditing priorities and agreements on auditors' fees, including E.ON's policy for the approval of all audit and permissible non-audit services performed by the Company's independent auditors. The Audit Committee also prepares the Supervisory Board's decision on the approval of the annual financial statements of E.ON AG and the acceptance of the annual consolidated financial statements. It also inspects the Company's Annual Report on Form 20-F and its quarterly reports and discusses the financial statements and the quarterly reports with the Company's independent auditors. For additional information, see Item 16C. Principal Accountant Fees and Services.

The Audit Committee also prepares the proposal on the selection of the Company's external auditors for the annual general meeting of shareholders. In order to ensure the auditors' independence, the Audit Committee secures a statement from the auditors proposed detailing any facts that could lead to the firm being excluded for independence reasons or otherwise conflicted. As a condition of their appointment, the external auditors agree to promptly inform the chair of the Audit Committee should any such facts arise during the course of the audit. The auditors also agree to promptly inform the Supervisory Board of anything arising during the course of their audit that is of relevance to the Supervisory Board's duties, and to inform the chair of the Audit Committee of, or to note in their audit report, any facts determined during the audit that contradict statements submitted by the Board of Management or Supervisory Board in connection with the requirements of the Code.

The Finance and Investment Committee consists of four members. It advises the Board of Management on all issues of Group financing and investment planning. It decides on behalf of the Supervisory Board on the approval of the acquisition and disposition of companies, company participations and parts of companies, as well as on finance

activities whose value exceeds 1 percent of the Group's equity, as listed in the latest consolidated balance sheet. If the value of any such transactions or activities exceeds 2.5 percent of this equity, the Finance and Investment Committee will prepare the Supervisory Board's decision on such matters.

*Measures Relating to the Sarbanes-Oxley Act.* As a company whose ADSs are listed on the NYSE, E.ON is subject to the U.S. federal securities laws and the jurisdiction of the U.S. securities regulator, the SEC. In particular,

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E.ON is subject to the provisions of Sarbanes-Oxley. The aim of Sarbanes-Oxley is to increase the monitoring, quality and transparency of financial reporting in light of corporate and accounting scandals in the United States, and its provisions generally apply to both U.S. and non-U.S. issuers with securities listed in the United States. E.ON has complied with all of the Sarbanes-Oxley requirements applicable to the Company, including for the first time Management's Report on Internal Control over Financial Reporting required by Section 404 of Sarbanes-Oxley. See Item 15. Controls and Procedures (which includes Management's Report on Internal Control over Financial Reporting), Item 16A. Audit Committee Financial Expert, Item 16B. Code of Ethics, Item 16C. Principal Accountant Fees and Services, Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers and the certifications appearing as exhibits at the end of this annual report. See Item 18. Financial Statements for the Report of the Independent Registered Public Accounting Firm on the Company's internal control over financial reporting.

E.ON has instituted the following measures to improve the transparency of its corporate governance and financial reporting:

In addition to E.ON's general Code of Conduct for all employees, the Company has developed a special Code of Ethics for members of the Board of Management and senior financial officers and published the text on its corporate website at [www.eon.com](http://www.eon.com). Material appearing on the website is not incorporated by reference in this annual report. This code obliges these managers to make full, appropriate, accurate, timely and understandable disclosure of information both in the documents E.ON submits to the SEC and in its other corporate publications.

In accordance with an SEC recommendation, E.ON has established a Disclosure Committee that is responsible for ensuring that effective procedures and control mechanisms for financial reporting are in place and for providing a correct and timely presentation of information to the financial markets. The committee is comprised of seven members from various sectors of E.ON AG who have a good overview of the Group and the processing of information relating to the quarterly reports and annual financial statements.

***Certain Provisions with Respect to Board Members***

As a member of the Supervisory Board or Board of Management, a person is not permitted to vote on resolutions relating to transactions between himself and the Company. Further, contracts between members of the Supervisory Board and the Company require consent of the entire Supervisory Board, unless the contract establishes an employment relationship or relates to the member's services on the Board. Members of both Boards are prohibited from voting on resolutions relating to the initiation or settlement of litigation between themselves and the Company. Compensation of Board of Management members is determined by the Supervisory Board while compensation for the Supervisory Board is stipulated in E.ON AG's Articles of Association. For more information about E.ON's Board of Management and Supervisory Board, see Item 6. Directors, Senior Management and Employees.

***Ordinary Shares***

The share capital of E.ON AG consists of Ordinary Shares with no par value. Certain provisions with respect to the Ordinary Shares under German law and E.ON AG's Articles of Association may be summarized as follows:

*Dividends.* Dividends in respect of Ordinary Shares are declared once a year at the annual general meeting of shareholders. For each fiscal year, the Board of Management approves E.ON AG's unconsolidated financial statements and submits them together with a proposal regarding the distribution of profits to the Supervisory Board for its approval. After examining the financial statements and proposal for profit distribution, the Supervisory Board presents a report in writing at the annual general shareholders' meeting. On the basis of the Supervisory Board's report, the shareholders vote on the Board of Management's proposal regarding the disposition of all unappropriated profits,

including the amount of net profits to be distributed as a dividend. E.ON's shareholders participate in the distribution of dividends of the Company in proportion to their ownership of the outstanding share capital. Prior to dissolution of E.ON AG, the only amounts that may be distributed to shareholders under the Stock Corporation Act are the distributable profits (*Bilanzgewinn*).

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Notice of the dividends to be paid will be published in the electronic form of the German Federal Official Gazette (*elektronischer Bundesanzeiger*). For further information regarding E.ON dividends, see Item 3. Key Information Dividends and Item 8. Financial Information Dividend Policy.

*Voting Rights.* Each Ordinary Share entitles its holder to one vote. The members of the Supervisory Board are each elected for the same fixed term of approximately five years; they are not elected at staggered intervals. Cumulative voting is not permitted under German law. E.ON AG's Articles of Association require that resolutions of shareholders meetings be adopted by a simple majority of votes and, in certain circumstances, by a simple majority of the share capital of the Company, unless a higher vote is required by German law. Under German law, certain corporate actions require approval by 75 percent of the shares represented at the shareholders' meeting at which the matter is proposed. Such actions include, among others:

amending the articles of association to alter the objects and purposes of the company;

increasing or reducing the share capital;

excluding preemptive rights of shareholders to subscribe for new shares;

dissolving the corporation;

merging the corporation into, or consolidating the corporation with, another company;

transferring all or virtually all of the corporation's assets; and

changing corporate form.

*Shareholder Rights in Liquidation.* In accordance with German law, in the event of liquidation, the assets of E.ON remaining after discharge of its liabilities would be distributed to its shareholders in proportion to their shareholdings.

*Redemption.* Under German law, the share capital of E.ON AG may be reduced by a shareholder resolution amending the Articles of Association, passed by at least 75 percent of the share capital represented at the shareholders' meeting. See Changes in Capital below.

*Preemptive Rights.* Pursuant to E.ON AG's Articles of Association, the preemptive right (*Bezugsrecht*) of shareholders to subscribe for any issue of additional shares in proportion to their shareholdings in the existing capital may be excluded under certain circumstances.

Due to the restrictions on the offer and sale of securities in the United States under U.S. securities laws and regulations, there can be no assurance that any offer of new shares to existing shareholders on the basis of their preemptive rights will be open to U.S. holders of ADSs or Ordinary Shares.

### ***Changes in Rights of Shareholders***

Under German law, the rights of holders of E.ON shares may only be changed by a shareholder resolution amending the Articles of Association. The resolution must be passed by at least 75 percent of the share capital represented at the shareholders' meeting at which the issue was voted upon.

### ***Shareholders' Meetings***

The annual general meeting of shareholders is convened by E.ON's Board of Management or, when required by law, by its Supervisory Board, and must be held during the first eight months of the fiscal year. In addition, an extraordinary meeting of the shareholders may be called by the Board of Management, the Supervisory Board or shareholders owning in the aggregate at least 5 percent of the Company's issued share capital. There is no minimum quorum requirement for shareholder meetings. Each shareholder may be represented by a proxy by means of a written or electronic power of attorney. In Germany, non-institutional shareholders typically deposit their shares with a German bank (*Depotbank*). Such a bank may exercise the voting rights in relation to the deposited shares only if authorized to do so by a proxy of the shareholder. Such proxies are revocable at any time. If a shareholder giving a proxy does not give the bank instructions on how to exercise the voting rights, the bank will exercise the voting rights in accordance with its own proposals as previously communicated to the shareholder. Holders of ADSs may



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vote their shares by proxy by signing and returning the proxy card mailed to them by JPMorgan Chase Bank N.A. (the Depository ) in advance of the meeting. The Depository will, to the extent permitted by law, the Articles of Association and the provisions of the ADSs, vote or cause to be voted all ADSs for which it receives signed proxies by the applicable record date.

At the annual general meeting, shareholders are called upon to approve the distribution of Company profits, to ratify the actions of the Board of Management and the Supervisory Board taken during the prior year, and to appoint the Company's auditors. When necessary, other matters shall be resolved at shareholders' meetings in accordance with the relevant provisions of German law, including:

- election of members of the Supervisory Board (other than those elected by the employees);
- amendment of the Articles of Association;
- measures to increase or reduce share capital;
- mergers and similar transactions; and
- resolutions regarding the dissolution of the Company.

Notice of any shareholders' meeting, including an agenda describing items to be voted upon, shall be published in the electronic form of the German Federal Official Gazette (*elektronischer Bundesanzeiger*) and in one other major daily German newspaper no later than thirty days before the deadline for registration as described below. Holders of ADRs will be notified of any shareholders' meeting by the Depository.

At the annual general meeting of shareholders in 2005, E.ON AG's Articles of Association were amended with respect to the requirements that shareholders must comply with in order to be eligible to participate in, and vote at, any E.ON shareholders' meeting. Specifically, shareholders are required to:

- register in text form in the German or English language no later than the end of the seventh day prior to the day of the shareholders' meeting; and
- prove their right to participate in the shareholders' meeting and to exercise the voting right. This must occur by the end of the seventh day prior to the day of the shareholders' meeting by presenting proof of the shareholding in text form in the German or English language issued by the institution where the shares are deposited. Such proof of shareholding must relate to the beginning of the twenty-first day prior to the shareholders' meeting.

The registration of the shareholder as well as the proof of the shareholding must be received by the Company at an address specified in the notice of the shareholders' meeting.

Pursuant to a shareholder resolution approved at the former VEBA extraordinary shareholders' meeting held on February 10, 2000, the Company excluded share certification in order to save the Company and its shareholders the high costs of printing and distributing share certificates. The shareholders' right to share certificates and profit-sharing coupons is thus excluded except as provided by the rules governing stock exchanges on which the shares are listed. E.ON has not issued share certificates.

### ***Transparency and Corporate Reporting***

The Board of Management and Supervisory Board of E.ON AG place a great deal of value on the transparency of corporate governance. E.ON's shareholders, capital markets participants, financial analysts, shareholder groups and the media are regularly and promptly informed of the condition of, and any material changes in, the Company's business. E.ON makes particular use of the Internet in communicating with its shareholders and the financial markets in general.

In particular, the Company produces the following financial reporting materials on a regular basis:

quarterly reports;

annual reports prepared in accordance with German law (in both German and English);

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the Annual Report on Form 20-F;

a press conference at the time of release of the German annual report; and

telephone conferences for analysts following the release of quarterly or annual results, as well as other investor relations presentations.

The expected dates of issue for the Company's financial reports are summarized in the financial calendar, which is available on the Internet at [www.eon.com](http://www.eon.com). Material appearing on the website is not incorporated by reference in this annual report.

In addition to its regularly scheduled financial reporting, announcements of material events are published by the Company through the German *ad hoc* disclosure system, released to the press and submitted to the SEC on Form 6-K.

According to amendments to the Securities Trading Act effective as of January 20, 2007, listed German corporations must disseminate public information relating to, *inter alia*, insider information, directors' dealings and notifications on shareholdings throughout the European Economic Area through several means of communication, including both electronic and print media. In addition, investors must have access to this information, as well as the corporations' financial statements, on the Internet at [www.unternehmensregister.de](http://www.unternehmensregister.de). Material appearing on the website is not incorporated by reference in this annual report.

According to amendments to the German Commercial Code (*Handelsgesetzbuch*) that came into effect on January 20, 2007, representatives of issuers who prepare consolidated accounts for which Germany is the home member state pursuant to the Securities Trading Act have to affirm by written statements that, according to their best knowledge, the consolidated financial statements prepared in accordance with the applicable accounting standards give a true and fair view of the assets and liabilities, financial position and results (*Vermögens-, Finanz- und Ertragslage*) of the issuer and that the group management report (*Konzernlagebericht*) includes a fair review of the development and performance of the business and the position of the issuer, together with a description of the principal risks and important prospects the issuer faces. Annual and half-yearly financial reports for financial years beginning after December 31, 2006 are required to contain written statements to such effect.

### ***Foreign Share Ownership***

There are no limitations on the right to own Ordinary Shares, including the right of non-resident or foreign owners to hold or vote the Ordinary Shares, imposed by German law or the Articles of Association of E.ON AG.

### ***Change of Control Provisions***

There are no provisions in E.ON AG's Articles of Association that would have an effect of delaying, deferring or preventing a change in control of E.ON and that would only operate with respect to a merger, acquisition or corporate restructuring involving it or any of its subsidiaries. German law does not specifically regulate business combinations with interested shareholders. However, general principles of German law may restrict business combinations under certain circumstances.

### ***Disclosure of Shareholdings***

E.ON AG's Articles of Association do not require shareholders to disclose their shareholdings. The Securities Trading Act requires each investor whose investment in a German corporation (including E.ON AG) listed on organized

markets of a German, European Union or European Economic Area stock exchange reaches, passes or falls below 5 percent, 10 percent, 25 percent, 50 percent or 75 percent of the voting rights of such corporation to notify such corporation and BAFin promptly in writing. According to amendments to the Securities Trading Act effective as of January 20, 2007, the time period for such notification has been shortened from seven to four trading days. In addition, the amended Securities Trading Act has additional notification thresholds of 3 percent, 15 percent, 20 percent and 30 percent of the voting rights. The corporation, upon receipt of such notification, is obliged to publish such notification promptly, but in any event within three trading days. The same obligations apply to financial instruments that result in an entitlement to acquire, upon the holder's own initiative, shares which are

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already issued and to which voting rights are attached, except that notifications are not required when reaching, passing or falling below the 3 percent threshold.

Failure of a shareholder to notify the company will, for so long as such failure continues, disqualify such shareholder from exercising the voting rights attached to his shares. In connection with this requirement, the Securities Trading Act contains various rules designed to ensure the attribution of shares to the person who has effective control over the shares.

Additionally, the German Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*) requires the publication of the acquisition of control, which is defined as the holding of at least 30 percent of the voting rights in a target company, within seven days.

The Securities Trading Act also requires the reporting of certain directors' dealings. According to the Act, persons discharging managerial responsibilities within a publicly traded issuer have to notify both the issuer and BAFin about their transactions relating to the issuer's shares and derivatives or other financial instruments linked to those shares. Certain persons closely associated with these managers, for example spouses, dependent children, or other relatives sharing the same household, are under the same obligation. Similarly, the reporting obligation also applies to legal entities, trusts and partnerships that are managed or controlled by any such manager or associated person, or that are set up for the benefit of such a person, or whose economic interests are substantially equivalent to those of such person. There is no notification obligation until the total amount of transactions of a covered manager and all his or her associated persons is at least 5,000 during any calendar year. The issuer is obliged to publish all notifications it receives on its website; E.ON made available all such disclosure received during 2006 on its website. Material appearing on the website is not incorporated by reference in this annual report.

***Changes in Capital***

Under German law, share capital may be increased in consideration of contributions in cash or in kind. To prepare such capital increase, the company may establish authorized capital (*Genehmigtes Kapital*) or conditional capital (*Bedingtes Kapital*). Authorized capital provides a company's board of management with the flexibility to issue new shares for a period of up to five years. Conditional capital allows the board of management to issue new shares for specified purposes, including employee stock option plans, mergers and the issuance of shares upon conversion of bonds with warrants and convertible bonds. Capital increases and the establishment of authorized or conditional capital require an amendment to the articles of association approved by 75 percent of the issued shares present at the shareholders' meeting at which the increase is proposed. The board of management must also obtain the approval of the supervisory board before issuing new shares. Likewise, the share capital may be reduced. This requires shareholders' authorization passed by at least 75 percent of the share capital represented at the shareholders' meeting. If those shares are to be canceled, an additional resolution of the board of management approved by the supervisory board to amend the articles of association to take into account the reduction in share capital is required. E.ON AG's Articles of Association do not contain conditions regarding changes in the share capital that are more stringent than German law requires.

***Authorized and Conditional Capital.*** Subject to the approval of the Supervisory Board, the Board of Management is authorized to increase the Company's capital stock until April 27, 2010 by up to 540,000,000 through the one-time or repeated issuance of new Ordinary Shares in return for cash or in kind contributions. E.ON shareholders generally have pre-emptive rights with respect to the issuance of authorized shares issued in return for cash contributions, though their rights may be excluded by the Board of Management, subject to approval by the Supervisory Board, under certain circumstances set forth in the Articles of Association. Subject to the approval of the Supervisory Board, the Board of Management is authorized to exclude the shareholders' pre-emptive rights with respect to the issuance of authorized shares issued in return for contributions in kind.

Also pursuant to its Articles of Association, E.ON's capital stock has been conditionally increased by up to 175,000,000. This conditional increase may be implemented only to the extent that holders of conversion rights or obligations or option rights issued under a program authorized by the E.ON shareholders on April 30, 2003 exercise their conversion or option rights or to the extent that the increase is necessary for the fulfillment of conversion obligations and no own shares are used for servicing.

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For more information regarding the Company's capital stock, see Note 17 of the Notes to Consolidated Financial Statements.

*Share Buyback.* Pursuant to shareholder resolutions approved at the annual general meeting of shareholders held on May 4, 2006, the Board of Management is authorized to buy back up to 10 percent of E.ON AG's outstanding share capital through November 4, 2007. For additional details on this share buyback plan and share repurchases in 2006, see Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers. See also Note 17 of the Notes to Consolidated Financial Statements for information on share repurchases in 2006, 2005 and 2004.

***Significant Differences in Corporate Governance Practices for Purposes of Section 303A.11 of the New York Stock Exchange Listed Company Manual (the NYSE Manual)***

Corporate governance principles for German stock corporations (*Aktiengesellschaften*) are set forth in the Stock Corporation Act, the Co-Determination Act and the German Corporate Governance Code. E.ON believes the following to be the significant differences between German corporate governance practices, as E.ON has implemented them, and those applicable to U.S. companies under NYSE listing standards, as set forth in Section 303A of the NYSE Manual.

*E.ON's Implementation of the German Corporate Governance Code.* The German Corporate Governance Code was released in 2002 by a commission comprised of German corporate governance experts, including top managers of large German companies and representatives of institutional and retail investors, academia, the accounting profession and labor unions, that was appointed by the German Federal Ministry of Justice in 2001. The Code has been amended twice since its initial release, most recently in June 2005. As a general rule, the Code will be reviewed annually and amended if necessary to reflect international corporate governance developments. The Code describes and summarizes the basic mandatory statutory corporate governance principles found in the Stock Corporation Act and other provisions of German law. In addition, it contains supplemental recommendations and suggestions for standards on responsible corporate governance intended to reflect generally accepted best practice.

The Code addresses six core areas of corporate governance. These are (i) shareholders and shareholders' meetings, (ii) the interaction between the board of management (*Vorstand*) and the supervisory board (*Aufsichtsrat*), (iii) the board of management, (iv) the supervisory board, (v) transparency and (vi) accounting and audits. Although these corporate governance issues are similar to those covered by the NYSE corporate governance guidelines and code of business conduct that a U.S. company subject to the NYSE listing standards must adopt and disclose, the Code's provisions as such are not legally binding.

The Code contains three types of provisions. First, the Code describes and summarizes the existing statutory, *i.e.*, legally binding, corporate governance framework set forth in the Stock Corporation Act and in other German laws. Those laws—and not the incomplete and abbreviated summaries of them reflected in the Code—must be complied with. The second type of provisions are recommendations. While these are not legally binding, §161 of the Stock Corporation Act requires that a German stock corporation listed on a stock exchange in the European Union or European Economic Area must issue an annual compliance report stating which of these Code recommendations, if any, are not being applied. The third and final type of Code provisions comprises suggestions which issuers may choose not to adopt without making any related disclosure. The Code contains a significant number of such suggestions, covering almost all of the core areas of corporate governance it addresses.

E.ON issued its annual compliance report for 2006 on December 13, 2006. E.ON's report notes that it has complied with all of the legally binding provisions of the Code, as well as with all of its recommendations, other than those relating to directors' and officers' insurance (the Code recommends that such policies include a deductible, E.ON includes such a deductible only since June 16, 2006). This point is not expressly addressed by the NYSE listing

standards applicable to U.S. companies. A copy of the complete compliance report is available on E.ON's website at [www.eon.com](http://www.eon.com). Information appearing on the website is not incorporated by reference into this annual report.

*A German Stock Corporation is Required to Have a Two-Tier Board System.* A German stock corporation is required by the Stock Corporation Act to have both a supervisory board and a board of management. This contrasts



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with the unitary board of directors envisaged by the relevant laws of all U.S. states and the NYSE listing standards. Under the Stock Corporation Act, the two boards are separate and no individual may be a member of both boards. Both the members of the board of management and the members of the supervisory board owe a duty of loyalty and care to the stock corporation.

The board of management is responsible for managing the company and representing the company in its dealings with third parties. The board of management is also required to ensure appropriate risk management within the corporation and to establish an internal monitoring system. The members of the board of management, including its chairman or speaker, are regarded as equals and share collective responsibility for all management decisions.

The supervisory board appoints and removes the members of the board of management. Although it is not permitted to make management decisions, the supervisory board has comprehensive monitoring functions, including advising the company on a regular basis and participating in decisions of fundamental importance to the company. To ensure that these monitoring functions are carried out properly, the board of management must, among other things, regularly report to the supervisory board with regard to current business operations and business planning, including any deviation of actual developments from concrete and material targets previously presented to the supervisory board. Transactions of fundamental importance to the stock corporation, such as major strategic decisions or other actions that may have a fundamental impact on the company's assets and liabilities, financial condition or results of operations, are also subject to the consent of the supervisory board. The supervisory board may also request special reports from the board of management at any time.

The supervisory board of a large company like E.ON is subject to the German principle of employee co-determination of the company's fundamental business direction. Accordingly, under the German Co-determination Act, E.ON's Supervisory Board consists of representatives of the shareholders and representatives of the employees. E.ON's employees have the right to elect one-half of the total of 20 Supervisory Board members. In addition, the Chairman of E.ON's Supervisory Board is a shareholder representative who has the deciding vote in the event of a tie.

*The Committees Required by the NYSE Manual are Not Required Under the Stock Corporation Act or the Code.* The only supervisory board committee required under German law is a mediation committee, which is required in companies with more than two thousand employees in Germany that are subject to the principle of employee co-determination. This committee's function is to assist the supervisory board by making proposals for board of management member nominees in the event that the two-thirds majority of employee votes needed to appoint a board of management member is not met. However, the Code contains the recommendation that the supervisory board also establish one or more committees with sufficiently qualified members. In particular, it recommends establishing an audit committee to handle issues of accounting and risk management, auditor independence, the engagement and compensation of outside auditors appointed by the shareholders' meeting and the determination of auditing focal points. The Code suggests that the chairman of the audit committee should not be the current chair of the supervisory board or a former member of the board of management of the stock corporation. The Code also includes suggestions on other subjects that may be handled by committees, including corporate strategy, compensation of the members of the board of management, investments and financing. Under the Stock Corporation Act, any supervisory board committee must regularly report to the supervisory board.

E.ON has created a Finance and Investment Committee, an Audit Committee and an Executive Committee. As a result of its listing on the NYSE, E.ON's Audit Committee is required to comply with the provisions of Section 301 of Sarbanes-Oxley and Rule 10A-3 of the U.S. Securities Exchange Act of 1934 ( Rule 10A-3 ), which are also applicable to U.S. companies. E.ON believes that its Audit Committee is in compliance with the provisions of Rule 10A-3 applicable to foreign private issuers. E.ON is also required to disclose information concerning any audit committee financial expert (as defined in the relevant SEC rules) serving on its Audit Committee, the fees E.ON pays to its auditors for various services and the policies E.ON has for approving engagements of these auditors, and has done so

in Item 16 of this annual report.

*E.ON's Audit Committee is Not Subject to All of the Requirements the NYSE Manual Applies to U.S. Companies.* E.ON's Audit Committee is not subject to requirements similar to those applied to U.S. companies under Section 303A.02 or Section 303A.07 of the NYSE Manual. These requirements include an affirmative determination that audit committee members are independent according to stricter criteria than those set forth in

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Rule 10A-3 as applicable to foreign private issuers, the adoption of an annual performance evaluation, and the review of an auditor's report describing internal quality-control issues and procedures and all relationships between the auditor and the corporation. The Code requires that the supervisory board and the audit committee monitor the work of the independent auditors and receive reports from the auditors on their activities. However, these reporting requirements are not as detailed as those set forth in Section 303A.07 of the NYSE Manual.

German corporate law does not require an affirmative independence determination, meaning that the supervisory board need not make affirmative findings that audit committee members are independent. Nevertheless, both the Stock Corporation Act and the Code contain several rules, recommendations and suggestions to ensure the supervisory board's independent advice and supervision of the board of management. Under the Stock Corporation Act, advisory, service and certain other contracts between a member of the supervisory board and the company require the supervisory board's approval. A similar requirement applies to loans granted by the stock corporation to a supervisory board member or other persons, such as certain members of the supervisory board member's family. In addition, the Code recommends that no more than two former members of the board of management be members of the supervisory board and that supervisory board members not exercise directorships or accept advisory tasks for important competitors of the stock corporation. Furthermore, the Code suggests that the chairman of the audit committee should not be the current chair of the supervisory board or a former member of the board of management of the stock corporation, and E.ON has complied with that suggestion.

The Code recommends that each member of the supervisory board inform the supervisory board of any conflicts of interest which may result from a consulting or directorship function with clients, suppliers, lenders or other business partners of the stock corporation. In the case of material conflicts of interest or ongoing conflicts, the Code recommends that the mandate of the supervisory board member be terminated. The Code further recommends that any conflicts of interest that have occurred be reported by the supervisory board at the annual shareholders' meeting, together with the action taken, and that potential conflicts of interest be also taken into account in the nomination process for the election of supervisory board members.

Section 303A.02 of the NYSE Manual also imposes independence requirements on members of audit committees of U.S. companies that are more stringent than those set forth in Rule 10A-3, requiring, for instance, that any director who is an employee of an issuer will not be considered independent until three years after the end of such employment relationship. E.ON's Audit Committee, in accordance with the requirements of the Co-Determination Act (and as permitted by Rule 10A-3, as applicable to foreign private issuers), includes two current employees, neither of whom is an executive officer, as well as the former chairman of E.ON's Board of Management, who retired from E.ON's Board of Management in May 2003.

### **MATERIAL CONTRACTS**

In May 2002, in connection with E.ON's acquisition of Ruhrgas, E.ON reached a definitive agreement with RAG to acquire RAG's more than 18 percent interest in Ruhrgas and to sell E.ON's majority interest in Degussa to RAG. See also Item 4. Information on the Company History and Development of the Company Ruhrgas Acquisition. An English translation of the Framework Agreement between RAG AG, RAG Beteiligungs-GmbH, RAG Projektgesellschaft mbH and EBV Aktiengesellschaft, and E.ON AG, Chemie Verwaltungs AG and E.ON Vermögensanlage GmbH has been incorporated by reference as an exhibit to this annual report.

In May 2005, E.ON sold Viterra to Deutsche Annington. The details of the transaction are described in more detail in Item 4. Information on the Company Business Overview Discontinued Operations Other Activities. A copy of the sale and purchase agreement has been incorporated by reference as an exhibit to this annual report.

In connection with financing the proposed acquisition of Endesa, E.ON has entered into the Facility Agreement and the Supplemental Facility Agreement. For more information, including the parties to and amounts and terms of these agreements, see Item 4. Information on the Company History and Development of the Company Proposed Endesa Acquisition. Copies of the Facility Agreement and the Supplemental Facility Agreement have been incorporated by reference as exhibits to this annual report.

**Table of Contents****EXCHANGE CONTROLS**

At the present time, Germany does not restrict the movement of capital between Germany and other countries or individuals except Iraq, certain persons and entities associated with Osama bin Laden, the Al-Qaida network and the Taliban and certain other countries and individuals subject to embargoes in accordance with German law and applicable resolutions adopted by the United Nations and the EU. However, for statistical purposes only, every individual or corporation residing in Germany (a Resident ) must report to the German Central Bank (*Deutsche Bundesbank*), subject only to certain immaterial exceptions, any payment received from or made to or on account of an individual or a corporation resident outside of Germany (a Non-resident ) if such payment exceeds 12,500 (or the equivalent in a foreign currency). In addition, Residents must report any claims against or any liabilities payable to Non-residents if such claims or liabilities, in the aggregate, exceed 5 million (or the equivalent in a foreign currency) at the end of any month. Residents are also required to report annually any shareholdings of 10 percent or more held in non-resident corporations with total assets of more than 3 million, and resident corporations with assets in excess of 3 million must report annually any shareholdings of 10 percent or more in the company held by a Non-resident.

**TAXATION**

The following is a summary of material U.S. federal income tax and German tax considerations relating to the ownership of ADSs or Ordinary Shares. The discussion is based on tax laws of the United States and Germany as in effect on the date of this annual report, including the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital and to Certain Other Taxes (the Income Tax Treaty ), and the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances, and Gifts (the Estate Tax Treaty ). Such laws are subject to change. In particular, changes to the Income Tax Treaty are expected to enter into effect in 2007.

The discussion is limited to a general description of certain U.S. federal income and German tax consequences with respect to ownership and disposition of ADSs or Ordinary Shares by a U.S. Holder. In general, a U.S. Holder is any beneficial owner of ADSs or Ordinary Shares (1) who is a resident of the United States for the purposes of the Income Tax Treaty, (2) who is not also a resident of the Federal Republic of Germany for the purposes of the Income Tax Treaty, (3) who owns the ADSs or Ordinary Shares as capital assets, (4) who does not hold ADSs or Ordinary Shares as part of the business property of a permanent establishment or a fixed base located in Germany and (5) who is entitled to benefits under the Income Tax Treaty with respect to income and gain derived in connection with the ADSs or Ordinary Shares. The discussion does not purport to be a comprehensive description of all the tax considerations that may be relevant to the ownership of ADSs or Ordinary Shares, and, in particular, it does not address U.S. federal taxes other than income tax or German taxes other than income tax, gift and inheritance taxes. Moreover, the discussion does not consider any specific facts or circumstances that may apply to a particular U.S. Holder, some of which (for example, tax-exempt entities, persons that own, directly or indirectly, 10 percent or more of any class of the Company's stock, holders subject to the alternative minimum tax, securities broker-dealers and certain other financial institutions, holders who hold the ADSs or Ordinary Shares in a hedging transaction or as part of a straddle or conversion transaction or holders whose functional currency is not the U.S. dollar) may be subject to special rules.

Owners of ADSs or Ordinary Shares are strongly urged to consult their tax advisers regarding the U.S. federal, state, local, German and other tax consequences of owning and disposing of ADSs or Ordinary Shares. In particular, owners of ADSs or Ordinary Shares are urged to consult their tax advisers to confirm their status as U.S. Holders and the consequence to them if they do not so qualify.

In general, for U.S. federal income tax purposes and for purposes of the Income Tax Treaty, holders of ADSs will be treated as the owners of the Ordinary Shares represented by those ADSs.

**Table of Contents****TAXATION OF GERMAN CORPORATIONS**

Profits earned by a German resident corporation are subject to a uniform corporate income tax rate of 25 percent. German resident corporations are also subject to a solidarity surcharge equal to 5.5 percent of their corporate income tax liability. The aggregate corporate income tax and solidarity surcharge amount to 26.375 percent. In addition to these taxes, profits of a German resident corporation are subject to a municipal trade income tax. This tax is levied at rates set by each municipality in which the corporation maintains a business establishment. The municipal trade income tax is an allowable deduction for corporate income and municipal trade income tax purposes.

**TAXATION OF DIVIDENDS**

The Company is generally required to withhold tax on dividends in an amount equal to 20 percent of the gross amount paid to resident and non-resident stockholders. There is a 5.5 percent solidarity surcharge on the German withholding tax on dividend distributions paid by the Company. The surcharge amounts to 1.1 percent (5.5 percent  $\times$  20 percent) of the gross dividend amount. This results in an aggregate withholding rate of 21.1 percent. A full refund of this surcharge and partial refund of the withholding tax can be obtained by U.S. Holders under the Income Tax Treaty. In the case of any U.S. Holder, other than a U.S. corporation owning ADSs or Ordinary Shares representing at least 10 percent of the voting stock of the Company, the German withholding tax is refunded to reduce such tax to 15 percent of the gross amount of the dividend.

For U.S. federal income tax purposes, the gross amount of dividends paid on Ordinary Shares, without reduction for German withholding tax, generally will be subject to U.S. federal income taxation as foreign source dividend income, and will not be eligible for the dividends received deduction generally allowed to U.S. corporations. Subject to certain exceptions for short-term and hedged positions, an individual U.S. Holder generally will be subject to U.S. taxation at a maximum rate of 15 percent in respect of dividends received before 2011 if the dividends are qualified dividends. Dividends that the Company pays generally will be treated as qualified dividends if the Company was not, in the year prior to the year in which the dividend was paid, and is not, in the year in which the dividend is paid, a passive foreign investment company ( PFIC ). Based on the Company's audited consolidated financial statements and relevant market and shareholder data, the Company believes that it was not treated as a PFIC for U.S. federal income tax purposes with respect to its 2005 or 2006 taxable year. In addition, based on the Company's audited consolidated financial statements and current expectations regarding the value and nature of its assets, the sources and nature of its income, and relevant market data, the Company does not anticipate becoming a PFIC for its 2007 taxable year.

German withholding tax, up to the 15 percent rate provided under the Income Tax Treaty, will be treated as a foreign income tax that, subject to generally applicable limitations under U.S. tax law, generally is eligible for credit against a U.S. Holder's U.S. federal income tax liability or, at the holder's election, may be deducted in computing its taxable income. Thus, for a declared dividend of \$100 with respect to which the Company withholds German tax at a rate of at least 15 percent, a U.S. Holder would be deemed to have paid German taxes of \$15. Foreign tax credits may not be allowed for withholding taxes imposed in respect of certain short-term or hedged positions in securities. U.S. Holders should consult their own advisers concerning the implications of these rules in light of their particular circumstances.

Dividends paid in euros to a U.S. Holder of ADSs or Ordinary Shares will be included in income in a dollar amount calculated by reference to an exchange rate in effect on the date the dividends are received by such holder (or, in the case of the ADSs, by the Depositary). If dividends paid in euros are converted into dollars on the date the dividends are received or treated as received by a U.S. Holder, the holder generally should not be required to recognize foreign currency gain or loss in respect of its dividend income. However, a U.S. Holder may be required to recognize domestic-source foreign currency gain or loss on the receipt of a refund in respect of German withholding tax to the extent the U.S. dollar value of the refund differs from the U.S. dollar equivalent of that amount on the date of receipt of the underlying dividend.





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**REFUND PROCEDURES**

Individual claims for refund are made on a special German form, which must be filed with the German tax authorities: *Bundeszentralamt für Steuern*, 53221 Bonn, Germany. Copies of the required form may be obtained from the German tax authorities at the same address, or from the Embassy of the Federal Republic of Germany, 4645 Reservoir Road N.W., Washington D.C. 20007-1998.

As part of the individual refund claim, a U.S. Holder must submit to the German tax authorities the original bank voucher (or certified copy thereof) issued by the paying entity documenting the tax withheld, and an official certification on IRS Form 6166 of its last filed United States federal income tax return. IRS Form 6166 generally may be obtained by filing a request (generally an IRS Form 8802) with the Internal Revenue Service Center in Philadelphia, Pennsylvania, U.S. Residency Certification Request, P.O. Box 16347, Philadelphia, PA 19114-0447. U.S. Holders should consult a tax adviser and the instructions to the IRS Form 8802 for further details regarding how to obtain this certification.

Claims must be filed within four years of the end of the calendar year in which the dividend was received.

Under a simplified refund procedure based on electronic data exchange (*Datenträgerverfahren*), a broker which is registered as a participant in the electronic data exchange procedure with the *Bundeszentralamt für Steuern* may file a collective refund claim on behalf of all of the U.S. Holders for whom it holds ADSs or Ordinary Shares in custody.

The refund is assessed against and paid to the broker, which will then pay the refund to the U.S. Holders for whom it is acting. The *Bundeszentralamt für Steuern* is entitled to review the U.S. Holders' eligibility for a refund of withholding tax under the Income Tax Treaty. The data transmitted by the broker may be used by the German tax authorities for administrative exchange of information between Germany and the United States.

Another simplified refund procedure applies if ADSs of a U.S. Holder are registered with brokers participating in the Depository Trust Company ( DTC ). Pursuant to administrative procedures agreed between the German Federal Ministry of Finance and the DTC, claims for refunds payable under the Income Tax Treaty to such U.S. Holders may be submitted to the German tax authorities by the DTC (or a custodian as its designated agent) collectively on behalf of all such U.S. Holders. Details of the collective refund procedure will be available from the DTC.

The *Bundeszentralamt für Steuern* will issue refunds to the DTC, which will issue corresponding refund checks to the participating brokers. The *Bundeszentralamt für Steuern* is entitled to conduct eligibility reviews, generally within a period of four years.

Refunds under the Treaty are not available in respect of Ordinary Shares or ADSs held in connection with a permanent establishment or fixed base in Germany.

**TAXATION OF CAPITAL GAINS**

Under the Income Tax Treaty, a U.S. Holder will be protected against German tax on capital gains realized or accrued on the sale or other disposition of ADSs or Ordinary Shares provided the assets of the Company do not consist and have not consisted predominantly of immovable property situated in Germany.

Upon a sale or other disposition of ADSs or Ordinary Shares, a U.S. Holder will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the U.S. dollar value of the amount realized and the U.S. Holder's U.S. dollar tax basis in the ADSs or Ordinary Shares. Such gain or loss will generally be capital gain or loss, and will be long-term capital gain or loss if the U.S. Holder's holding period for the ADSs or Ordinary

Shares exceeds one year. The net amount of long-term capital gain recognized by an individual U.S. Holder generally is subject to taxation at a minimum rate of 15 percent for gains recognized prior to 2011. Deposits and withdrawals of Ordinary Shares in exchange for ADSs generally will not result in realization of gain or loss for U.S. federal income tax purposes.

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### **GIFT AND INHERITANCE TAXES**

The Estate Tax Treaty provides that an individual whose domicile is determined to be in the United States for purposes of such Treaty will not be subject to German inheritance and gift tax (the equivalent of the United States federal estate and gift tax) on the individual's death or making of a gift unless the ADSs or Ordinary Shares (1) are part of the business property of a permanent establishment located in Germany or (2) are part of the assets of a fixed base of an individual located in Germany and used for the performance of independent personal services. An individual's domicile in the United States, however, does not prevent imposition of German inheritance and gift tax with respect to an heir, donee, or other beneficiary who either is or is deemed to be resident in Germany at the time the individual died or the gift was made.

The Estate Tax Treaty also provides a credit against U.S. federal estate and gift tax liability for the amount of inheritance and gift tax paid to Germany, subject to certain limitations, in a case where the ADSs or Ordinary Shares are subject to German inheritance or gift tax and U.S. federal estate or gift tax.

### **OTHER GERMAN TAXES**

There are no German transfer, stamp or other similar taxes that would apply to U.S. Holders who purchase or sell ADSs or Ordinary Shares.

### **INFORMATION REPORTING AND BACKUP WITHHOLDING**

Dividends on Ordinary Shares or ADSs, and payments of the proceeds of a sale of Ordinary Shares or ADSs, paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting and may be subject to backup withholding unless the holder (1) is a corporation or other exempt recipient or (2) provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. Holders that are not U.S. persons generally are not subject to information reporting or backup withholding. However, such a holder may be required to provide a certification to establish its non-U.S. status in connection with payments received within the United States or through certain U.S.-related financial intermediaries.

### **DOCUMENTS ON DISPLAY**

E.ON AG is subject to the reporting requirements of the Securities Exchange Act of 1934, as amended. In accordance with these requirements, E.ON files reports and other information with the Securities and Exchange Commission. These materials, including this annual report and its exhibits, may be inspected and copied at the SEC's Public Reference Room at 100 F Street N.E., Washington D.C. 20549. Copies of materials may be obtained from the Public Reference Room at prescribed rates. The public may obtain information on the operation of the SEC's Public Reference Room by calling the SEC in the United States at 1-800-SEC-0330. E.ON's filings, including this annual report, are also available on the SEC's website at [www.sec.gov](http://www.sec.gov). Material appearing on this website is not incorporated by reference into this annual report. In addition, material filed by E.ON with the SEC may be inspected at the offices of the New York Stock Exchange at 20 Broad Street, New York, New York 10005.

### **Item 11. Quantitative and Qualitative Disclosures about Market Risk.**

The following discussion should be read in conjunction with "Summary of Significant Accounting Policies" in Note 2 of the Notes to Consolidated Financial Statements and in conjunction with Notes 28 and 29 of the Notes to Consolidated Financial Statements, which provides a summarized comparison of nominal values and fair values of financial instruments used by the Company for risk management purposes and other information relating to those instruments.

***Risk Identification and Analysis***

In the normal course of business, the Company is exposed to foreign currency risk, interest rate risk, commodity price risk, share price risk, and counterparty risk. These risks create volatility in equity, earnings and cash flows from period to period. The Company makes use of derivative instruments generally in order to manage

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currency risk, interest rate risk, share price risk and commodity price risk. Foreign exchange, equity and interest rate derivatives held by the Company are used only for hedging purposes. The market units also engage in hedging and proprietary trading of energy-related commodity derivatives, subject to established guidelines for risk management. See **Commodity Price Risk Management** below and the subsections on trading of the market units in **Item 4. Information on the Company Business Overview**. In its hedging and proprietary trading activities, the Company generally utilizes established and widely-used derivative instruments for which significant liquidity exists. The Company's comprehensive framework for risk management includes general risk management guidelines for the use and evaluation of derivative instruments that are in place throughout the Group.

As part of its risk management system, the Company utilizes instruments such as interest rate swaps, interest rate/cross currency swaps, foreign exchange forward contracts, cross currency swaps, foreign exchange options, equity forwards, commodity forwards, commodity swaps, commodity futures and commodity options, seeking to reduce its risk exposure by entering into offsetting market positions.

The following discussion of the Company's risk management activities and the estimated amounts generated from profit-at-risk, value-at-risk and sensitivity analyses are forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those projected due to actual developments in the global financial markets. The methods used by the Company to analyze risks, as discussed below, should not be considered projections of future events or losses. The Company also faces risks that are either non-financial or non-quantifiable. Such risks principally include country risk, operational risk and legal risk, which are not represented in the following analyses.

***Foreign Exchange and Interest Rate Risk Management Principles***

The Company's Corporate Treasury, which is primarily responsible for entering into derivative foreign exchange and interest rate contracts for the Group and its companies, acts as a service center for the Company and not as a profit center. With E.ON AG's approval, individual Group companies may also hedge their currency and interest rate risks directly with third parties in exceptional cases.

The Company uses a Group-wide treasury, risk management and reporting system which incorporates all relevant functions, including those of the Corporate Treasury, Back Office and Financial Controlling units. This system is a standard information technology solution and is both fully integrated and continuously updated. It is designed to provide for the systematic and consistent identification and analysis of the Company's overall financial and market risks with regard to liquidity, currencies and interest rates. The system is also used to determine, analyze and monitor the Company's short- and long-term financing and investment requirements as well as market and counterparty risks arising from short- and long-term deposits and hedging transactions.

The range of actions, responsibilities and financial reporting procedures to be followed by each Group company are outlined in detail in the Company's internal financial guidelines. The market units have enacted their own guidelines for financial risk management within the limits established by the Group's financial guidelines. To ensure efficient risk management at E.ON AG, the Corporate Treasury, Back Office and Financial Controlling departments are organized as strictly separate units. Standard software is employed in processing relevant business transactions. The Financial Controlling department performs continuous and independent risk controlling. The department prepares operational financial plans, calculates market price and counterparty risks, and evaluates financial transactions. The Financial Controlling department reports to management at regular intervals on the Group's liquidity, foreign exchange, interest rate and commodity price risks as well as counterparty risks. Those subsidiaries that make use of external hedging transactions with third parties have similar organizational and reporting arrangements in place.

***Foreign Exchange Rate Risk Management***

Due to the international nature of some of its business activities, the Company is exposed to exchange risk related to sales, assets, receivables and liabilities denominated in foreign currencies, net investments in foreign operations and anticipated foreign exchange payments. Of the Company's consolidated revenue in 2006, 2005 and 2004, approximately 38 percent, 35 percent and 34 percent, respectively, arose due to transactions with customers which were not located in member states of the EMU, and therefore exposed the Company to foreign exchange rate

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risk. The Company's exposure results mainly from transactions in U.S. dollars, British pounds, Hungarian forint and Swedish krona and from net investments in foreign operations whose functional currencies are U.S. dollars, British pounds and Swedish krona. As of December 31, 2006, the Company was using hedging transactions with respect to each of these currencies.

In accordance with E.ON's hedging policy, macro-hedging transactions relating to currency risks are generally completed for periods of up to 18 months. Under certain circumstances the hedging horizon is longer. Macro-hedging transactions comprise a number of individual underlying transactions that have been grouped together and hedged as an individual unit.

The principal derivative financial instruments used by E.ON to cover foreign currency exposures are foreign exchange forward contracts, cross currency swaps, interest rate/cross currency swaps and foreign exchange options. As of December 31, 2006, the E.ON Group had entered into foreign exchange forward contracts with a nominal value of 11.5 billion, cross currency swaps with a nominal value of 18.5 billion, interest rate/cross currency swaps with a nominal volume of 0.3 billion and foreign exchange options with a nominal value of zero.

Market risks for foreign exchange derivatives consist of the positive and negative changes in net asset value that result from fluctuations of the relevant currencies on the respective financial markets. The market values of derivative financial instruments are calculated by comparing all relevant price components of a transaction at the time of the deal with those prevailing on the valuation date. The relevant parameters used to calculate the potential change in market value are the contract amount and the contractual forward-exchange rate. In line with international banking standards, market risk has been calculated using the value-at-risk method on the basis of historical market data. The value-at-risk is equal to the maximum potential loss (on the basis of a probability of 99 percent) from derivative positions that could be incurred within the following business day. The calculations take account of correlations between individual transactions; the risk of a portfolio is generally lower than the sum of its individual risks.

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The market risk analysis of the Company's foreign exchange derivatives by transaction and maturity as of December 31, 2006 and December 31, 2005 is summarized in the following table.

***Total Volume of Foreign Currency Derivatives as of December 31, 2006 and December 31, 2005***

	December 31, 2006				December 31, 2005			
	Nominal Value	Fair Value	1-day Value-at-Risk	10-day Value-at-Risk	Nominal Value	Fair Value	1-day Value-at-Risk	10-day Value-at-Risk
	( in millions)							
FX forward transactions								
Buy	4,532.7	(27.1)	8.1	25.5	4,091.3	79.2	16.9	53.4
Sell	6,982.4	19.4	15.6	49.4	8,331.2	(81.7)	23.6	74.6
FX currency options								
Buy	7.4	0.1	0.0	0.0	227.7	32.8	0.2	0.6
Sell					139.6	(39.0)	0.4	1.3
<b>Subtotal</b>	<b>11,522.5</b>	<b>(7.6)</b>	<b>8.1</b>	<b>25.5</b>	<b>12,789.8</b>	<b>(8.7)</b>	<b>8.5</b>	<b>26.9</b>
(Remaining maturities)								
Cross currency swaps								
up to 1 year	1,457.8	9.7	4.4	14.0	1,734.7	34.7	1.9	6.0
1 year to 5 years	10,812.9	(22.8)	32.2	101.9	8,163.2	57.8	34.6	109.3
more than 5 years	6,228.6	20.5	6.9	21.8	6,358.4	66.6	8.7	27.5
Interest rate/cross currency swaps								
up to 1 year					125.0	13.1	0.5	1.6
1 year to 5 years	321.9	(17.0)	2.5	7.8	316.4	5.0	2.3	7.3
more than 5 years								
<b>Subtotal</b>	<b>18,821.2</b>	<b>(9.6)</b>	<b>35.7</b>	<b>112.8</b>	<b>16,697.7</b>	<b>177.2</b>	<b>40.6</b>	<b>128.3</b>
<b>Total</b>	<b>30,343.7</b>	<b>(17.2)</b>	<b>39.5</b>	<b>124.7</b>	<b>29,487.5</b>	<b>168.5</b>	<b>48.0</b>	<b>151.7</b>

The market risk table shows the outstanding nominal values and market values of foreign exchange derivatives as of the balance sheet date without taking into account any economic hedging correlations between hedging contracts on the one hand, and recognized and pending underlying transactions or net foreign investments on the other hand. In fact, all of the Group's foreign currency derivatives are assigned to a balance sheet item, a pending purchase or sales contract or an anticipated transaction.

As an additional means of monitoring market risks, a 10-day value-at-risk is calculated on derivative positions at regular intervals. In doing so, the market risk, as calculated using the value-at-risk concept, is multiplied by a factor of 3.16 (the square root of ten), in line with the recommendation for the capital adequacy of banks issued by the Bank for International Settlements (BIS). The results of this calculation are included in the table above.



While the nominal value of foreign exchange currency derivatives at December 31, 2006 remained essentially unchanged compared with year-end 2005, the fair value has decreased, mainly due to foreign exchange rate changes in the major currency pairs. While the development of the foreign exchange rate between the euro and the U.S. dollar was positive during 2006, the other foreign exchange rates (especially the exchange rate between the euro and GBP) turned negative.

The value-at-risk amounts presented here are maximum potential daily losses. It is highly unlikely that the Company would experience continuous daily losses such as these over an extended period of time.

**Table of Contents*****Interest Rate Risk Management***

Several line items on the Group's balance sheet and associated financial derivatives bear fixed interest rates, and are therefore subject to changes in fair value resulting from changes in market rates. The Company also faces a similar risk with regard to balance sheet items and associated financial derivatives bearing floating rates, as changes in interest rates will affect the Company's cash flows. The Company seeks to maintain a desired mix of floating-rate and fixed rate debt in its overall debt portfolio. The Company uses interest rate swaps to allow it to diversify its sources of funding and to reduce the impact of interest rate volatility on its financial condition.

Financial derivatives are also used to realize time congruent hedging of interest rate risks. E.ON's policy provides that macro-hedging transactions can be concluded for periods of up to five years to cover interest rate risks. For micro-hedging purposes, any adequate term is allowed for individual hedges of foreign exchange and interest rates. However, where economically feasible, the Company applies hedge accounting under SFAS 133 to its interest rate derivatives.

The principal derivative financial instruments used by E.ON to cover interest rate risk exposures are interest rate swaps. As of December 31, 2006, the E.ON Group had entered into interest rate swaps with a nominal value of 8.4 billion.

Market risks for interest rate derivatives are calculated in the same manner as those for foreign exchange instruments, as discussed in detail under Foreign Exchange Rate Risk Management above.

The market risk analysis of the Company's interest rate derivatives by transaction and maturity as of December 31, 2006 and December 31, 2005 is summarized in the following table.

***Total Volume of Interest Rate Derivatives as of December 31, 2006 and December 31, 2005***

	December 31, 2006				December 31, 2005			
	Nominal Value	Fair Value	1-day Value-at-Risk	10-day Value-at-Risk	Nominal Value	Fair Value	1-day Value-at-Risk	10-day Value-at-Risk
	( in millions)							
	(Remaining maturities)							
Interest rate swaps								
fixed-rate payer								
up to 1 year	150.9	0.8	0.9	2.7	612.2	(11.8)	0.1	0.3
1 year to 5 years	1221.8	(3.1)	1.1	3.4	1,294.9	(44.1)	1.4	4.4
more than 5 years	919.8	(14.1)	8.3	26.2	1,033.5	(18.0)	4.0	12.6
fixed-rate receiver								
up to 1 year	55.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1 year to 5 years	5,263.9	(75.5)	5.8	18.5	5,364.4	64.3	7.7	24.3
more than 5 years	759.3	(14.3)	4.9	15.5	1,196.4	(20.7)	4.4	13.9
<b>Total</b>	<b>8,370.8</b>	<b>(106.2)</b>	<b>9.0</b>	<b>28.5</b>	<b>9,501.4</b>	<b>(30.3)</b>	<b>6.6</b>	<b>20.9</b>

The market risk table shows the outstanding nominal values and fair values of interest rate derivatives without taking into account any economic hedging correlations between hedging contracts and underlying transactions. In fact, all of the Group's interest rate derivatives are assigned to a balance sheet item.

The nominal values of interest rate derivatives at December 31, 2006 remained essentially stable compared with year-end 2005. The negative development of the fair values resulted from significantly rising euro interest rates in comparison to Czech krona, GBP and Swedish krona interest rates.

A sensitivity analysis was performed on the Group's interest-bearing short- and long-term capital investments and borrowings, including interest rate derivatives. The aggregate hypothetical loss in fair value on all financial instruments and derivative instruments that would have resulted from a 100 basis-point shift in the interest rate structure curve would change the interest rate portfolio's market value by 62 million (2005: 43 million) as of the

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balance sheet date. The market risk according to the value-at-risk calculation amounted to 49 million as of December 31, 2006 (2005: 60 million).

***Commodity Price Risk Management***

E.ON is also exposed to risks resulting from fluctuations in the prices of commodity derivatives and raw materials. Hedging transactions with respect to commodity-related risks of notable scope are conducted only by the market units.

The principal derivative instruments used by E.ON to cover commodity price risk exposures are electricity, gas, coal and oil swaps and forwards, electricity options, and exchange-traded electricity and coal future and option contracts, as well as emission-related derivatives.

Derivative instruments are used by the market units to hedge the impact of electricity, gas, coal, oil and CO<sub>2</sub> emission certificate price fluctuations and to enable the market units to make better use of their own power generating capacities as well as power and gas distribution and sales capabilities. To a limited extent, proprietary trading is conducted with the goal of improving operating results within defined limits in specified markets. The trading limits for proprietary trading as well as for other trading activities are established and monitored by a board independent from the trading operations. Limits used on hedging and proprietary trading activities mainly include value- and profit-at-risk numbers, as well as volume, book, credit and stop-loss limits. Additional key elements of the risk management system are a set of Group-wide commodity risk guidelines, the clear division of duties between scheduling, trading, settlement and control, as well as a risk reporting system independent of the trading operations.

As of December 31, 2006, the E.ON Group had entered into electricity, gas, coal, oil and emissions derivative instruments with a nominal value of 56 billion (2005: 44 billion). The increase in the nominal value of commodities derivatives at December 31, 2006 compared with year-end 2005 reflects an enlarged business volume as well as the effects of increased volatility.

The fair value of commodity trading transactions for which E.ON has not established economic hedging conditions involving recognized or contractually agreed upon or planned underlying transactions amounted to negative 70 million as of December 31, 2006 (2005: negative 133 million). A hypothetical 10 percent change in underlying commodity prices would cause the market value of these commodity trading transactions to change by 41 million (2005: 20 million).

***Counterparty Risk From the Use of Derivative Financial Instruments***

Counterparty risk consists of potential losses that may arise from the non-fulfillment of contractual obligations by individual counterparties. With respect to derivative transactions, counterparty risk is equivalent to the replacement cost incurred by covering the open position in the event of counterparty default. Only transactions with a positive market value for E.ON are exposed to this risk. The Company's counterparties for derivatives include financial institutions, commodity exchanges, energy distribution companies and broker-dealers, and other entities that satisfy E.ON's credit criteria. The creditworthiness of all counterparties that are involved in financial electricity-, gas-, coal-, oil- or emissions-related derivatives with E.ON are thoroughly checked and monitored on a regular basis. The Company receives and pledges collateral in connection with long-term interest and currency hedging derivatives in the banking sector and with some partners in the energy sector. Furthermore, collateral is required when entering into transactions in commodity derivatives with counterparties that have a low degree of creditworthiness. Derivative transactions are generally executed on the basis of standard agreements that allow for the netting of all outstanding transactions with individual contracting partners. For currency and interest-rate derivatives in the banking sector, this netting option is reflected in the accounting treatment. Exchange-traded electricity future and option contracts as well as emission-related derivatives with a nominal value of 8,198 million as of December 31, 2006 (2005: 5,059 million)

are liquid instruments and do not bear individual counterparty risk. The Company's counterparty risk with respect to derivatives amounts to 4,095 million as of December 31, 2006 (2005: 7,149 million). The decrease in the counterparty risk at December 31, 2006 compared with year-end 2005 was mainly caused by the negative development in gas and electricity prices during 2006. Not all counterparties are rated by S&P and/or Moody's; for these unrated counterparties thorough credit limit checks and credit risk evaluation systems are installed and collateral is sometimes required.

E.ON's Group-wide credit risk management

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system and credit risk management guidelines are designed to assure thorough and uniform creditworthiness analysis for all counterparties. Significant Group-wide limits and risks are identified and their credit risk exposures are regularly monitored and reported to the E.ON risk committee. The credit risk management system incorporates information on all counterparty risks resulting from commodity trading transactions and financial transactions in the area of deposits, interest rate and foreign exchange risks.

E.ON's contractual ability to net transactions with positive and negative market values with any defaulting counterparty for which a netting agreement is in place is not reflected in the figures presented in the prior paragraph, regardless of whether the counterparty is rated or unrated, causing the credit risk to appear greater than it is in actuality. In addition, the value of collateral posted by counterparties is not taken into account in calculating such figures.

**Item 12. Description of Securities Other than Equity Securities.**

Not applicable.

**PART II**

**Item 13. Defaults, Dividend Arrearages and Delinquencies.**

None.

**Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds.**

Not applicable.

**Item 15. Controls and Procedures.**

The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon the Company's evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. There were no changes in the Company's internal control over financial reporting that occurred during 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Management's Annual Report on Internal Control Over Financial Reporting**

E.ON management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. It can only provide reasonable assurance regarding financial statement preparation and presentation. 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 because the degree of compliance with the policies or procedures may deteriorate.

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Management assessed the effectiveness of its internal control over financial reporting as of December 31, 2006. The assessment was based on criteria established in the framework Internal Controls – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on the assessment, E.ON management has concluded that as of December 31, 2006, the Company's internal control over financial reporting was effective.

Management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, an independent registered public accounting firm ( PwC ), as stated in their report which is included under Item 18. Financial Statements.

**Item 16A. Audit Committee Financial Expert.**

E.ON's Supervisory Board has determined that the Company's Audit Committee currently includes two members who qualify as an Audit Committee Financial Expert within the meaning of this Item 16A: Dr. Karl-Hermann Baumann and Ulrich Hartmann. Dr. Karl-Hermann Baumann and Ulrich Hartmann are independent, as that term is defined in Rule 10A-3 under the Securities Exchange Act for purposes of the listing standards of the NYSE that are applicable to E.ON.

**Item 16B. Code of Ethics.**

E.ON has adopted a special Code of Ethics for the Chief Executive Officer, the Chief Financial Officer and its senior financial officers. The Company has published the text of this Code of Ethics on its corporate website at [www.eon.com](http://www.eon.com). Material appearing on this website is not incorporated by reference into this annual report. If E.ON amends the provisions of this Code of Ethics or grants any waiver of such provisions, it will disclose such amendment or waiver on its website at the same address.

**Item 16C. Principal Accountant Fees and Services.**

In January 2003, the SEC adopted rules requiring disclosure of fees billed by a public company's independent auditors in each of the company's two most recent fiscal years.

The following table sets forth the fees billed to the Company for professional services by its principal independent auditor, PwC, during the fiscal years 2006 and 2005:

Type of Fees	Year Ended	Year Ended
	December 31, 2006	December 31, 2005 ( in millions)
Audit Fees	53.4	39.8
Audit-Related Fees	4.6	9.7
Tax Fees	0.9	1.4
All Other Fees	1.9	1.1
<b>Total</b>	<b>60.8</b>	<b>52.0</b>



***Audit Committee Pre-Approval Policies***

In accordance with German law, E.ON's independent auditors are appointed by the annual general meeting of shareholders based on a recommendation of E.ON's Supervisory Board. The Audit Committee of the Supervisory Board prepares the board's recommendation on the selection of the independent auditors. Subsequent to the auditor's appointment, the Audit Committee awards the contract and in its sole authority approves the terms and scope of the audit and all audit engagement fees as well as monitors the auditors' independence. On May 4, 2006, the annual general meeting of shareholders appointed PwC to serve as the Company's independent auditors for the 2006 fiscal year.

In order to assure the integrity of independent audits, in May 2003 E.ON's Audit Committee established a policy to approve all audit and permissible non-audit services provided by E.ON's independent auditors prior to the

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auditors' engagement. As part of the approval process, the Audit Committee adopted pre-approval policies and procedures pursuant to which the Audit Committee annually pre-approves certain types of services to be performed by E.ON's independent auditors. Compliance with these policies is audited and monitored by the Audit Committee on a quarterly basis. Under the policies, the Company's independent auditors are not allowed to perform any non-audit services which may impair the auditors' independence under the SEC's rules. Furthermore, the Audit Committee has limited the aggregate amount of non-audit fees payable to PwC during a fiscal year to a maximum of 40 percent of all fees.

In 2006, the Audit Committee pre-approved the performance by PwC of material services, mainly including the following:

***Audit Services***

Annual audit for E.ON's Consolidated Financial Statements;

Quarterly review of E.ON's interim financial statements;

Statutory audits of financial statements of E.ON AG and of its subsidiaries under the rules of their respective countries;

Attestation of internal controls as part of the external audit; and

Attestation of regulatory filing and other compliance requirements, including regulatory advice, such as carve-out reports and comfort letters.

***Audit-Related Services***

Accounting advice relating to transactions or events;

Due diligence relating to acquisitions, dispositions and contemplated transactions;

Consultation in accounting and corporate reporting matters;

Attestation of compliance with provisions or calculations required by agreements;

Employee benefit plan audits;

Agreed-upon procedures engagements; and

Advisory services relating to internal controls and systems documentation.

***Tax Services***

Tax compliance services, including return preparation and tax payment planning;

Tax advice relating to transactions or events;

Transfer pricing studies; and

Tax services for employee benefit plans.

***All Other Services***

Advisory services on corporate governance and risk management;

Advisory services on corporate treasury processes and systems;

Advisory services on information systems; and

Educational and training services on accounting and industry matters.

Services that are not included in one of the categories listed above or in the Audit Committee's catalogue of pre-approved services require specific pre-approval of the Audit Committee. An approval may not be granted if the

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service falls into a category of services not permitted by current law or if it is inconsistent with maintaining auditor independence, as expressed in the rules promulgated by the SEC.

**Item 16D. Exemptions from the Listing Standards for Audit Committees.**

Information required by this Item is incorporated by reference to Item 10. Additional Information Memorandum and Articles of Association Corporate Governance The Supervisory Board Committees.

**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers.**

The following table provides information on Ordinary Shares purchased by the Company in 2006:

2006	Total Number of Shares Purchased (a)	Average Price Paid per Share in (b)	Total Number of Shares Purchased as Part of the Share Buyback Plan (c)	Maximum Number of Shares that may yet be Purchased under the Share Buyback Plan (d)
Jan. 1-31	3,400	88.16		36,353,552
Feb. 1-28				36,353,552
Mar. 1-31				36,353,552
Apr. 1-30	3,666	91.06		36,353,552
May 1-31				36,353,574
Jun. 1-30				36,353,574
Jul. 1-31				36,353,574
Aug. 1-31				36,353,574
Sep. 1-30				36,353,574
Oct. 1-31				36,353,574
Nov. 1-30				36,797,269
Dec. 1-31				36,797,269
<b>Total</b>	<b>7,066</b>	<b>89.66</b>		

(a) 366 Ordinary Shares were purchased for the benefit of the Company's Group Works Council. 6,700 Ordinary Shares were purchased to compensate a minority shareholder in the context of the squeeze-out proceedings of E.ON Bayern. All of the purchases were made in the market.

(c)(d) Pursuant to shareholder resolutions approved at the annual general meeting of shareholders held on May 4, 2006, the Board of Management is authorized to buy back up to 10 percent of E.ON AG's outstanding share capital, or 692,000,000 Ordinary Shares, through November 4, 2007. Pursuant to the German Stock Corporation Act, the maximum number of shares the Company may purchase at any time equals 10 percent of 692,000,000 (or 69,200,000 Ordinary Shares) less the number of Ordinary Shares held in treasury stock

at such time. Therefore, the maximum number of Ordinary Shares that may be purchased under the Company's share buyback plan, as reflected in column D, fluctuated over the course of 2006 due to changes in the number of Ordinary Shares held in treasury stock, rather than due to share repurchases. The Company did not buy back any Ordinary Shares pursuant to this share buyback plan in 2006, as the shares purchased for the benefit of the Company's Group Works Council and for compensation in the context of the E.ON Bayern squeeze-out were not purchased pursuant to such plan.

For information about E.ON's share repurchases in 2004 and 2005, see Note 17 of the Notes to Consolidated Financial Statements.

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**PART III**

**Item 17. Financial Statements.**

Not applicable.

**Item 18. Financial Statements.**

See pages F-1 to F-82, incorporated by reference.

**Item 19. Exhibits.**

**Exhibit No. Exhibit Title**

- 1.1 English translation of the Articles of Association (*Satzung*) of E.ON AG as amended to date.\*
- 4.1 Unofficial English translation of Framework Agreement between RAG AG, RAG Beteiligungs-GmbH, RAG Projektgesellschaft mbH and EBV Aktiengesellschaft, and E.ON AG, Chemie Verwaltungs AG and E.ON Vermögensanlage GmbH, dated May 20, 2002.\*\*
- 4.2 Amended and Restated Fiscal Agency Agreement between E.ON AG, E.ON International Finance B.V., E.ON UK PLC, and Citibank, N.A. as Fiscal Agent, and Banque du Luxembourg S.A. and Citibank AG as Paying Agents, relating to the Euro 20,000,000,000 Medium Term Note Programme, dated August 21, 2002.\*\*
- 4.3 Sale and Purchase Agreement Regarding the Sale and Purchase of All Shares in Viterra AG between E.ON Viterra-Beteiligungsgesellschaft mbH, E.ON AG, Atrium Einhunderterste VV GmbH and Praetorium 40. VV GmbH, dated May 17, 2005.\*\*\*
- 4.4 EUR 37,100,000,000 Syndicated Term and Guarantee Facility Agreement, dated October 16, 2006, between and among E.ON, as Original Borrower and Guarantor, HSBC Bank plc, Citigroup Global Markets Limited, J.P. Morgan plc, BNP Paribas, The Royal Bank of Scotland plc and Deutsche Bank AG, as mandated lead arrangers and the other parties thereto.\*\*\*\*
- 4.5 EUR 5,300,000,000 Term Loan and Guarantee Facility Agreement, dated February 2, 2007, between and among E.ON, as Original Borrower and Guarantor, HSBC Bank plc, Citigroup Global Markets Limited, J.P. Morgan plc, BNP Paribas, The Royal Bank of Scotland plc and Deutsche Bank AG, as mandated lead arrangers and the other parties thereto.\*\*\*\*\*
- 8.1 Subsidiaries as of the end of the year covered by this annual report: see Item 4. Information on the Company Organizational Structure.
- 12.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 12.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- 13.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

\* Filed herewith.

\*\* Incorporated by reference to the Form 20-F filed by E.ON AG with the Securities and Exchange Commission on March 19, 2003, file number 1-14688.

- \*\*\* Incorporated by reference to the Form 20-F filed by E.ON AG with the Securities and Exchange Commission on March 9, 2006, file number 1-14688.
- \*\*\*\* Incorporated by reference to the Tender Offer Statement on Schedule TO filed by E.ON AG with the Securities and Exchange Commission on January 26, 2007, file number 005-80961.
- \*\*\*\*\* Incorporated by reference to Amendment No. 2 to the Tender Offer Statement on Schedule TO filed by E.ON AG with the Securities and Exchange Commission on February 5, 2007, file number 005-80961.

Confidential material appearing in this document has been omitted and filed separately with the Securities and Exchange Commission in accordance with the Securities Exchange Act of 1934, as amended, and Rule 24b-2 promulgated thereunder. Omitted information has been redacted and marked with an asterisk and appropriate legend to indicate redaction.

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**E.ON AG AND SUBSIDIARIES**

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**Report of Independent Registered Public Accounting Firm**

We have completed an integrated audit of E.ON AG's 2006 consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 and audits of its 2005 and 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America. Our opinions, based on our audits, are presented below.

**Consolidated financial statements**

We have audited the accompanying consolidated balance sheets of E.ON AG and its subsidiaries ( E.ON ) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in 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 the Company'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 in the United States of America. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of E.ON at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the Consolidated Financial Statements, effective December 31, 2006, E.ON adopted Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R) .

**Internal control over financial reporting**

We have also audited management's assessment, included in the accompanying Management's annual report on Internal Control over Financial Reporting appearing under Item 15, that E.ON 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 (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of 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 the Company's internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America. 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. An audit of internal control over financial reporting includes 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 consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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 generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance

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with 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 (iii) 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.

In our opinion, management's assessment that E.ON maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, E.ON maintained, in all material respects, 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 (COSO).

Düsseldorf,  
March 6, 2007

PricewaterhouseCoopers  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

/s/ Dr. Vogelpoth

/s/ Laue

Dr. Vogelpoth  
Wirtschaftsprüfer  
(German Public Auditor)

Laue  
Wirtschaftsprüfer  
(German Public Auditor)

Table of Contents**E.ON AG AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(\$ / in millions, except for per share amounts)

	Note	2006*	Year Ended December 31,		2004
			2006	2005	
Public utility sales		\$ 60,838	46,100	39,729	34,054
Gas sales		32,976	24,987	17,914	13,227
Other sales		(4,392)	(3,328)	(1,502)	(792)
<b>Sales</b>	(31)	<b>89,422</b>	<b>67,759</b>	<b>56,141</b>	<b>46,489</b>
Electricity and petroleum tax		(4,701)	(3,562)	(4,525)	(4,339)
Sales, net of electricity and petroleum tax		84,721	64,197	51,616	42,150
Cost of goods sold Public utility		(45,723)	(34,646)	(28,482)	(23,019)
Cost of goods sold Gas		(27,662)	(20,961)	(13,588)	(9,017)
Cost of goods sold and services provided Other		4,359	3,303	1,467	766
Cost of goods sold and services provided		(69,026)	(52,304)	(40,603)	(31,270)
<b>Gross profit on sales</b>		<b>15,695</b>	<b>11,893</b>	<b>11,013</b>	<b>10,880</b>
Selling expenses		(5,729)	(4,341)	(3,845)	(4,226)
General and administrative expenses		(2,341)	(1,774)	(1,516)	(1,334)
Other operating income (expenses), net	(5)	(1,119)	(848)	1,674	1,378
Financial earnings, net	(6)	(835)	(633)	(607)	(1,014)
Income/(Loss) from companies accounted for under the equity method	(11c)	1,103	836	433	648
Income/(Loss) from continuing operations before income taxes and minority interests		6,774	5,133	7,152	6,332
Income taxes	(7)	426	323	(2,261)	(1,852)
Income/(Loss) from continuing operations after income taxes		7,200	5,456	4,891	4,480
Minority interests	(8)	(694)	(526)	(536)	(469)
Income/(Loss) from continuing operations		6,506	4,930	4,355	4,011
Income/(Loss) from discontinued operations net (less applicable income taxes of 42, (35) and 95, respectively):	(4)	168	127	3,059	328
Income before cumulative effect of changes in accounting principles		6,674	5,057	7,414	4,339
Cumulative effect of changes in accounting principles, net (less applicable income taxes of (0),				(7)	

(3) and 0, respectively)

<b>Net income</b>		<b>6,674</b>	<b>5,057</b>	<b>7,407</b>	<b>4,339</b>
<b>Basic earnings per share:</b>	(10)				
Income/(Loss) from continuing operations		9.87	7.48	6.61	6.11
Income/(Loss) from discontinued operations, net		0.25	0.19	4.64	0.50
Cumulative effect of changes in accounting principles, net				(0.01)	
Net income		10.12	7.67	11.24	6.61
<b>Diluted earnings per share:</b>	(10)				
Income/(Loss) from continuing operations		9.87	7.48	6.61	6.11
Income/(Loss) from discontinued operations, net		0.25	0.19	4.64	0.50
Cumulative effect of changes in accounting principles, net				(0.01)	
Net income		10.12	7.67	11.24	6.61

\* Note 1

The accompanying Notes are an integral part of these Consolidated Financial Statements.

Table of Contents**E.ON AG AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

( in millions)

	Note	2006*	December 31, 2006	2005
<b>ASSETS</b>				
Goodwill	(11a)	\$ 19,959	15,124	15,363
Intangible assets	(11a)	4,948	3,749	4,125
Property, plant and equipment	(11b)	56,367	42,712	41,323
Companies accounted for under the equity method	(11c)	10,514	7,967	9,689
Other financial assets	(11c)	26,836	20,335	16,119
Financial receivables and other financial assets	(13)	1,839	1,394	2,059
Operating receivables, other operating assets and prepaid expenses	(13)	4,689	3,553	3,530
Deferred tax assets	(7)	1,993	1,510	1,706
<b>Non-current assets</b>		<b>127,145</b>	<b>96,344</b>	<b>93,914</b>
Inventories	(12)	5,266	3,990	2,457
Financial receivables and other financial assets	(13)	1,870	1,417	1,060
Operating receivables, other operating assets and prepaid expenses	(13)	24,199	18,337	18,180
Restricted cash	(14)	775	587	98
Securities and fixed-term deposits	(15)	5,870	4,448	5,453
Cash and cash equivalents	(16)	1,520	1,152	4,346
Assets of disposal groups	(4)	805	610	681
Deferred tax assets	(7)	458	347	373
<b>Current assets</b>		<b>40,763</b>	<b>30,888</b>	<b>32,648</b>
<b>Total assets</b>		<b>167,908</b>	<b>127,232</b>	<b>126,562</b>
	Note	2006*	December 31, 2006	2005
<b>STOCKHOLDERS EQUITY AND LIABILITIES</b>				
Capital stock	(17)	\$ 2,374	1,799	1,799
Additional paid-in capital	(18)	15,520	11,760	11,749
Retained earnings	(19)	34,713	26,304	25,861
Accumulated other comprehensive income	(20)	10,838	8,212	5,331
Treasury stock	(17)	(304)	(230)	(256)
<b>Stockholders equity</b>		<b>63,141</b>	<b>47,845</b>	<b>44,484</b>

<b>Minority interests</b>	(21)	<b>6,489</b>	<b>4,917</b>	<b>4,734</b>
Financial liabilities	(24)	13,143	9,959	10,555
Operating liabilities and deferred income	(24)	7,715	5,846	6,365
Provisions for pensions	(22)	4,974	3,769	8,290
Other provisions	(23)	26,929	20,406	19,112
Deferred tax liabilities	(7)	9,626	7,294	7,929
<b>Non-current liabilities</b>		<b>62,387</b>	<b>47,274</b>	<b>52,251</b>
Financial liabilities	(24)	4,540	3,440	3,807
Operating liabilities and deferred income	(24)	19,273	14,604	13,504
Provisions for pensions	(22)	153	116	430
Other provisions	(23)	10,296	7,802	6,030
Liabilities of disposal groups	(4)	812	615	831
Deferred tax liabilities	(7)	817	619	491
<b>Current liabilities</b>		<b>35,891</b>	<b>27,196</b>	<b>25,093</b>
<b>Total stockholders' equity and liabilities</b>		<b>167,908</b>	<b>127,232</b>	<b>126,562</b>

\* Note 1

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**Table of Contents****E.ON AG AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

( in millions)

	Year Ended December 31,			
	2006*	2006	2005	2004
<b>Net income</b>	<b>\$ 6,674</b>	<b>5,057</b>	<b>7,407</b>	<b>4,339</b>
Income applicable to minority interests	694	526	536	469
Adjustments to reconcile net income to net cash provided by operating activities				
Income from discontinued operations	(168)	(127)	(3,059)	(328)
Depreciation, amortization and impairment on intangible assets, property, plant, equipment and equity investments	4,950	3,751	3,030	3,014
Changes in provisions	2,376	1,800	(362)	68
Changes in deferred taxes	(1,090)	(826)	390	(570)
Other non-cash income and expenses	(494)	(374)	90	209
Gain/Loss on disposal:				
Equity investments	(974)	(738)	(44)	(397)
Intangible assets and property, plant and equipment	(120)	(91)	(36)	(31)
Securities (other than trading) (> 3 months)	(650)	(493)	(398)	(240)
Changes in current assets and other operating liabilities				
Inventories	(1,793)	(1,359)	(281)	(279)
Trade receivables	(1,918)	(1,453)	(1,502)	(195)
Other operating receivables	888	673	(3,828)	(21)
Trade payables	113	86	1,386	(119)
Other operating liabilities	1,006	762	3,215	(143)
<b>Cash provided by operating activities</b>	<b>9,494</b>	<b>7,194</b>	<b>6,544</b>	<b>5,776</b>
Proceeds from disposal of				
Equity investments	4,818	3,651	6,093	1,619
Intangible assets and property, plant and equipment	400	303	201	269
Purchase of				
Equity investments	(1,423)	(1,078)	(985)	(2,203)
Intangible assets and property, plant and equipment	(5,388)	(4,083)	(2,956)	(2,574)
Changes in securities (other than trading) (> 3 months)	(1,017)	(771)	(568)	(135)
Changes in financial receivables and fixed-term deposits	(3,127)	(2,369)	(1,339)	2,697
Changes in restricted cash	(203)	(154)	(4)	(32)
<b>Cash provided by (used for) investing activities</b>	<b>(5,940)</b>	<b>(4,501)</b>	<b>442</b>	<b>(359)</b>
Payments received from/(made for) capital including minority interests	1	1	(26)	3
Payments received from/(made for) treasury stock, net	37	28	(33)	
Payment of cash dividends to Stockholders of E.ON AG	(6,089)	(4,614)	(1,549)	(1,312)



Minority stockholders	(319)	(242)	(239)	(278)
Proceeds from financial liabilities	14,313	10,846	3,013	3,522
Repayments of financial liabilities	(15,662)	(11,868)	(7,624)	(6,684)
<b>Cash provided by (used for) financing activities</b>	<b>(7,719)</b>	<b>(5,849)</b>	<b>(6,458)</b>	<b>(4,749)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(4,165)</b>	<b>(3,156)</b>	<b>528</b>	<b>668</b>
Cash provided by operating activities of discontinued operations	91	69	114	196
Cash used for investing activities of discontinued operations	(144)	(109)	(315)	(269)
Cash provided by financing activities of discontinued operations	3	2	(171)	288
<b>Net increase in cash and cash equivalents from discontinued operations</b>	<b>(50)</b>	<b>(38)</b>	<b>(372)</b>	<b>215</b>
Effect of foreign exchange rates on cash and cash equivalents			77	(60)
Cash and cash equivalents at the beginning of the period	5,735	4,346	4,113	3,290
<b>Cash and cash equivalents from continuing operations at the end of the period</b>	<b>1,520</b>	<b>1,152</b>	<b>4,346</b>	<b>4,113</b>

\* Note 1

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**Table of Contents****E.ON AG AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
( in millions)

	Capital stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income			Cash flow hedges	Treasury stock	Total
				Currency translation adjustments	Available- for-sale securities	Minimum pension liability			
<b>Balance as of January 1, 2004</b>	<b>1,799</b>	<b>11,564</b>	<b>16,976</b>	<b>(1,021)</b>	<b>1,184</b>	<b>(492)</b>	<b>20</b>	<b>(256)</b>	<b>29,774</b>
Shares reacquired/sold		182							182
Dividends paid			(1,312)						(1,312)
Net income			4,339						4,339
Other comprehensive income				125	994	(598)	56		577
Total comprehensive income									4,916
<b>Balance as of December 31, 2004</b>	<b>1,799</b>	<b>11,746</b>	<b>20,003</b>	<b>(896)</b>	<b>2,178</b>	<b>(1,090)</b>	<b>76</b>	<b>(256)</b>	<b>33,560</b>
Shares reacquired/sold		3							3
Dividends paid			(1,549)						(1,549)
Net income			7,407						7,407
Other comprehensive income				620	4,698	(312)	57		5,063
Total comprehensive income									12,470
<b>Balance as of December 31, 2005</b>	<b>1,799</b>	<b>11,749</b>	<b>25,861</b>	<b>(276)</b>	<b>6,876</b>	<b>(1,402)</b>	<b>133</b>	<b>(256)</b>	<b>44,484</b>
Shares reacquired/sold		11						26	37
Dividends paid			(4,614)						(4,614)
Net income			5,057						5,057
Other comprehensive income				167	3,139	346	(221)		3,431
Total comprehensive income									8,488
SFAS 158						1,056	(1,606)		(550)
<b>Balance as of December 31, 2006</b>	<b>1,799</b>	<b>11,760</b>	<b>26,304</b>	<b>(109)</b>	<b>10,015</b>		<b>(88)</b>	<b>(230)</b>	<b>47,841</b>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Basis of Presentation**

The Consolidated Financial Statements of E.ON AG and its consolidated companies ( E.ON, the E.ON Group or the Company ), Düsseldorf, Germany, have been prepared in accordance with generally accepted accounting principles in the United States of America ( U.S. GAAP ).

The E.ON Group is an internationally active group of energy companies with integrated electricity and gas operations based in Germany. Effective January 1, 2004, the Group has been organized around five defined target markets:

The Central Europe market unit, led by E.ON Energie AG ( E.ON Energie ), Munich, Germany, operates E.ON's integrated electricity business and the downstream gas business in Central Europe.

Pan-European Gas is responsible for the upstream and midstream gas business. Moreover, this market unit holds predominantly minority shareholdings in the downstream gas business. This market unit is led by E.ON Ruhrgas AG ( E.ON Ruhrgas ), Essen, Germany.

The U.K. market unit encompasses the integrated energy business in the United Kingdom. This market unit is led by E.ON UK plc. ( E.ON UK ), Coventry, U.K.

The Nordic market unit, which is led by E.ON Nordic AB ( E.ON Nordic ), Malmö, Sweden, focuses on the integrated energy business in Northern Europe. It operates through the integrated energy company E.ON Sverige AB ( E.ON Sverige ), Malmö, Sweden.

The U.S. Midwest market unit, led by E.ON U.S. LLC ( E.ON U.S. ), Louisville, Kentucky, U.S., is primarily active in the regulated energy market in the U.S. state of Kentucky.

The Corporate Center contains those interests held directly by E.ON AG that are not allocated to a particular segment, as well as E.ON AG itself.

These market units form the core energy business and are at the same time segments as defined in Statement of Financial Accounting Standards ( SFAS ) No. 131, Disclosures about Segments of an Enterprise and Related Information ( SFAS 131 ). The Corporate Center as part of the core energy business also contains the consolidation effects that take place at the Group level.

The other activities of the E.ON Group included the activities of Degussa AG ( Degussa ), Düsseldorf, Germany, which was accounted for under the equity method until the final disposal of E.ON's minority interest in the third quarter of 2006.

Note 31 provides additional information about the market units.

Pursuant to Article 57 Sentence 1 No. 2 of the Introductory Law to the German Commercial Code ( EGHGB ), E.ON is exempted from the requirement to prepare consolidated financial statements in accordance with the International Financial Reporting Standards ( IFRS ) and a management report in accordance with Article 315a of the German Commercial Code ( HGB ) for the 2006 fiscal year. E.ON is preparing consolidated financial statements and a management report in accordance with internationally accepted accounting standards (U.S. GAAP), as provided for by Article 292a HGB, in combination with Article 58 (5) Sentence 2 EGHGB. For an assessment of the conformity of U.S. GAAP regulations with the Fourth and Seventh EU Accounting Directives, E.ON refers to German Accounting

Standard ( DRS ) No. 1, Exempting Consolidated Financial Statements in accordance with Article 292a HGB, and DRS No. 1a, Exempting Consolidated Financial Statements in accordance with Article 292a HGB U.S. GAAP Consolidated Financial Statements: Goodwill and Other Intangible Assets, as well as to the transitional regulations of German Accounting Amendment Standard ( DRÄS ) No. 2, Article 2.

Solely for the convenience of the reader, the December 31, 2006, financial statements (except the changes in stockholders' equity) have also been translated into United States dollars ( \$ ) at the rate of 1 = \$1.3197, the Noon Buying Rate of the Federal Reserve Bank of New York on December 29, 2006. Such translation is unaudited.

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### **(2) Summary of Significant Accounting Policies**

#### **Principles of Consolidation**

The Consolidated Financial Statements include the accounts of E.ON AG and its consolidated subsidiaries. The subsidiaries, associated companies and other related companies have been included in the Consolidated Financial Statements in accordance with the following criteria:

Majority-owned subsidiaries in which E.ON directly or indirectly exercises control through a majority of the stockholders' voting rights ( affiliated companies ) are generally fully consolidated. However, certain subsidiaries controlled by E.ON that are inconsequential, both individually and in the aggregate, are accounted for at cost with no subsequent adjustment, unless impaired. Financial Accounting Standards Board ( FASB ) Interpretation ( FIN ) No. 46 (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 ( FIN 46(R) ), requires E.ON to consolidate so-called variable interest entities in which it is the primary beneficiary for economic purposes, even if it does not have a controlling interest.

Majority-owned companies in which E.ON does not exercise management control due to restrictions concerning the control of assets and management ( unconsolidated affiliates ) are generally accounted for under the equity method. Companies in which E.ON has the ability to exercise significant influence on operations ( associated companies ) are also accounted for under the equity method. These are mainly companies in which E.ON holds an interest of between 20 and 50 percent. However, certain associated companies controlled by E.ON that are inconsequential, both individually and in the aggregate, are accounted for at cost with no subsequent adjustment, unless impaired.

All other share investments are accounted for under the cost method or, if marketable, at fair value.

A list of all E.ON shareholdings and other interests is published in a separate listing of shareholdings in the German Electronic Federal Gazette ( elektronischer Bundesanzeiger ).

Intercompany results, sales, expenses and income, as well as receivables and liabilities between the consolidated companies are eliminated. If companies are accounted for under the equity method, intercompany results are eliminated in the consolidation process if and to the extent that these are material.

#### **Business Combinations**

In accordance with SFAS No. 141, Business Combinations ( SFAS 141 ), all business combinations are accounted for under the purchase method of accounting, whereby all assets acquired and liabilities assumed are recorded at their fair value. After adjustments to the fair values of assets acquired and liabilities assumed are made, any resulting positive differences are capitalized in the balance sheet as goodwill. Situations in which the fair value of net assets acquired is greater than the purchase price paid result in an excess that is first allocated as a pro rata reduction of certain acquired assets. Should any such excess remain, the remaining amount is recognized as a separate gain. Goodwill arising in companies for which the equity method is applied is calculated on the basis of the same principles that are applicable to fully consolidated companies.

#### **Foreign Currency Translation**

The Company's transactions denominated in currencies other than the euro are translated at the current exchange rate at the time of the transaction and adjusted to the current exchange rate at each balance sheet date; any gains and losses resulting from fluctuations in the relevant currencies are included in other operating income and other operating

expenses, respectively. Gains and losses from the translation of financial instruments used to hedge the value of its net investments in its foreign operations are recorded with no effect on net income as a component of stockholders' equity. The assets and liabilities of the Company's foreign subsidiaries with a functional currency other than the euro are translated using year-end exchange rates, while the statements of income are translated using annual-average exchange rates. Significant transactions of foreign subsidiaries occurring during the fiscal year are included in the financial statements using the exchange rate at the date of the transaction. Differences arising from

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the translation of assets and liabilities, as well as gains or losses in comparison with the translation of prior years, are included as a separate component of stockholders' equity and accordingly have no effect on net income.

The following chart depicts the movements in exchange rates for the periods indicated for major currencies of countries outside the European Monetary Union (1):

	ISO Code	1, rate as of December 31,		1, annual average rate		
		2006	2005	2006	2005	2004
British pound	GBP	0.67	0.69	0.68	0.68	0.69
Norwegian krone	NOK	8.24	7.99	8.05	8.01	8.00
Swedish krona	SEK	9.04	9.39	9.25	9.28	9.12
Hungarian forint	HUF	251.77	252.87	264.26	248.05	251.68
U.S. dollar	USD	1.32	1.18	1.26	1.24	1.13

(1) The countries within the European Monetary Union in 2006 were Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain.

**Presentation of Sales and Cost of Goods Sold and Services Provided**

Public utility sales and Cost of goods sold - Public utility are shown separately in the Consolidated Statements of Income and include the total sales and cost of goods sold of the reportable segments Central Europe, U.K., Nordic and U.S. Midwest.

Gas sales and Cost of goods sold - Gas reflect the supply, transmission, storage and sale of natural gas from the reportable segment Pan-European Gas.

Other sales and Cost of goods sold and services provided - Other are presented in the Consolidated Statements of Income and primarily include consolidation effects at the Group level.

**Revenue Recognition**

The Company generally recognizes revenue upon delivery of products to customers or upon fulfillment of services. Delivery has occurred when the risks and rewards associated with ownership have been transferred to the buyer, compensation has been contractually established and collection of the resulting receivable is probable. The following is a description of E.ON's major revenue recognition policies in the various segments.

*Core Energy Business*

Sales in the Central Europe, Pan-European Gas, U.K., Nordic and U.S. Midwest market units result mainly from the sale of electricity and gas to industrial and commercial customers and to retail customers. Additional revenue is earned from the distribution of electricity and deliveries of steam and heat.

Revenue from the sale of electricity and gas to industrial and commercial customers and to retail customers is recognized when earned on the basis of a contractual arrangement with the customer; it reflects the value of the volume supplied, including an estimated value of the volume supplied to customers between the date of their last



meter reading and year-end.

Net gains on derivative financial instruments used for proprietary trading are presented in the line item Sales .

*Other Activities*

Sales at Viterra AG, Essen and subsidiaries ( Viterra ), which in 2005 and 2004 were included in Income/Loss from discontinued operations, net and which were derived from the business of residential real estate and from the growing business of real estate development, were recognized net of discounts, sales incentives, customer bonuses and rebates granted when risk is transferred, remuneration is contractually fixed or determinable and satisfaction of the associated claims is probable. Sales attributable to services under long-term contracts (in

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particular property leases and service contracts) were recognized according to the terms of the contracts or at the point when the relevant services were rendered.

### **Electricity Tax**

The electricity tax is levied on electricity delivered to retail customers by domestic utilities in Germany and Sweden and is calculated on the basis of a fixed tax rate per kilowatt-hour (kWh). This rate varies between different classes of customers.

### **Energy Taxes**

The new German Energy Tax Act ( Energiesteuergesetz, EnergieStG ) regulates the taxation of energy generated from petroleum, natural gas and coal. It replaced the Petroleum Tax Act effective August 1, 2006. Under the Energy Tax Act, natural gas tax is not levied until delivery to the end consumer. Under the previously applicable Petroleum Tax Act, natural gas tax became due at the time of the procurement or removal of the natural gas from storage facilities.

### **Taxes other than Income Taxes**

Taxes other than income taxes totaled 190 million in 2006 (2005: 57 million; 2004: 78 million) and consisted principally of property taxes and higher taxes on installed nuclear and hydroelectric powercapacities in Sweden. In 2005 and 2004, taxes other than income taxes consisted primarily of property tax and real estate transfer taxes.

### **Cost of Goods Sold and Services Provided**

Cost of goods sold and services provided primarily includes the cost of generation, procured electricity and gas, the cost of raw materials and supplies used to produce energy, depreciation of the equipment used to generate, store and transfer electricity and gas, personnel costs directly related to the generation and supply of energy, as well as costs incurred in the purchase of production-related services. Net losses on derivative financial instruments used for proprietary trading are presented in the line item Cost of goods sold and services provided.

### **Selling Expenses**

Selling expenses include all expenses incurred in connection with the sale of energy. These primarily include personnel costs and other sales-related expenses of the regional utilities in the Central Europe market unit.

### **Administrative Expenses**

Administrative expenses primarily include the personnel costs for those employees who do not work in the areas of production and sales, as well as the depreciation of administration buildings.

### **Accounting for Sales of Stock of Subsidiaries or Associated Companies**

If a subsidiary or associated company sells its stock to a third party, leading to a reduction in E.ON's ownership interest of the relevant company ( dilution ), in accordance with SEC Staff Accounting Bulletin ( SAB ) No. 51, Accounting for Sales of Stock of a Subsidiary ( SAB 51 ), gains and losses from these dilutive transactions are included in the income statement under Other operating income (expenses), net .

### **Advertising Costs**

Advertising costs are expensed as incurred and totaled 281 million in 2006 (2005: 156 million; 2004: 130 million).

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### **Research and Development Costs**

Research and development costs are expensed as incurred, and recorded as other operating expenses. They totaled 27 million in 2006 (2005: 24 million; 2004: 19 million).

### **Earnings per Share**

Earnings per share ( EPS ) are computed in accordance with SFAS No. 128, Earnings per Share ( SFAS 128 ). Basic (undiluted) EPS is computed by dividing consolidated net income by the weighted average number of ordinary shares outstanding during the relevant period. The computation of diluted EPS is identical to basic EPS, as E.ON AG does not have any dilutive securities.

### **Goodwill and Intangible Assets**

#### *Goodwill*

SFAS No. 142, Goodwill and Other Intangible Assets ( SFAS 142 ), requires that goodwill not be periodically amortized, but rather be tested for impairment at the reporting unit level on an annual basis. Goodwill must be evaluated for impairment between these annual tests if events or changes in circumstances indicate that goodwill might be impaired. The Company has identified its reporting units as the operating units one level below its reportable segments.

The testing of goodwill for impairment involves two steps:

The first step is to compare each reporting unit's fair value with its carrying amount including goodwill. If a reporting unit's carrying amount exceeds its fair value, this indicates that its goodwill may be impaired and the second step is required.

The second step is to compare the implied fair value of the reporting unit's goodwill with the carrying amount of its goodwill. The implied fair value is computed by allocating the reporting unit's fair value to all of its assets and liabilities in a manner that is similar to a purchase price allocation in a business combination in accordance with SFAS 141. The remainder after this allocation is the implied fair value of the reporting unit's goodwill. If the fair value of goodwill is less than its carrying value, the difference is recorded as an impairment.

The annual testing of goodwill for impairment at the reporting unit level, as required by SFAS 142, is carried out in the fourth quarter of each year.

#### *Intangible Assets Not Subject to Amortization*

SFAS 142 also requires that intangible assets other than goodwill be amortized over their useful lives unless their lives are considered to be indefinite. Any intangible asset that is not subject to amortization must be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. This impairment test for intangible assets with indefinite lives consists of a comparison of the fair value of the asset with its carrying value. Should the carrying value exceed the fair value, an impairment loss equal to the difference is recognized in other operating expenses.

#### *Intangible Assets Subject to Amortization*

Intangible assets subject to amortization are classified into marketing-related, customer-related, contract-based, and technology-based, all of which are valued at cost and amortized using the straight-line method over their expected useful lives, generally for a period between 5 and 25 years or between 3 and 5 years for software, respectively.

Accounting for internally-developed software for internal use within the Company is governed by the guidelines of the American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. In accordance with this SOP, any costs incurred from the moment at which the decision on the implementation and on all functions,

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characteristics and specifications of the software was made, are capitalized and amortized over the probable useful life. Any costs incurred up to that point are immediately expensed.

Intangible assets with definite lives subject to amortization are reviewed for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS 144 ), whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Please see Note 11(a) for additional information about goodwill and intangible assets.

**Property, Plant and Equipment**

Property, plant and equipment are valued at historical or production costs, including asset retirement costs to be capitalized and depreciated over their expected useful lives, generally using the straight-line method, as summarized in the following table.

Buildings	10 to 50 years
Technical equipment, plant and machinery	10 to 65 years
Other equipment, fixtures, furniture and office equipment	3 to 25 years

Property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is measured in accordance with SFAS 144 by comparison of the carrying amount of the asset and its expected undiscounted future cash flows. If such a long-lived asset's carrying amount exceeds its undiscounted future cash flows, the carrying value of such an asset is written down to its lower fair value. Unless quoted market prices in active markets are available, fair value is measured by discounted estimated future cash flows. If necessary, the remaining useful life of the asset is correspondingly revised.

Interest on debt apportioned to the construction period of qualifying assets is capitalized as a part of their cost of acquisition or construction. The additional cost is depreciated over the expected useful life of the related asset, commencing on the completion or commissioning date.

Repair and maintenance costs are expensed as incurred.

**Leasing**

Leasing transactions are classified according to the lease agreements which specify the benefits and risks associated with the leased property. E.ON concludes some agreements in which it is the lessor and other agreements in which it is the lessee.

Leasing transactions in which E.ON is the lessee are differentiated into capital leases and operating leases. In a capital lease, the Company receives the economic benefit of the leased property and recognizes the asset and associated liability on its balance sheet. All other transactions in which E.ON is the lessee are classified as operating leases. Payments made under operating leases are recorded as an expense.

Leasing transactions in which E.ON is the lessor and the lessee enjoys substantially all the benefits and bears the risks of the leased property are classified as sales-type leases or direct financing leases. In these two types of leases, E.ON records the present value of the minimum lease payments as a receivable. The lessee's payments to E.ON are allocated between a reduction of the lease obligation and interest income. All other transactions in which E.ON is the lessor are categorized as operating leases. E.ON records the leased property as an asset and the scheduled lease payments as

income.

**Financial Assets**

Shares in associated companies are generally accounted for under the equity method. E.ON's accounting policies are also generally applied to its associated companies. Other share investments that are marketable, similar to securities, are valued in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities ( SFAS 115 ). SFAS 115 requires that a security be accounted for according to its classification as trading, available-for-sale or held-to-maturity. Debt securities that the Company does not have the positive intent

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and ability to hold to maturity, as well as all marketable securities, are classified as available-for-sale securities. The Company does not hold any securities classified as trading or held-to-maturity.

Securities classified as available-for-sale are carried at fair value, with any resulting unrealized gains and losses net of related deferred taxes reported as a separate component of stockholders' equity until realized. Realized gains and losses are recorded based on the specific identification method. Unrealized losses on all marketable securities and investments that are other than temporary are recognized in the line item Financial earnings, net as Write-down of financial assets and other share investments.

The residual value of debt securities is adjusted for premiums and discounts which remain to be amortized or accreted until maturity of the respective security. Such amortization and accretion is included in income. Realized gains and losses on such securities are respectively included in Other operating income (expenses), net. Other share investments that are non-marketable are accounted for at acquisition cost.

## **Inventories**

The Company values inventories at the lower of acquisition or production cost or market value. Raw materials, products and goods purchased for resale are primarily valued at average cost. Gas inventories are generally valued at LIFO. In addition to production materials and wages, production costs include material and production overheads based on normal capacity. The costs of general administration, voluntary social benefits and pensions are not capitalized. Inventory risks resulting from excess and obsolescence are provided for by appropriate valuation allowances.

## **Receivables and Other Assets**

Receivables and other assets are recorded at their nominal values. Valuation allowances are provided for identified individual risks. Further, if the recoverability of a certain portion of the receivables is not probable, valuation allowances are provided to cover the expected loss.

## **Emission Rights**

Emission rights held under national and international emission-rights systems are reported as inventory. Emission rights are capitalized at their acquisition costs when issued for the respective reporting period as (partial) fulfillment of the notice of allocation from the responsible national authorities. Emission rights are subsequently valued at amortized cost. The consumption of emission rights is valued at average cost. Any shortfall in emission rights is accrued throughout the year within other provisions. The expenses incurred for the consumption of emission rights and the recognition of a corresponding provision are reported under cost of goods sold.

As part of operating activities, emission rights are also held for proprietary trading purposes. Emission rights held for proprietary trading are reported under Operating receivables, other operating assets and prepaid expenses .

## **Discontinued Operations and Assets Held for Sale**

Discontinued operations are those operations of a reportable or operating segment, or of a component thereof, that either have been disposed of or are classified as held for sale. Assets and liabilities attributable to a component must be clearly distinguishable from the other consolidated entities in terms of their operations and cash flows. In addition, the reporting entity must not have any significant continuing involvement in the operations classified as a discontinued operation.



Also reported under assets and liabilities of discontinued operations are groups of long-lived assets held for disposal in one single transaction together with other assets and liabilities ( disposal groups ). SFAS 144 requires that certain defined criteria be met for an entity to be classified as a disposal group, and specifies the conditions under which a planned transaction becomes reportable separately as a discontinued operation.

Gains or losses from the disposal and income and expenses from the operations of a discontinued operation are reported under Income/Loss from discontinued operations, net ; prior-year income statement figures are adjusted

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accordingly. Cash flows of discontinued operations are stated separately in the Consolidated Statement of Cash Flows. However, there is no reclassification of prior-year balance sheet line items attributable to discontinued operations, as such reclassification is not required by SFAS 144.

The income and expenses related to operations that will be disposed of but are not classified as discontinued operations are included in `Income/Loss from continuing operations` until they are sold.

Individual assets and disposal groups identified as held for sale are no longer depreciated once they are classified as assets held for sale or as disposal groups. Instead, they are reported at the lower of their book value or their fair value. If the fair value of such assets, less selling costs, is less than the carrying value of the assets at the time of their classification as held for sale, an impairment is recognized immediately. The fair value is determined based on discounted cash flows. The underlying interest rate that management deems reasonable for the calculation of such discounted cash flows is contingent on the type of property and prevailing market conditions. Appraisals and, if appropriate, current estimated net sales proceeds from pending offers are also considered.

## **Restricted Cash**

Restricted cash with a remaining maturity in excess of twelve months is classified as `Financial receivables and other financial assets`.

## **Securities and Fixed-Term Deposits**

Deposits at banking institutions and available-for-sale securities that management does not intend to hold long-term with original maturities greater than three months are classified as `Securities and fixed-term deposits`. Unrealized gains and losses in these investments are reported net of related deferred taxes as a separate component of stockholders' equity. Realized gains and losses, as well as unrealized losses that are other than temporary, are recognized in `Other operating income (expenses), net`.

## **Cash and Cash Equivalents**

Cash and cash equivalents with an original maturity of three months or less include checks, cash on hand, balances in Bundesbank accounts and at other banking institutions. Included herein are also securities with an original maturity of three months or less unless they are restricted.

## **Stock-Based Compensation**

Effective January 1, 2006, E.ON applies the accounting and measurement guidelines of SFAS No. 123 (revised 2004), `Share-Based Payment (SFAS 123(R))`. SFAS 123(R) requires that the virtual stock option program (`Stock Appreciation Rights, SAR`) used by the E.ON Group be recognized as an expense on the basis of their fair value. Previously, under SFAS 123 in conjunction with FASB Interpretation No. 28, `Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans (FIN 28)`, SAR were accounted for at their intrinsic value on the balance sheet date, with the corresponding expenses also recognized on the income statement. In accordance with SFAS 123(R), E.ON determines fair value using the Monte Carlo simulation technique. The cumulative effect of the initial application of the standard, which was effected using the modified prospective transitional method, did not exceed 1 million. Consequently, no separate presentation of pro forma information is provided.

## **U.S. Regulatory Assets and Liabilities**

Accounting for E.ON's regulated utility businesses, Louisville Gas and Electric Company ( LG&E ), Louisville, Kentucky, U.S., and Kentucky Utilities Company ( Kentucky Utilities ), Lexington, Kentucky, U.S., of the U.S. Midwest market unit, conforms with U.S. generally accepted accounting principles as applied to regulated public utilities in the United States of America. These entities are subject to SFAS No. 71, Accounting for the Effects of Certain Types of Regulation ( SFAS 71 ), under which costs that would otherwise be charged to expense are deferred as regulatory assets based on expected recovery of such costs from customers in future rates approved by the relevant regulator. Likewise, certain credits that would otherwise be reflected as income are

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deferred as regulatory liabilities. The current or expected recovery by the entities of deferred costs and the expected return of deferred credits is generally based on specific ratemaking decisions or precedent for each item.

The U.S. Midwest market unit currently receives interest on most regulatory assets except for certain assets that have separate rate mechanisms providing for recovery within twelve months. No return is earned on the pension and postretirement regulatory asset, which represents the changes in the funded status of the plans. Additionally, no return is earned on the asset retirement obligation ( ARO ) regulatory asset. This regulatory asset will be offset against the associated regulatory liability, ARO asset and ARO liability at the time the underlying asset is retired.

U.S. regulatory assets and provisions are included in Operating receivables, other operating assets and prepaid expenses and Other provisions, respectively.

**Provisions for Pensions**

The valuation of pension liabilities is based upon actuarial computations using the projected unit credit method in accordance with SFAS No. 87, Employers Accounting for Pensions ( SFAS 87 ), and SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions ( SFAS 106 ). The valuation is based on current pensions and pension entitlements and on economic assumptions that have been chosen in order to reflect realistic expectations.

Cash balance pension plans are valued in accordance with the interpretation of the Emerging Issues Task Force (EITF) 03-4 (traditional unit credit method). The expanded disclosure requirements outlined in SFAS No. 132 (revised 2003),

Employers Disclosures about Pensions and Other Postretirement Benefits ( SFAS 132(R) ), were followed by E.ON for all domestic and foreign pension plans.

The effective date for fixing the economic measurement parameters is December 31 of each year. Variations in measurement assumptions, differences between the estimated and actual number of beneficiaries and underlying assumptions can result in actuarial gains and losses. Together with unrecognized prior service cost or credit, these are recognized as income or expense on a delayed basis and amortized separately over periods determined for each individual pension plan.

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 ) was adopted at the end of the 2006 fiscal year. SFAS 158 requires balance sheet recognition of the overfunded or underfunded status of pension and postretirement benefits.

Unrecognized actuarial gains or losses and past service cost have been recognized net of tax in Accumulated other comprehensive income as part of the adoption of SFAS 158. See Note 22 for more information.

**Other Provisions and Liabilities**

Other provisions and liabilities are recorded when an obligation to a third party has been incurred, the payment is probable and the amount can be reasonably estimated.

SFAS No. 143, Accounting for Asset Retirement Obligations ( SFAS 143 ), requires that the fair value of a liability arising from the retirement or disposal of an asset be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. When the liability is recorded, the Company must capitalize the costs of the liability by increasing the carrying amount of the long-lived asset. In subsequent periods, the liability is accreted to its present value and the carrying amount of the asset is depreciated over its useful life. Provisions for nuclear decommissioning costs are based on external studies and are continuously updated. Other provisions for the retirement or decommissioning of property, plant and equipment are based on estimates of the amount needed to fulfill the obligations.

Changes to these estimates arise pursuant to SFAS 143 particularly when there are deviations from original cost estimates or changes to the payment schedule or the level of relevant obligation. The liability must be adjusted in the case of both negative and positive changes to estimates (i.e., when the liability is less or greater than the accreted prior-year liability less utilization). Such an adjustment is usually effected through a corresponding adjustment to fixed assets and is not recognized in income. Provisions for liabilities are accreted annually at the same interest rate that was used to establish fair value. The interest rate for existing liabilities will not be changed in future years. For new liabilities, as well as for increases in fair value due to changes in estimates that are treated like

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new liabilities, the interest rate to be used for subsequent valuations will be the interest rate that was valid at the time the new liability was incurred or when the change in estimate occurred.

FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* – an Interpretation of FASB Statement No. 143 ( FIN 47 ), clarifies that SFAS 143 also applies to asset retirement obligations even though uncertainty exists about the timing and/or method of settlement. A liability must be recognized for an obligation if its fair value can be reasonably estimated. For the E.ON Group, the adoption of FIN 47 in 2005 resulted in a charge against earnings of 7 million after taxes ( 10 million before taxes). The net book values of long-lived assets increased by 13 million through the adoption of FIN 47, U.S. regulatory assets increased by 13 million, and additional provisions of 36 million were recognized.

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ( FIN 45 ), requires the guarantor to recognize a liability for the fair value of an obligation assumed under certain guarantees. It also expands the scope of the disclosures made concerning such guarantees. Note 25 contains additional information on significant guarantees that have been entered into by E.ON.

**Deferred Taxes**

Under SFAS No. 109, *Accounting for Income Taxes* ( SFAS 109 ), deferred taxes are recognized for all temporary differences between the applicable tax balance sheets and the Consolidated Balance Sheet. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. SFAS 109 also requires the recognition of the future tax benefits of net operating loss carryforwards. A valuation allowance is established when the deferred tax assets are not expected to be realized within a reasonable period of time.

Deferred tax assets and liabilities are measured using the enacted tax rates expected to be applicable for taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income for the period that includes the enactment date. The deferred taxes for German companies during the reporting year were generally calculated using a tax rate of 39 percent (2005: 39 percent; 2004: 39 percent) on the basis of a federal statutory rate of 25 percent for corporate income tax, a solidarity surcharge of 5.5 percent on corporate tax, and the average trade tax rate applicable for E.ON. Foreign subsidiaries use applicable national tax rates.

Note 7 shows the major temporary differences as recorded.

**Derivative Instruments and Hedging Activities**

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ), as amended by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133* – an amendment of FASB Statement No. 133 ( SFAS 137 ), and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* – an amendment of FASB Statement No. 133 ( SFAS 138 ), as well as the interpretations of the Derivatives Implementation Group ( DIG ), are applied as amended by SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* ( SFAS 149 ). SFAS 133 contains accounting and reporting standards for hedge accounting and for derivative financial instruments, including certain derivative financial instruments embedded in other contracts.

Instruments commonly used are foreign currency forwards, swaps and options, interest-rate swaps, interest-rate options and cross-currency swaps. Equity forwards are entered into to cover price risks on securities. In commodities, the instruments used include physically and cash-settled forwards and options based on the prices of electricity, gas,

coal, oil and emission rights. As part of conducting operations in commodities, derivatives are also acquired for proprietary trading purposes. Income and losses from derivative proprietary trading instruments are shown net in the Consolidated Statement of Income.

SFAS 133 requires that all derivatives be recognized as either assets or liabilities in the Consolidated Balance Sheet and measured at fair value. Depending on the documented designation of a derivative instrument, any change

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in fair value is recognized either in net income or stockholders' equity as a component of accumulated other comprehensive income.

SFAS 133 prescribes requirements for designation and documentation of hedging relationships and ongoing retrospective and prospective assessments of effectiveness in order to qualify for hedge accounting. The Company does not exclude any component of derivative gains and losses from the assessment of hedge effectiveness. Hedge accounting is considered to be appropriate if the assessment of hedge effectiveness indicates that the change in fair value of the designated hedging instrument is 80 to 125 percent effective at offsetting the change in fair value due to the hedged risk of the hedged item or transaction.

For qualifying fair value hedges, the change in the fair value of the derivative and the change in the fair value of the hedged item that is due to the hedged risks are recorded in income. If a derivative instrument qualifies as a cash flow hedge, the effective portion of the hedging instrument's gain or loss is reported in stockholders' equity (as a component of accumulated other comprehensive income) and is reclassified into earnings in the period or periods during which the transaction being hedged affects earnings. For hedging instruments used to establish cash flow hedges, the change in fair value of the ineffective portion is recorded in current earnings. To hedge the foreign currency risk arising from the Company's net investment in foreign operations, derivative as well as non-derivative financial instruments are used. Gains or losses due to changes in fair value and from foreign-currency translation are recorded in the cumulative translation adjustment within stockholders' equity as a currency translation adjustment in accumulated other comprehensive income.

Fair values of derivative instruments are classified as operating assets or liabilities. Changes in fair value of derivative instruments affecting income are classified as other operating income or expenses. Gains and losses from interest-rate derivatives are included in interest income. Certain realized amounts are, if related to the sale of products or services, included in Sales or Cost of goods sold and services provided.

Unrealized gains and losses resulting from the initial measurement of derivative financial instruments at the inception of the contract are not recognized in income. They are instead deferred and recognized in net income systematically over the term of the derivative. An exception to the accrual relates to unrealized gains and losses from the initial measurement that are verified by quoted market prices in an active market, observable prices of other current market transactions or other observable data supporting the valuation technique. In this case, the result of the initial measurement is recognized in income.

Option contracts relating to minority interests in fully consolidated companies and affiliates that do not fall within the scope of SFAS 133 are carried at fair value in accordance with SFAS No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150), EITF 00-6 Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary and EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.

Please see Note 28 for additional information regarding the Company's use of derivative instruments.

**Consolidated Statement of Cash Flows**

The Consolidated Statement of Cash Flows is classified by operating, investing and financing activities pursuant to SFAS No. 95, Statement of Cash Flows (SFAS 95). Cash flows of discontinued operations are reported separately in the Consolidated Statement of Cash Flows. The separate line item, Other non-cash income and expenses, is mainly comprised of undistributed income from companies accounted for under the equity method. Effects of changes in the scope of consolidation are shown in investing activities, but have been eliminated from operating and financing



activities. This also applies to valuation changes due to exchange rate fluctuations, whose impact on cash and cash equivalents is separately disclosed.

**Segment Information**

The Company's segment reporting is prepared in accordance with SFAS 131. The management approach required by SFAS 131 designates that the internal reporting organization that is used by management for making

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operating decisions and assessing performance should be used as the basis for presenting the Company's reportable segments (see Note 31).

## **Use of Estimates**

The preparation of the Consolidated Financial Statements requires management to make estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent amounts as of the balance sheet date and reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

## **Presentation of the Consolidated Balance Sheet and Reclassifications**

The Consolidated Balance Sheet as of December 31, 2006 has for the first time been prepared using a classified balance sheet structure, which improves the presentation of the financial condition. Assets that will be realized within twelve months of the reporting date are presented as current. Liabilities that are due to be settled within one year of the reporting date are classified as current. Prior-year information has been reclassified to conform to this presentation.

In addition, prior-year information has been reclassified in order to conform to the current-year presentation.

## **New Accounting Pronouncements**

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), was published in July 2006. FIN 48 describes the treatment of uncertain tax positions in financial reporting. FIN 48 applies to fiscal years that begin after December 15, 2006. E.ON is currently evaluating the potential effects of applying FIN 48.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 provides additional guidance for fair value measurements of assets and liabilities. It applies whenever other standards require assets or liabilities to be measured at fair value. It does not expand the use of fair value to any new circumstances. Under SFAS 157, fair value is the price in an orderly transaction between market participants to sell an asset or transfer a liability. A fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. In accordance with this principle, SFAS 157 establishes a fair value hierarchy that gives highest priority to quoted prices on active markets. At the lowest rung of this hierarchy are unobservable data such as the reporting entity's own data. This statement is effective for fiscal years beginning after November 15, 2007. E.ON is currently evaluating the potential effects of applying SFAS 157.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. E.ON has initially applied the provisions of SAB 108 for the fiscal year ending December 31, 2006. The initial application had no effects on the Consolidated Financial Statements.

On February 15, 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* Including an amendment of FASB Statement No. 115 (SFAS 159), which provides the option to measure certain financial assets and liabilities at fair value. Entities may decide whether to elect the fair value option for financial instruments to which the new accounting standard applies. Measurement classifications generally may be different for different financial instruments of similar types. The election is irrevocable and is applied only to an entire instrument; an instrument may not be split up for measurement purposes. SFAS 159 also contains rules concerning the presentation of items measured at fair value and corresponding disclosures in the notes to the financial statements. The application of SFAS 159 is mandatory for fiscal years that begin after November 15, 2007. E.ON is currently

evaluating the potential effects of applying SFAS 159.

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**Table of Contents****(3) Scope of Consolidation**

The number of consolidated companies changed as follows during the reporting year:

	<b>Domestic</b>	<b>Foreign</b>	<b>Total</b>
<b>Consolidated companies as of December 31, 2005</b>	<b>128</b>	<b>379</b>	<b>507</b>
Additions	15	18	33
Disposals/Mergers	5	35	40
<b>Consolidated companies as of December 31, 2006</b>	<b>138</b>	<b>362</b>	<b>500</b>

In 2006, a total of 109 domestic and 62 foreign associated companies were accounted for under the equity method (2005: 127 domestic and 63 foreign).

The mutual insurance fund Versorgungskasse Energie Versicherungsverein auf Gegenseitigkeit ( VKE ), Hanover, Germany, which reinsures part of the pension obligations toward E.ON Energie employees, was consolidated for the first time in 2006. A portion of the pension benefits received by these employees during retirement is covered by insurance contracts entered into with VKE. VKE also provides services with regard to the administration of pension payments for E.ON Group companies.

See Note 4 for additional information on acquisitions, disposals, discontinued operations and disposal groups.

The variable interest entities consolidated within the E.ON Group as of December 31, 2006, are two jointly managed electricity generation companies, one real estate leasing company and one company managing investments. During the second quarter of 2006, E.ON acquired additional interests in another real estate leasing company. E.ON now consolidates this company under the general consolidation rules as opposed to the variable interest criteria under FIN 46(R).

As of December 31, 2006, these variable interest entities included in the E.ON Group had total assets of 710 million (2005: 795 million) and recorded earnings of 27 million (2005: 17 million; 2004: 91 million) before consolidation. Total assets of 239 million and earnings of 3 million before consolidation were reported as of December 31, 2005, for the real estate leasing company in which E.ON obtained additional interests in the second quarter of 2006. As of December 31, 2004 earnings of 76 million before consolidation were reported for a variable interest entity disposed of during 2005 and no earnings before consolidation for the real estate leasing company in which E.ON obtained further interest in the second quarter 2006. Non-current assets of 132 million serve as collateral for liabilities relating to financial leases and bank loans.

The recourse of creditors of the consolidated variable interest entities to the assets of the primary beneficiary is generally limited. One variable interest entity has no such limitation of recourse. The primary beneficiary is liable for 75 million in respect of this entity.

In addition, the Company has had contractual relationships with another leasing company in the energy sector since July 1, 2000. The Company is not the primary beneficiary of this variable interest entity. The entity is currently in liquidation pursuant to a shareholder resolution. As of December 31, 2006, and December 31, 2005, the entity had no material assets and no liabilities. Neither the relationship to this entity nor its liquidation is expected to result in a realization of losses.

The extent of E.ON's interest in another variable interest entity, which has been in existence since 2001 and was expected to terminate in the fourth quarter of 2005, still cannot be assessed in accordance with the FIN 46(R) criteria due to insufficient information. The significant transactions between this entity and the E.ON Group took place in the fourth quarter of 2005, with no activities thereafter. However, the entity's liquidation remains outstanding. The entity handled the liquidation of assets from operations that had already been sold. Originally, its total assets amounted to 127 million. The termination of the relationship with this entity is not expected to result in any significant effects on earnings.

**Table of Contents****(4) Acquisitions, Disposals, Discontinued Operations and Disposal Groups**

The presentation of E.ON's acquisitions, disposals, discontinued operations and disposal groups in this Note is based on SFAS 141 and 144. Pursuant to SFAS 141, acquisitions are classified as either significant or other. Additional disclosures must be made for material transactions. No acquisition was classified as significant under these guidelines in 2006 and 2005.

All acquisitions and disposals are in principle consistent with E.ON's strategy for growth, which is to focus on its activities in the electricity and gas sectors.

***Acquisitions in 2006*****Central Europe*****JCP/DDGáz***

In the course of portfolio adjustments undertaken in the Czech Republic and Hungary, minority shareholdings in various companies were sold. In exchange, E.ON acquired, in addition to two other minority shareholdings, a further 46.7 percent of the company Jihočeská plynárenská, a.s. ( JCP ), České Budejovice, Czech Republic, in which E.ON previously held a 13.1 percent share. This company was fully consolidated as of September 1, 2006. An additional 39.2 percent interest was acquired in a separate transaction, which also took place in September. E.ON now holds 99.0 percent of JCP.

As part of the portfolio adjustment, an additional 49.9 percent interest was acquired in the fully consolidated company Déldunántúli Gázszolgáltató Rt. ( DDGáz ), Pécs, Hungary, in which E.ON previously held a 50.02 percent interest. As a result E.ON now holds 99.9 percent of DDGáz.

The exchange transaction resulted in total acquisition costs of 103 million, taking into account a cash component of 29 million. The acquisition of the share in DDGáz resulted in goodwill of 3 million; the purchase price allocation of JCP is still preliminary. Gains on disposals of minority interests totaled 31 million.

**Pan-European Gas*****E.ON Földgáz Storage/E.ON Földgáz Trade***

Effective March 31, 2006, E.ON Ruhrgas acquired a 100 percent interest in the gas trading and storage business of the Hungarian oil and gas company MOL through the acquisition of interests in MOL Földgázellátó Rt. (now E.ON Földgáz Storage) and MOL Földgázraktározó Rt. (now E.ON Földgáz Trade), both of Budapest, Hungary. The purchase price was approximately 400 million. It has been agreed that, contingent on regulatory developments in Hungary, compensatory payments may be required until the end of 2009 which could lead to a subsequent adjustment of the purchase price. The companies were fully consolidated as of March 31, 2006. As at December 31, 2006, the purchase price allocation resulted in goodwill of 119 million.

***Disposals, Discontinued Operations and Disposal Groups in 2006*****Discontinued Operations in 2006**

Pursuant to SFAS 144, the following two companies are reported as discontinued operations in 2006: E.ON Finland, Espoo, Finland, within the Nordic market unit and the operations of Western Kentucky Energy Corp. ( WKE ),

Henderson, Kentucky, U.S., within the U.S. Midwest market unit. E.ON Finland was sold in June 2006. In addition, E.ON recorded a gain in 2006 of approximately \$52 million (net of tax: \$51 million) from a purchase price adjustment on the sale of Viterra.

**Nordic**

*E.ON Finland*

On June 26, 2006, E.ON Nordic and the Finnish energy group Fortum Power and Heat Oy ( Fortum ) finalized the transfer to Fortum of all of E.ON Nordic's shares in E.ON Finland pursuant to an agreement signed on

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February 2, 2006. The purchase price for the 65.56 percent stake totaled approximately 390 million. E.ON Finland was classified as a discontinued operation in mid-January 2006.

The table below provides selected financial information from the discontinued operations of the Nordic segment for the periods indicated:

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Sales	131	258	253
Gain on disposal, net	11		
Other income/(expenses), net	(115)	(202)	(230)
<b>Income from continuing operations before income taxes and minority interests</b>	<b>27</b>	<b>56</b>	<b>23</b>
Income taxes	(7)	(15)	2
Minority interests	(9)	(17)	(9)
<b>Income from discontinued operations</b>	<b>11</b>	<b>24</b>	<b>16</b>

**U.S. Midwest***WKE*

Through WKE, E.ON U.S. has a 25-year lease on and operates the generating facilities of Big Rivers Electric Corporation ( BREC ), a power generation cooperative in western Kentucky, and a coal-fired facility owned by the city of Henderson, Kentucky.

In November 2005, E.ON U.S. entered into a letter of intent with BREC regarding a proposed transaction to terminate the lease and the operational agreements for nine coal-fired and one oil-fired electricity generation units in western Kentucky, which were held through its wholly-owned subsidiary WKE and affiliates. The parties remain in the process of negotiating definitive agreements regarding the transaction, the closing of which would be subject to a number of conditions, including review and approval by various regulatory agencies and acquisition of certain consents by other interested parties. Subject to such contingencies, the parties are working on completing the proposed termination transaction during 2007. WKE therefore continues to be classified as a discontinued operation, just as in 2005.

The tables below provide selected financial information from the discontinued WKE operations in the U.S. Midwest segment for the periods indicated:

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Sales	227	214	195
Other income/(expenses), net	(129)	(466)	(199)
<b>Income from continuing operations before income taxes and minority interests</b>	<b>98</b>	<b>(252)</b>	<b>(4)</b>
Income taxes	(34)	90	2



<b>Income from discontinued operations</b>	<b>64</b>	<b>(162)</b>	<b>(2)</b>
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<b>in millions</b>	<b>December 31, 2006</b>	<b>December 31, 2005</b>
Property, plant and equipment	214	212
Other assets	396	469
<b>Total assets</b>	<b>610</b>	<b>681</b>
Total liabilities	615	831

In accordance with U.S. GAAP, the income and expenses of discontinued operations are reported separately under Income/Loss from discontinued operations, net. The Consolidated Statements of Income, including the notes relating to them, for the period ended December 31, 2006, and for the prior reporting periods have been

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adjusted for all discontinued operations. The assets and liabilities of these discontinued operations are presented in the Consolidated Balance Sheet as of December 31, 2006, under Assets of disposal groups and Liabilities of disposal groups. The balance sheet disclosures for the prior reporting periods were not adjusted, as SFAS 144 does not require such an adjustment. Cash flows to and from discontinued operations are reported separately in the Consolidated Statement of Cash Flows.

*Other Disposals*

In December 2005, E.ON AG and RAG AG ( RAG ), Essen, Germany, signed a framework agreement on the sale of E.ON's 42.9 percent stake in Degussa to RAG. As part of the implementation of that framework agreement, on March 21, 2006, E.ON transferred its stake in Degussa into RAG Projektgesellschaft mbH, Essen, Germany. E.ON's stake in this entity was forward sold to RAG on the same date. On July 3, 2006, E.ON and RAG executed the forward sales agreement for E.ON's stake in RAG Projektgesellschaft mbH. E.ON has now sold its entire remaining, indirectly held stake in Degussa. RAG paid E.ON the roughly 2.8 billion purchase price on August 31, 2006. The transaction initially resulted in a gain of 618 million, which subsequently had to be adjusted for the intercompany gain attributable to E.ON's minority ownership interest in RAG (39.2 percent). A gain of 376 million was thus realized from the transfer and the subsequent sale.

*Acquisitions in 2005***Central Europe***Gorna Oryahovitzza/Varna*

At the end of February 2005, E.ON Energie acquired 67 percent stakes in each of the regional utilities Elektrorazpredelenie Gorna Oryahovitzza AD ( Gorna Oryahovitzza ), Gorna Oryahovitzza, Bulgaria, and Elektrorazpredelenie Varna AD ( Varna ), Varna, Bulgaria, for an aggregate purchase price of approximately 138 million. Total goodwill of 16 million resulted from the purchase price allocation. The companies were fully consolidated as of March 1, 2005.

*ETE*

In July 2005, E.ON Energie transferred its 51 percent interest (49 percent voting interest) in Gasversorgung Thüringen GmbH ( GVT ), Erfurt, Germany, and its 72.7 percent interest in Thüringer Energie AG ( TEAG ), Erfurt, Germany, to Thüringer Energie Beteiligungsgesellschaft mbH ( TEB ), Munich, Germany. Municipal shareholders also transferred interests in GVT totaling 43.9 percent to TEB. GVT was then merged into TEAG, and the merged entity was renamed E.ON Thüringer Energie AG ( ETE ), Erfurt, Germany. As a result of this reorganization, E.ON Energie holds an 81.5 percent interest in TEB and TEB holds a 76.8 percent interest in ETE.

The consolidation of GVT as of July 1, 2005, undertaken at an acquisition cost of 168 million, resulted in goodwill of 58 million from the purchase price allocation. The transfer of the stake in TEAG resulted in a gain of 90 million, which is recognized under other operating income.

*NRE*

In September 2005, E.ON Energie completed the acquisition of 100 percent of the Dutch electric and gas utility NRE Energie b.v. ( NRE ), Eindhoven, The Netherlands. The purchase price amounted to 79 million, with 46 million in goodwill resulting from the purchase price allocation. NRE was fully consolidated as of September 1, 2005.

*E.ON Moldova*

At the end of September 2005, E.ON Energie completed the acquisition of the regional utility Electrica Moldova S.A. ( Moldova ), Bacau, Romania now E.ON Moldova S.A. ( E.ON Moldova ) by acquiring a 24.6 percent stake in and then increasing its stake in the company to 51 percent through a capital increase. The purchase price for this 51 percent interest amounted to 101 million. E.ON Moldova was fully consolidated as of September 30, 2005. No goodwill resulted from the purchase price allocation.

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**Table of Contents****Pan-European Gas***Distrigaz*

Following approval by the relevant authorities, E.ON Ruhrgas in June 2005 purchased a 30 percent interest in the gas utility S.C. Distrigaz Nord S.A. ( Distrigaz ), Târgu Mures, Romania, from the Romanian government for 127 million. Following a simultaneous increase in capital by 178 million, this holding increased to 51 percent. The company was fully consolidated as of June 30, 2005. Goodwill in the amount of 60 million resulted from the purchase price allocation. The entity was subsequently renamed E.ON Gaz România S.A.

*Caledonia*

E.ON Ruhrgas in November 2005 bought the British gas exploration company Caledonia Oil and Gas Limited ( Caledonia ), London, U.K., which has a stake in 15 gas fields in the British part of the southern North Sea. The purchase price including incidental acquisition expenses for the 100 percent interest in Caledonia totaled 602 million and was primarily paid through the issuance of loan notes. The company was fully consolidated on November 1, 2005. Goodwill in the amount of 390 million resulted from the final purchase price allocation. The company was subsequently renamed E.ON Ruhrgas UK North Sea Limited.

**U.K.***Enfield*

During the first half of 2005, E.ON UK bought 100 percent of the shares of Enfield Energy Centre Ltd. ( Enfield ), Coventry, U.K., in two phases. The purchase price was approximately 185 million (GBP 127 million). The company was fully consolidated as of April 1, 2005. No goodwill resulted from the purchase price allocation.

*Holford*

In July 2005, E.ON UK acquired Holford Gas Storage Ltd. ( Holford ), Edinburgh, U.K. The purchase price for the company was approximately 140 million (GBP 96 million). Full consolidation of the company took place on July 28, 2005. No goodwill resulted from the purchase price allocation.

***Disposals, Discontinued Operations and Disposal Groups in 2005*****Discontinued Operations in 2005**

For the 2005 fiscal year, Viterra and Ruhrgas Industries, both of which were sold during the year, were reported as discontinued operations in accordance with SFAS 144. In the U.S. Midwest market unit, the activities of WKE were classified as a discontinued operation. In addition, there were gains in 2005 from the discontinued operations of the Company's former aluminum segment, which had already been sold in 2002, as well as from the discontinued operations of a company in the U.S. Midwest market unit that was sold in 2003. These gains totaled 11 million before taxes (after-tax gain: 11 million).

**Pan-European Gas***Ruhrgas Industries*

On June 15, 2005, E.ON Ruhrgas sold Ruhrgas Industries GmbH ( Ruhrgas Industries ), Essen, Germany, which operates in the gas measurement and control segments and in the construction of industrial blast furnaces, to the holding company CVC Capital Partners for a price of approximately 1.2 billion. The company was classified as a discontinued operation in June 2005 and deconsolidated as of August 31, 2005. The sale resulted in a gain of approximately 0.6 billion.

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The table below provides details of selected financial information from the discontinued operations of the Pan-European Gas segment for the periods indicated:

<b>in millions</b>	<b>2005</b>	<b>2004</b>
Sales	847	1,188
Gain on disposal, net	606	
Other income/(expenses), net	(803)	(1,123)
<b>Income from continuing operations before income taxes and minority interests</b>	<b>650</b>	<b>65</b>
Income taxes	(21)	(35)
Minority interests	(1)	(1)
<b>Income from discontinued operations</b>	<b>628</b>	<b>29</b>

**Other Activities***Viterra*

On May 17, 2005, E.ON sold 100 percent of Viterra, which is active in residential real estate and in the growing real estate development business, to Deutsche Annington GmbH, Düsseldorf, Germany. The price for the shares was approximately 4 billion. The company was classified as a discontinued operation in May 2005 and deconsolidated as of July 31, 2005. A book gain of 2.4 billion was recognized on the sale.

The table below provides details of selected financial information from the discontinued operations of the other activities segment for the periods indicated:

<b>in millions</b>	<b>2005</b>	<b>2004</b>
Sales	453	978
Gain on disposal, net	2,406	
Other income/(expenses), net	(282)	(595)
<b>Income from continuing operations before income taxes and minority interests</b>	<b>2,577</b>	<b>383</b>
Income taxes	(19)	(64)
Minority interests		(25)
<b>Income from discontinued operations</b>	<b>2,558</b>	<b>294</b>

*Acquisitions in 2004***Significant Acquisitions in 2004****U.K.**

*Midlands Electricity*

On January 16, 2004, E.ON UK completed the acquisition of 100 percent of the British distributor of electricity Midlands Electricity plc ( Midlands Electricity ), Worcester, U.K. The purchase price, including incidental acquisition expenses, amounted to 1,706 million (GBP 1,180 million), of which 55 million was paid to stockholders and 881 million was paid to creditors. Moreover, financial debts amounting to an equivalent of 856 million were assumed. The payments to stockholders were offset by acquired liquid funds of 86 million. The company was thus fully consolidated as of January 16, 2004.

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The table below contains a presentation of the major classes of assets and liabilities of Midlands Electricity as of the acquisition date:

<b>in millions</b>	<b>January 16, 2004</b>
Goodwill	473
Intangible assets	10
Property, plant and equipment	1,745
Financial assets	34
Other assets	217
<b>Total assets</b>	<b>2,479</b>
Provisions	(178)
Liabilities	(2,246)
<b>Total liabilities</b>	<b>(2,424)</b>
<b>Net assets</b>	<b>55</b>

**Other Acquisitions in 2004****Central Europe***JME/JCE*

In 2003, majority stakes in two Czech regional utilities, Jihomoravská energetika a.s. ( JME ), Brno, Czech Republic, and Jihočeská energetika a.s. ( JCE ), České Budějovice, Czech Republic, were acquired for a total of 207 million, and both companies were fully consolidated on October 1, 2003. In December 2004, additional interests in JME and JCE were acquired; these transactions increased the Company's respective interests in JME and JCE from 85.7 percent and 84.7 percent as of January 1, 2004, to 99.0 percent and 98.7 percent as of December 31, 2004. The total purchase price in 2004 amounted to 81 million.

Through the acquisition of all minority interests in 2005, E.ON's ownership interest in both companies was increased to 100 percent. The acquisition costs for the stakes acquired in 2005 amounted to 5 million. The businesses of JCE and JME were subsequently transferred to the Group companies E.ON Distribuce a.s., E.ON Česká Republika a.s. and E.ON Energie a.s., all registered in České Budějovice, Czech Republic. For the interests acquired in 2004 and 2005, no goodwill remained after purchase price allocation.

*E.ON Bayern*

In 2004, the acquisition of the remaining E.ON Bayern shares by means of a squeeze-out procedure resulted in acquisition costs of 189 million, of which 165 million were attributable to the transfer of E.ON AG shares. The goodwill resulting from this transaction was 148 million.

Following the conclusion of all legal challenges to the squeeze-out procedure, the squeeze-out was entered in the commercial register in July 2004. E.ON now holds 100 percent of E.ON Bayern.



## **Pan-European Gas**

### *Thüga*

In May 2004, the squeeze-out transaction for the outstanding Thüga shares (3.4 percent) was completed and entered in the commercial register, with the result that the total E.ON Group stake in Thüga amounted to 100 percent as of December 31, 2004. The remaining 2.9 million shares were acquired at a purchase price of 223 million (including ancillary costs related to the acquisition). The purchase price allocation for these shares resulted in goodwill amounting to 106 million.

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**Table of Contents****Nordic***Graninge*

In the first half of 2004, E.ON Sverige increased its stake in Graninge AB ( Graninge ), Sollefteå, Sweden, from 79.0 percent as of January 1, 2004, to 100 percent through the acquisition of the outstanding shares in three tranches for an aggregate price of 307 million (2.82 billion SEK). The purchase price allocation relating to these shares resulted in goodwill amounting to 76 million. As of December 31, 2004, the goodwill relating to the 100 percent interest in Graninge amounted to 233 million.

***Disposals, Discontinued Operations and Disposal Groups in 2004*****Disposal Groups in 2004****Nordic***Graninge*

In 2004, E.ON reached an understanding in principle with the Norwegian utility Statkraft SF ( Statkraft SF ), Oslo, Norway, on the sale of part of the hydroelectric generation capacity that E.ON had acquired when it purchased Graninge.

E.ON Sverige and Statkraft AS ( Statkraft AS ), Oslo, Norway, signed an agreement to that effect on July 1, 2005. The sales price was approximately 480 million (SEK 4.46 billion). Statkraft AS took over the power plants in October 2005. Because assets and liabilities were recognized at fair values as part of the purchase price allocation following the acquisition of Graninge, the sale of the disposal group did not result in a significant effect on income.

The table below shows the major balance sheet line items affected by the transaction; they were presented in the Consolidated Balance Sheet as of December 31, 2004, under Assets/Liabilities of disposal groups.

<b>in millions</b>	<b>December 31, 2004</b>
Fixed assets	553
Other assets	
<b>Total assets</b>	<b>553</b>
Total liabilities	(54)
<b>Net assets</b>	<b>499</b>

**(5) Other Operating Income and Expenses**

The table below provides details of other operating income and expenses for the periods indicated:

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
--------------------	-------------	-------------	-------------

Gains from the disposal of investments, net	579	34	397
(Loss) Gain on derivative instruments, net	(2,748)	931	602
Exchange rate differences	44	138	(309)
SAB 51 Gain	7	31	
Research and development costs	(27)	(24)	(19)
Miscellaneous	1,297	564	707
<b>Total</b>	<b>(848)</b>	<b>1,674</b>	<b>1,378</b>

Other operating expenses include costs that cannot be allocated to production, selling or administration activities.

In the reporting period, net gains on the disposal of investments include the proceeds from the sale of the interest in Degussa ( 376 million; see also Note 4). The higher gains in 2004 compared to 2005 were mainly

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attributable to the sale of stakes in EWE Aktiengesellschaft and Verbundnetz Gas AG (total gain: 317 million) and the disposal of 3.6 percent of the shares of Degussa AG ( 51 million).

Loss (Gain) on derivative financial instruments, net include the losses and gains recognized as a result of the required marking to market and realized gains from derivatives under SFAS 133. The net loss in 2006 compared to a net gain in 2005 consists primarily of expenses from the fulfillment of derivative gas supply contracts and from the marking to market of energy derivatives, primarily at the U.K. market unit. These derivatives are used to hedge against fluctuations in prices. As of the end of 2006, this marking to market resulted in a loss of approximately 2.7 billion. In 2005, gains on the marking to market of derivatives increased in comparison with 2004 by 329 million.

Realized gains from currency derivatives and the effects of positive exchange rate differences recognized in income are reported as income from exchange rate differences.

The issuance of shares of E.ON Avacon AG ( E.ON Avacon ), Helmstedt, Germany, resulted in SAB 51 gains of 7 million and 31 million in 2006 and 2005, respectively.

Miscellaneous other operating income in 2006 includes net gains realized on the sale of securities in the amount of 492 million (2005: 398 million; 2004: 231 million). Also included in this line item are gains from the disposal of institutional securities funds as part of the transfer to the Contractual Trust Arrangement ( CTA ) in the amount of 159 million (see also Note 22) as well as income from the reversal of provisions ( 146 million). The decrease in 2005 compared to 2004 of 143 million was mainly attributable to lower income from the reversal of provisions ( 218 million) and an impairment loss recorded at cogeneration facilities in the U.K. market unit ( 129 million) which was partly offset by higher gains realized on the sale of securities ( 153 million) and the gain from the reduction of the Company's stake in TEAG in connection with the bundling of its electric and gas activities in the German state of Thuringia into ETE ( 90 million).

**(6) Financial earnings, net**

The following table provides details of financial earnings, net for the periods indicated:

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Income from companies in which share investments are held; thereof from affiliated companies: 35 (2005: 33; 2004: 32)	223	203	185
Income from profit-and-loss-pooling agreements; thereof from affiliated companies: 4 (2005: 3; 2004: 5)	4	3	5
Losses from profit-and-loss-pooling agreements; thereof from affiliated companies: (8) (2005: (1); 2004: (8))	(9)	(3)	(10)
<b>Income from share investments</b>	<b>218</b>	<b>203</b>	<b>180</b>
Income from other securities	37	45	36
Other interest and similar income; thereof from affiliated companies: 11 (2005: 6; 2004: 8)	1,213	1,001	576
Interest and similar expenses; thereof from affiliated companies: (3) (2005: (8); 2004: (5))	(1,937)	(1,782)	(1,675)
thereof SFAS 143 accretion expense: (524) (2005: (511); 2004: (499))	(1,937)	(1,782)	(1,675)

<b>Interest and similar expenses (net)</b>	<b>(687)</b>	<b>(736)</b>	<b>(1,063)</b>
Write-down of financial assets and share investments	(164)	(74)	(131)
<b>Financial earnings, net</b>	<b>(633)</b>	<b>(607)</b>	<b>(1,014)</b>

Net interest and similar expenses improved in 2006 as a result of lower net financial indebtedness; additionally, increasing interest rates had a positive effect on interest income from cash investments. Moreover, the first-time inclusion of VKE had a positive effect. Interest expense was reduced by capitalized interest on debt totaling 27 million (2005: 24 million; 2004: 20 million).

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Included in interest and similar expenses (net) is a balance of 31 million resulting from various loans (2005: 31 million; 2004: 43 million).

**(7) Income Taxes**

The following table provides details of income taxes, including deferred taxes, for the periods indicated:

in millions	2006	2005	2004
Current taxes			
Domestic corporate income tax	(406)	1,081	952
Domestic trade tax	351	416	446
Foreign income tax	553	374	387
Other income taxes	5		(1)
<b>Total</b>	<b>503</b>	<b>1,871</b>	<b>1,784</b>
Deferred taxes			
Domestic	(360)	(4)	92
Foreign	(466)	394	(24)
<b>Total</b>	<b>(826)</b>	<b>390</b>	<b>68</b>
<b>Income taxes</b>	<b>(323)</b>	<b>2,261</b>	<b>1,852</b>

The decrease in tax expenses of 2,584 million over the previous year primarily reflects the following effects: Current income taxes were reduced as a result of a higher proportion of tax-exempt earnings and the first-time recognition of 1,279 million in corporate tax credits (see below). In addition, deferred tax benefits of approximately 1,200 million were generated primarily as a result of losses recognized on the marking to market of commodity derivatives. The increase in tax expenses of 409 million in 2005 compared to 2004 reflected increases in operating income and reduced tax-exempt earnings, as well as higher foreign deferred tax expense due to marking to market of energy derivatives in the U.K. market unit.

The first-time recognition of corporate tax credits is based on new German legislation providing for fiscal measures to accompany the introduction of the European Company and amending other fiscal provisions ( SE-Steuer-gesetz , or SEStEG ), which came into effect on December 13, 2006. The new legislation altered the regulations on corporate tax credits arising from the corporate imputation system ( Anrechnungsverfahren ), which had existed until 2001. The change de-links the corporate tax credit from distributions of dividends. Instead, after December 31, 2006, an unconditional claim for payment of the credit in ten equal annual installments from 2008 through 2017 has been established. The total amount of the credit is 1,599 million. After discounting, tax income for the financial year was 1,279 million. The elimination in 2006 of the exclusion of corporate tax credits for dividends distributed after April 11, 2003, and before January 1, 2006, resulted in a tax relief of approximately 76 million on the dividend distributions, including the special dividend, totaling 4,614 million that were carried out in 2006.

In 2005, a deferred tax liability of 436 million was recorded to take into account the difference between net assets and the tax bases of subsidiaries and associated companies. As of December 31, 2006, the deferred tax liability amounted to 526 million. No deferred taxes have been recognized for temporary differences between net assets and the tax bases

of foreign subsidiaries held by companies in third countries, since no actual reversals of these differences are expected to occur, which in turn makes it impracticable to determine deferred taxes for them.

Changes in foreign tax rates resulted in a total deferred tax benefit of 20 million. This compares to a deferred tax expense of 4 million recorded in 2005 and a deferred benefit of 2 million for 2004.

Whereas prior to 2006 the reconciliation to effective income taxes and tax rate has been derived from the corporate tax rate, the reconciliation for 2006 for the first time uses the income tax rate applicable to E.ON in

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Germany (consisting of corporate tax, trade tax and the solidarity surcharge) of 39 percent as a basis. The differences between the respective base income tax rate and the effective tax rate are reconciled as follows:

	<b>2006</b>		<b>2005 (1)</b>		<b>2004</b>	
	<b>in</b>	<b>%</b>	<b>in</b>	<b>%</b>	<b>in</b>	<b>%</b>
	<b>millions</b>		<b>millions</b>		<b>millions</b>	
Corporate income tax	2,002	39.0	2,789	39.0	2,469	39.0
Credit for dividend distributions	(76)	(1.5)				
Foreign tax rate differentials	(33)	(0.6)	(355)	(5.0)	(170)	(2.7)
Changes in valuation allowances	(41)	(0.8)	109	1.5	(202)	(3.2)
Changes in tax rate/tax law	(21)	(0.4)	4	0.1	149	2.4
Tax effects on						
Tax-free income	(634)	(12.4)	(315)	(4.4)	(501)	(7.9)
Equity accounting	(258)	(5.0)	(67)	(0.9)	(185)	(2.9)
Other (2)	(1,262)	(24.6)	96	1.3	292	4.6
<b>Effective income taxes/tax rate</b>	<b>(323)</b>	<b>(6.3)</b>	<b>2,261</b>	<b>31.6</b>	<b>1,852</b>	<b>29.3</b>

(1) Prior-year values have been adjusted accordingly to reflect the combined rate of 39 percent

(2) thereof in 2006 income from capitalization of corporate tax credits: 1,279 million

As discussed in Note 4, the corporate income taxes relating to discontinued operations are reported in E.ON's Consolidated Statement of Income under Income/Loss from discontinued operations, net, and are as follows:

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Viterra	1	19	64
Ruhrgas Industries		21	35
WKE	34	(90)	(2)
E.ON Finland	7	15	(2)
<b>Income taxes from discontinued operations</b>	<b>42</b>	<b>(35)</b>	<b>95</b>

Income from continuing operations before income taxes and minority interests was attributable to the following geographic locations in the periods indicated:

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Domestic	3,664	3,526	3,553
Foreign	1,469	3,626	2,779
<b>Total</b>	<b>5,133</b>	<b>7,152</b>	<b>6,332</b>





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Deferred tax assets and liabilities are as follows as of December 31, 2006 and 2005:

<b>in millions</b>	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Deferred tax assets</b>		
Intangible assets	66	41
Property, plant and equipment	549	624
Financial assets	208	383
Inventories	12	7
Receivables	508	178
Provisions	4,227	4,753
Liabilities	2,315	2,421
Net operating loss carryforwards	613	891
Tax credits	38	33
Other	190	269
<b>Subtotal</b>	<b>8,726</b>	<b>9,600</b>
Valuation allowance	(434)	(573)
<b>Total</b>	<b>8,292</b>	<b>9,027</b>
<b>Deferred tax liabilities</b>		
Intangible assets	1,140	1,030
Property, plant and equipment	6,631	6,609
Financial assets	2,510	2,312
Inventories	122	94
Receivables	1,851	2,401
Provisions	443	1,167
Liabilities	107	911
Other	1,544	844
<b>Total</b>	<b>14,348</b>	<b>15,368</b>
<b>Net deferred tax assets/liabilities (-)</b>	<b>(6,056)</b>	<b>(6,341)</b>

Of the deferred tax liabilities on financial assets reported for 2006, 1,793 million (2005: 1,137 million) relate to the marking to market of other share investments. Of this amount, 1,777 million (2005: 1,120 million) were recorded in stockholders' equity (other comprehensive income), with no effect on income.

The adoption of SFAS 158 has led to an increase in deferred tax assets of 254 million. In addition, the reclassification of existing gross additional minimum pension liabilities totaling 1,374 million, 318 million in deferred taxes not recognized in income was reclassified as a component of accumulated other comprehensive income. The Consolidated Statement of Changes in Stockholders' Equity provides additional information.

Net deferred income taxes included in the Consolidated Balance Sheet are as follows:

in millions	December 31, 2006		December 31, 2005	
	current	non-current	current	non-current
Deferred tax assets	358	1,933	383	2,269
Valuation allowance	(11)	(423)	(10)	(563)
<b>Net deferred tax assets</b>	<b>347</b>	<b>1,510</b>	<b>373</b>	<b>1,706</b>
Deferred tax liabilities	(619)	(7,294)	(491)	(7,929)
<b>Net deferred tax assets/liabilities (-)</b>	<b>(272)</b>	<b>(5,784)</b>	<b>(118)</b>	<b>(6,223)</b>

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The purchase price allocations of the acquisitions of DDGáz, E.ON Földgáz Trade, E.ON Földgáz Storage, Somet and E.ON Värme resulted in the recognition on December 31, 2006, of a total of 6 million in deferred tax assets and 27 million in deferred tax liabilities.

In the acquisition of E.ON Ruhrgas North Sea Limited, the purchase price allocation resulted in deferred tax assets of 112 million and deferred tax liabilities of 245 million as of December 31, 2005. The purchase price allocation of GVT resulted in a deferred tax liability of 36 million as of December 31, 2005.

The purchase price allocations of the acquisitions of E.ON Gaz România S.A., NRE Energie, Varna and Enfield resulted in a total deferred tax liability of 56 million as of December 31, 2005.

Based on subsidiaries' past performance and the expectation of similar performance in the future, it is expected that the future taxable income of these subsidiaries will more likely than not be sufficient to permit recognition of their deferred tax assets. A valuation allowance has been provided for that portion of the deferred tax assets for which this criterion is not expected to be met.

The tax loss carryforwards as of the dates indicated are as follows:

<b>in millions</b>	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Domestic tax loss carryforwards	2,016	2,907
Foreign tax loss carryforwards	956	1,220
<b>Total</b>	<b>2,972</b>	<b>4,127</b>

Since January 1, 2004, a tax loss carryforward can only be offset against up to 60 percent of taxable income, subject to a full offset against the first 1 million. This minimum corporate taxation also applies to trade tax loss carryforwards. Despite the introduction of minimum taxation, the German tax loss carryforwards have no expiration date.

Foreign tax loss carryforwards expire as follows: 15 million in 2007, 34 million between 2008 and 2011, 388 million after 2011. 519 million do not have an expiration date.

Tax credits totaling 38 million are exclusively foreign. Of these, 24 million expire after 2011 and 14 million do not have an expiration date.

**(8) Minority Interests in Net Income**

Minority stockholders participate in the profits of the affiliated companies in the amount of 667 million (2005: 567 million; 2004: 524 million) and in the losses in the amount of 141 million (2005: 31 million; 2004: 55 million).

**(9) Personnel-Related Information****Personnel Costs**

The following table provides details of personnel costs for the periods indicated:

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Wages and salaries	3,470	3,218	2,916
Social security contributions	579	549	500
Pension costs and other employee benefits; thereof pension costs: 505 (2005: 415; 2004: 373)	524	465	394
<b>Total</b>	<b>4,573</b>	<b>4,232</b>	<b>3,810</b>

In 2006, E.ON utilized 443,290 of its own shares (0.06 percent of E.ON's outstanding shares) (2005: 308,555 shares; 0.04 percent) for resale to employees as part of an employee stock purchase program. These shares were sold to employees at preferential prices between 38.37 and 74.77 (2005: between 35.01 and 64.04). The

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costs arising from the granting of these preferential prices were charged to personnel costs as wages and salaries. Further information about the changes in the number of its own shares held by E.ON AG can be found in Note 17.

Since the 2003 fiscal year, employees in the U.K. have the opportunity to purchase E.ON shares through an employee stock purchase program and to acquire additional bonus shares. The cost of issuing these bonus shares is also recorded under personnel costs as part of Wages and salaries.

**Share-Based Payment**

Members of the Board of Management of E.ON AG and certain executives of E.ON AG and of the market units receive share-based payment as part of their long-term variable compensation. Share-based payment can only be granted if the qualified executive owns a certain minimum number of shares of E.ON stock, which must be held until maturity or full exercise. The purpose of such compensation is to reward their contribution to E.ON's growth and to further the long-term success of the Company. This variable compensation component, comprising a long-term incentive effect along with a certain element of risk, provides for a sensible linking of the interests of shareholders and management.

The following discussion includes a report on the E.ON AG Stock Appreciation Rights plan, which ended in 2005, and on the E.ON Share Performance Plan, newly introduced in 2006.

**Stock Appreciation Rights of E.ON AG**

From 1999 up to and including 2005, E.ON annually granted virtual stock options ( Stock Appreciation Rights or SAR ) through the E.ON AG Stock Appreciation Rights program. The first tranche of SAR (from 1999) was exercised in full in 2002, and the second tranche (from 2000) was exercised in full in 2006. SAR from the third through seventh tranches may still be exercised after the end of the program, in accordance with the SAR terms and conditions.

	<b>7th tranche</b>	<b>6th tranche</b>	<b>5th tranche</b>	<b>4th tranche</b>	<b>3rd tranche</b>	<b>2nd tranche</b>
Date of issuance	Jan. 3, 2005	Jan. 2, 2004	Jan. 2, 2003	Jan. 2, 2002	Jan. 2, 2001	Jan. 3, 2000
Term	7 years	7 years	7 years	7 years	7 years	7 years
Blackout period	2 years	2 years	2 years	2 years	2 years	2 years
Price at issuance (in €)*	61.10	44.80	37.86	50.70	58.70	44.10
Level of the Dow Jones STOXX Utilities Index (Price EUR) at SAR issuance	268.66	211.58	202.14	262.44	300.18	285.77
Number of participants in year of issuance	357	357	344	186	231	155
Number of SAR issued (in millions)	2.9	2.7	2.6	1.7	1.8	1.5
Exercise hurdle (minimum)	10	10	10	10	20	20

percentage by which exercise price exceeds the price at issuance)						
Exercise hurdle (minimum exercise price in )*	67.21	49.28	41.65	55.77	70.44	52.92
Maximum exercise gain (in )	65.35	49.05				

\* Adjusted for special dividend distribution

SAR can be exercised by eligible executives following the blackout period within predetermined exercise windows, provided that the E.ON AG share price outperforms the Dow Jones STOXX Utilities Index (Price EUR) on at least ten consecutive trading days during the period from issuance until exercise, and that the E.ON AG share price on exercise is at least 10.0 percent (for the second and third tranches: at least 20.0 percent) above the price at issuance. The term of the SAR is limited to a total of 7 years.

Starting with the fourth tranche, the original underlying share price is equal to the average of the XETRA closing quotations for E.ON stock during the December prior to issuance. For tranches two and three, the underlying

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share price is the E.ON share price at the actual time of issuance. Because of the distribution of the special dividend of 4.25 per E.ON AG share declared by resolution of the Annual Shareholders Meeting on May 4, 2006, the original price at issuance and the exercise hurdles were adjusted in accordance with the SAR terms and conditions.

The amount paid to executives when they exercise their SAR is paid out in cash, and is equal to the difference between the E.ON AG share price at the time of exercise and the underlying share price at issuance multiplied by the number of SAR exercised. Beginning with the sixth tranche, a cap on gains on SAR equal to 100 percent of the underlying price at the time of issuance was put in place in order to limit the effect of unforeseen extraordinary increases in the underlying share price. This cap on gains took effect for the first time in the 2006 fiscal year. The exercise gains from 651,016 SAR of the sixth tranche were limited to the cap of 49.05.

As part of U.S. GAAP measurement, in accordance with SFAS 123(R), the SAR were measured at fair value for the first time in 2006.

A recognized option pricing model is used for measuring the value of these options. This option pricing model simulates a large number of different possible developments of the E.ON share price and the benchmark Dow Jones STOXX Utilities Index (Price EUR) (Monte Carlo simulation).

A certain exercise behavior is assumed when determining fair value. Individual exercise rates are defined for each of the tranches, depending on the price performance of the E.ON share. There is no liquid options market for the benchmark index, so no use is made of implicit volatility for reasons of consistency. Historical volatility and correlations of the E.ON share price and of the benchmark index that reflect remaining maturities are used in the calculations. The reference interest rate is the zero-swap rate for the corresponding remaining maturity. The dividend yields of E.ON stock and of the benchmark index are also taken into account in this pricing model. They are established based on the ratio of the last dividend distributed and the share prices on the valuation day. Future dividend expectations thus correspond to the most recent dividends paid out.

The table above and the following overview contain the parameters used for measurement on the balance sheet date.

	<b>7th tranche</b>	<b>6th tranche</b>	<b>5th tranche</b>	<b>4th tranche</b>	<b>3rd tranche</b>
E.ON AG share price on December 31, 2006 (in €)	102.83	102.83	102.83	102.83	102.83
Level of the Dow Jones STOXX Utilities Index (Price EUR) on December 31, 2006	464.95	464.95	464.95	464.95	464.95
Intrinsic value as of December 31, 2006 (in €)	41.73	49.05	64.97	52.13	44.13
Fair value as of December 31, 2006 (in €)	41.87	47.38	61.43	48.52	43.72
Swap rate (in %)	4.03	4.03	4.04	4.04	3.98
Volatility of the E.ON share (in %)	25.81	26.22	26.29	25.46	22.57
Volatility of the Dow Jones STOXX Utilities Index (Price EUR) (in %)	14.66	14.85	14.96	14.74	13.62
Correlation between the E.ON share price and the Dow Jones STOXX Utilities Index (Price EUR)	0.6802	0.6896	0.7066	0.7382	0.7901



Most recent cash dividend paid on E.ON AG stock (in ¢)	2.75	2.75	2.75	2.75	2.75
Dividend yield of the E.ON share (in %)	2.67	2.67	2.67	2.67	2.67
Dividend yield of the Dow Jones STOXX Utilities Index (Price EUR) (in %)	4.36	4.36	4.36	4.36	4.36

In 2006, 2,948,702 SAR from tranches two through six were exercised on an ordinary basis. In addition, 64,890 SAR from tranches six and seven were exercised in accordance with the SAR terms and conditions on an extraordinary basis. The gain to the holders on exercise totaled 134.4 million (2005: 78.1 million). During 2006,

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42,181 SAR from tranches five, six and seven expired. The provision for the SAR program was 143.1 million as of the balance sheet date (2005: 164.4 million). The expense for the 2006 fiscal year amounted to 113.0 million (2005: 137.7 million).

The number of SAR, provisions for and expenses arising from the E.ON SAR program have changed as shown in the following table:

	7th tranche	6th tranche	5th tranche	4th tranche	3rd tranche	2nd tranche
<b>SAR outstanding as of January 1, 2005</b>		<b>2,647,181</b>	<b>2,502,393</b>	<b>809,886</b>	<b>1,300,900</b>	<b>192,500</b>
SAR granted in 2005	2,904,949	17,297				
SAR exercised in 2005	7,521	55,983	1,860,682	503,477	983,650	161,000
SAR expired in 2005	12,000	20,000			7,000	
Change in scope of consolidation in 2005		(170,500)	(28,000)	(67,500)	(151,500)	(19,000)
<b>SAR outstanding as of December 31, 2005</b>	<b>2,885,428</b>	<b>2,417,995</b>	<b>613,711</b>	<b>238,909</b>	<b>158,750</b>	<b>12,500</b>
SAR granted in 2006						
SAR exercised in 2006	49,511	2,349,731	346,358	169,742	85,750	12,500
SAR expired in 2006	26,041	13,717	2,423			
Change in scope of consolidation in 2006						
<b>SAR outstanding as of December 31, 2006</b>	<b>2,809,876</b>	<b>54,547</b>	<b>264,930</b>	<b>69,167</b>	<b>73,000</b>	
Gains on exercise in 2006 (in millions of )	2.0	106.8	16.9	5.7	2.3	0.7
Provision as of December 31, 2006 (in millions of )	117.6	2.6	16.3	3.4	3.2	
Expense in 2006 (in millions of )	87.8	16.7	5.4	1.2	1.7	0.2
Average exercise gain per SAR (in )	40.31	45.45	48.84	33.24	27.27	54.66

The SAR of tranches three through six were exercisable on December 31, 2006. The blackout period for the seventh tranche ended on December 31, 2006.

**E.ON Share Performance Plan**

In 2006, a new stock-based compensation system, the E.ON Share Performance Plan, was introduced, and virtual shares ( Performance Rights ) from the first tranche were granted for the first time. The amount of compensation from the E.ON Share Performance Plan depends both on the development of the E.ON share price and explicitly on the relative performance of E.ON stock in comparison to a sector index.

	<b>1st tranche</b>
Date of issuance	Jan. 2, 2006
Term	3 years
Target value at issuance (in )	79.22
Number of participants in year of issuance	396
Number of Performance Rights issued	458,641
Maximum cash amount (in )	237.66

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At the beginning of the three-year term of each tranche, plan participants are granted Performance Rights. At the end of the term, each Performance Right is entitled to a cash payment linked to the final E.ON share price established at that time. The amount of the payment is also linked to the relative performance of the E.ON share price in comparison with the benchmark, the Dow Jones STOXX Utilities Index (Total Return EUR). The amount paid out is equal to the target value of this compensation component if the E.ON share price at the end of the term is equal to the initial price at the beginning of the term and the performance matches that of the benchmark. The maximum amount to be paid out to each participant per Performance Right is limited to three times the original target value on the grant date.

60-day average prices are used to determine the initial price, the final price and the relative performance, in order to mitigate the effects of incidental, short-lived price movements. The target value of the first tranche is equal to the initial price of 79.22.

The calculation of the payment amount takes place at the same time for all plan participants with effect on the last day of the term of the tranche. If the performance of the E.ON share matches that of the index, the amount paid out is not adjusted; the final share price is paid out. However, if the E.ON share outperforms the index, the amount paid out is increased proportionally by one percent for each one percent of outperformance. If, on the other hand, the E.ON share should underperform the index, disproportionate deductions of five percent are made for each one percent of underperformance, and in the case of underperformance by 20 percent or more, no payment at all takes place.

The plan contains adjustment mechanisms to eliminate the effect of events such as interim corporate actions. Accordingly, to compensate for the economic effects of the special dividend payment of May 5, 2006, capital adjustment factors were established for the first tranche.

At the end of the first year of the three-year term, the intrinsic value of one Performance Right dropped from 79.22 to 42.00. The decline is primarily due to the fact that the E.ON share could not match the positive performance of the benchmark index to the same degree. The performance during the 60-day review period established lagged far behind the original performance targets set. Whereas the absolute price performance since plan inception is very strong, this performance only partially compensates for the losses resulting from the relative performance. The two value-driving factors, the share price and the relative performance, are thus both reflected in the change in intrinsic value of the Performance Rights, and both receive the desired consideration as a result.

Instead of reporting the target value or the intrinsic value on the financial statements, the fair value is determined for the Performance Rights in accordance with SFAS 123(R) using a recognized option pricing model. Similar to the option pricing model used for the SAR program, this model involves the simulation of a large number of different possible development tracks for the E.ON share price (taking into account the effects of reinvested dividends and capital adjustment factors) and the benchmark index (Monte Carlo simulation). However, unlike the SAR program, the benchmark for this plan is the Dow Jones STOXX Utilities Index (Total Return EUR). Since payments to all plan participants take place on a specified date, no assumptions concerning exercise behavior are made in this plan structure, and such assumptions are therefore not considered in this option pricing model. Dividend payments and corporate actions are taken into account through corresponding factors that are analogous to those employed by the index provider.

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	<b>1st tranche</b>
E.ON AG share price on December 31, 2006 (in €)	102,83
Level of the Dow Jones STOXX Utilities Index (Total Return EUR) on December 31, 2006	796.53
Intrinsic value as of December 31, 2006 (in €)	42.00
Fair value as of December 31, 2006 (in €)	58.54
Swap rate (in %)	4.04
Volatility of the E.ON share (in %)	19.65
Volatility of the Dow Jones STOXX Utilities Index (Total Return EUR) (in %)	12.40
Correlation between the E.ON share price and the Dow Jones STOXX Utilities Index (Total Return EUR)	0.8273
Most recent cash dividend paid on E.ON AG stock (in €)	2.75
Dividend yield of the E.ON share (in %)	2.67

458,641 first-tranche Performance Rights were granted in 2006. As of December 31, 2006, the cash amount from 2,020 Performance Rights was paid out on an extraordinary basis in accordance with the terms and conditions. Total payments amounted to 0.1 million (2005: 0.0 million). 2,020 Performance Rights expired during the term. The provision was 8.9 million at year-end (2005: 0.0 million). The provision was prorated for the first year of the total three-year term. The total expense for the E.ON Share Performance Plan amounted to 9.0 million in 2006 (2005: 0.0 million 2004: 0.0 million). As of the balance sheet date, a total expense from the first tranche of 26.7 million on a fair-value basis is expected upon expiration of the three-year term.

	<b>1st tranche</b>
Performance Rights granted in 2006	458,641
Settled Performance Rights in 2006	2,020
Performance Rights expired in 2006	2,020
Change in scope of consolidation in 2006	
Performance Rights outstanding as of December 31, 2006	454,601
Cash amount paid in 2006 (in millions of €)	0.1
Provision as of December 31, 2006 (in millions of €)	8.9
Expense in 2006 (in millions of €)	9.0
Average cash amount per Performance Right (in €)	42.00

The first tranche was not yet payable on an ordinary basis on the balance sheet date.

The issue of a second tranche of the E.ON AG Share Performance Plan is planned for 2007.

**Employees**

During 2006, the Company employed an average of 80,453 people (2005: 74,788), not including 2,280 apprentices (2005: 2,174). The breakdown by segments is shown below:

	<b>2006</b>	<b>2005</b>
Central Europe	44,148	42,835

Pan-European Gas	12,653	11,025
U.K.	14,599	12,106
Nordic	5,697	5,381
U.S. Midwest	2,919	3,007
Corporate Center	437	434
<b>Total</b>	<b>80,453</b>	<b>74,788</b>

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**Table of Contents****(10) Earnings per Share**

The computation of basic and diluted earnings per share for the periods indicated is shown below.

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Income/Loss from continuing operations	4,930	4,355	4,011
Income/Loss from discontinued operations	127	3,059	328
Income/Loss from cumulative effect of changes in accounting principles, net		(7)	
<b>Net income</b>	<b>5,057</b>	<b>7,407</b>	<b>4,339</b>
Weighted-average number of shares outstanding (in millions)	659	659	657
<b>Earnings per share (in )</b>			
from continuing operations	7.48	6.61	6.11
from discontinued operations	0.19	4.64	0.50
from cumulative effect of changes in accounting principles, net	0.00	(0.01)	
<b>from net income</b>	<b>7.67</b>	<b>11.24</b>	<b>6.61</b>

The computation of diluted EPS is identical to basic EPS, as E.ON AG does not have any dilutive securities.

**Table of Contents****(11) Goodwill and Intangible Assets; Property, Plant and Equipment; Financial Assets**

in millions	January 1, 2006	Exchange rate differences	Acquisition and production costs				December 31, 2006	
			Change in scope of consolidation	Additions	Disposals	Transfers Impairment		
Goodwill	15,662	(242)	73	52	(12)	(126)	15,407	
Intangible assets	6,056	53	(58)	145	(98)	(21)	(45)	6,032
Advance payments on intangible assets	26			11		(23)		14
<b>Goodwill and intangible assets</b>	<b>21,744</b>	<b>(189)</b>	<b>15</b>	<b>208</b>	<b>(110)</b>	<b>(170)</b>	<b>(45)</b>	<b>21,453</b>
Real estate and leasehold rights	4,011	85	(11)	55	(48)	(139)	(5)	3,948
Buildings	7,761	7	(59)	98	(21)	274	(25)	8,035
Technical equipment, plant and machinery	77,391	90	182	1,989	(1,294)	885	(379)	78,864
Other equipment, fixtures, furniture and office equipment	3,348	26	(78)	244	(180)	7		3,367
Advance payments and construction in progress	1,331	(28)	42	1,800	(32)	(1,039)		2,074
<b>Property, plant and equipment</b>	<b>93,842</b>	<b>180</b>	<b>76</b>	<b>4,186</b>	<b>(1,575)</b>	<b>(12)</b>	<b>(409)</b>	<b>96,288</b>
Shares in unconsolidated affiliates	676	(2)	(34)	263	(144)	(82)	(12)	665
Shares in associated companies	10,248	200	(47)	1,216	(3,247)	325	(243)	8,452
Other share investments	2,230	3	(62)	100	(50)	(246)	(112)	1,863
Non-current securities	5,652	3	(60)	3,070	(1,527)	(115)		7,023
<b>Financial assets</b>	<b>18,806</b>	<b>204</b>	<b>(203)</b>	<b>4,649</b>	<b>(4,968)</b>	<b>(118)</b>	<b>(367)</b>	<b>18,003</b>
<b>Total</b>	<b>134,392</b>	<b>195</b>	<b>(112)</b>	<b>9,043</b>	<b>(6,653)</b>	<b>(300)</b>	<b>(821)</b>	<b>135,744</b>

Exchange rate	Change in	Accumulated depreciation		Fair value OCI	Net book values



	January 1, 2006	difference	scope of consolidation	Additions	Disposals	Transfers	adjustments	December 31, 2006	December 31, 2006	December 31, 2005
Goodwill	299	(1)	(15)					283	15,124	15,363
Intangible assets	1,957	23	(18)	374	(39)			2,297	3,735	4,099
Advance payments on intangible assets									14	26
<b>Goodwill and intangible assets</b>	<b>2,256</b>	<b>22</b>	<b>(33)</b>	<b>374</b>	<b>(39)</b>			<b>2,580</b>	<b>18,873</b>	<b>19,488</b>
Real estate and leasehold rights	303	1		12	(1)	(96)		219	3,729	3,708
Buildings	3,823	5	(36)	222	(2)	93		4,105	3,930	3,938
Technical equipment, plant and machinery	46,012	50	(387)	2,121	(905)	(15)		46,876	31,988	31,379
Other equipment, fixtures, furniture and office equipment	2,373	18	(39)	201	(174)	(6)		2,373	994	975
Advance payments and construction in progress	8				(5)			3	2,071	1,323
<b>Property, plant and equipment</b>	<b>52,519</b>	<b>74</b>	<b>(462)</b>	<b>2,556</b>	<b>(1,087)</b>	<b>(24)</b>		<b>53,576</b>	<b>42,712</b>	<b>41,323</b>
Shares in unconsolidated affiliates	9		(3)					6	659	667
Shares in associated companies	494	(1)			(1)	15	(309)	198	8,254	9,754
Other share investments	(6,775)					(31)	(3,776)	(10,582)	12,445	9,005
Non-current securities	(730)					703	106	79	6,944	6,382
<b>Financial assets</b>	<b>(7,002)</b>	<b>(1)</b>	<b>(3)</b>		<b>(1)</b>	<b>687</b>	<b>(3,979)</b>	<b>(10,299)</b>	<b>28,302</b>	<b>25,808</b>
<b>Total</b>	<b>47,773</b>	<b>95</b>	<b>(498)</b>	<b>2,930</b>	<b>(1,127)</b>	<b>663</b>	<b>(3,979)</b>	<b>45,857</b>	<b>89,887</b>	<b>86,619</b>

**Table of Contents****a) Goodwill and Other Intangible Assets****Goodwill**

During the 2006 and 2005 fiscal years, the carrying amount of goodwill changed as follows in each of E.ON's segments:

in millions	Central Europe	Pan- European Gas	U.K.	Nordic	U.S. Midwest	Corporate Center	Core energy business	Other activities	Total
<b>Book value as of January 1, 2005</b>	<b>2,305</b>	<b>3,920</b>	<b>4,779</b>	<b>359</b>	<b>3,080</b>	<b>1</b>	<b>14,444</b>	<b>10</b>	<b>14,454</b>
Goodwill additions/disposals	115	481	21	7		(1)	623		623
Other changes (1)	(1)	(332)	155	2	472		296	(10)	286
<b>Book value as of December 31, 2005</b>	<b>2,419</b>	<b>4,069</b>	<b>4,955</b>	<b>368</b>	<b>3,552</b>		<b>15,363</b>		<b>15,363</b>
Goodwill additions/disposals	65	142		3			210		210
Other changes (1)	(19)	53	1	(73)	(411)		(449)		(449)
<b>Book value as of December 31, 2006</b>	<b>2,465</b>	<b>4,264</b>	<b>4,956</b>	<b>298</b>	<b>3,141</b>		<b>15,124</b>		<b>15,124</b>

(1) Other changes include transfers and exchange rate differences from the respective reporting year as well as reclassifications to discontinued operations (2006, Nordic segment: (83) million; 2005, Pan-European Gas segment: (326) million; other activities: (10) million).

To perform the annual impairment test, the Company determines the fair value of its reporting units based on a valuation model that draws on medium-term planning data that the Company uses for internal reporting purposes. The model uses the discounted cash flow method and market comparables. Goodwill must also be evaluated at the reporting unit level for impairment between these annual tests if events or changes in circumstances indicate that goodwill might be impaired.

As the fair value of each reporting unit exceeded the carrying amount, no charges were recognized in 2006, 2005 or 2004, respectively, in connection with the testing of goodwill for impairment.

**Table of Contents****Intangible Assets**

As of December 31, 2006, the Company's other intangible assets, including advance payments, consisted of the following:

in millions	December 31, 2006			December 31, 2005		
	Acquisition costs	Accumulated amortization	Net book value	Acquisition costs	Accumulated amortization	Net book value
<b>Intangible assets subject to amortization</b>						
<b>Marketing-related intangible assets</b>	<b>186</b>	<b>176</b>	<b>10</b>	<b>223</b>	<b>123</b>	<b>100</b>
thereof brand names	186	176	10	223	123	100
<b>Customer-related intangible assets</b>	<b>2,457</b>	<b>962</b>	<b>1,495</b>	<b>2,419</b>	<b>765</b>	<b>1,654</b>
thereof customer lists and customer relationships	2,292	885	1,407	2,305	704	1,601
<b>Contract-based intangible assets</b>	<b>1,678</b>	<b>629</b>	<b>1,049</b>	<b>1,674</b>	<b>593</b>	<b>1,081</b>
thereof concessions	1,080	327	753	1,223	392	831
<b>Technology-based intangible assets</b>	<b>733</b>	<b>530</b>	<b>203</b>	<b>662</b>	<b>476</b>	<b>186</b>
thereof computer software	666	477	189	563	408	155
<b>Intangible assets not subject to amortization</b>	<b>992</b>		<b>992</b>	<b>1,104</b>		<b>1,104</b>
thereof easements	725		725	818		818
<b>Total</b>	<b>6,046</b>	<b>2,297</b>	<b>3,749</b>	<b>6,082</b>	<b>1,957</b>	<b>4,125</b>

The table below includes all intangible assets added in 2006. Also included are the intangible assets that were acquired as part of business combinations.

	Acquisition costs ( in millions)	Weighted average amortization period (in years)
<b>Intangible assets subject to amortization</b>		
<b>Marketing-related intangible assets</b>		
<b>Customer-related intangible assets</b>	<b>38</b>	<b>7</b>
thereof customer lists and customer relationships	29	4
<b>Contract-based intangible assets</b>	<b>31</b>	<b>10</b>
<b>Technology-based intangible assets</b>	<b>102</b>	<b>3</b>
thereof computer software	92	3

<b>Intangible assets not subject to amortization</b>	<b>24</b>
thereof licenses for exploration and production	22
<b>Total</b>	<b>195</b>

In 2006, the Company recorded an aggregate amortization expense of 374 million (2005: 361 million; 2004: 365 million). Impairment charges of 45 million on intangible assets were recognized in 2006 (2005: 0 million; 2004: 9 million).

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Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the five succeeding fiscal years is as follows:

<b>in millions</b>	
2007	333
2008	292
2009	231
2010	168
2011	156
<b>Total</b>	<b>1,180</b>

As acquisitions and disposals occur in the future, actual amounts may vary.

**b) Property, Plant and Equipment**

Property, plant and equipment includes capitalized interest on debt apportioned to the construction period of qualifying assets as part of their cost of acquisition and production in the amount of 27 million (2005: 24 million; 2004: 20 million). Impairment charges on property, plant and equipment were 409 million (2005: 163 million; 2004: 156 million). This amount in 2006 included 227 million in impairment charges (recorded under cost of goods sold) for gas distribution network operations in Germany that resulted from the regulation of network charges.

In 2006, the Company recorded depreciation of property, plant and equipment in the amount of 2,556 million (2005: 2,459 million; 2004: 2,254 million).

Restrictions on disposals of the Company's property, plant and equipment exist in the amount of 4,236 million (2005: 4,191 million) mainly with regard to land, buildings and technical equipment. For additional information on collateralized property, plant and equipment, see Note 24.

**Jointly Owned Power Plants**

E.ON holds joint ownership and similar contractual rights in certain power plants that are all independently financed by each respective participant. These jointly owned power plants were formed under ownership agreements or arrangements that did not create legal entities for which separate financial statements are prepared. They are therefore included in the financial statements of their owners. E.ON's share of the operating expenses for these facilities is included in the Consolidated Financial Statements.

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The following table provides additional details about these plants, which are located in Germany unless otherwise indicated:

Name of plants by type	E.ON's Ownership interest in %	E.ON's Total acquisition cost ( in millions)	E.ON's Accumulated depreciation & amortization ( in millions)	E.ON's Construction work in progress ( in millions)
<b>Nuclear</b>				
Isar 2	75.00	1,968	1,842	7
Gundremmingen B	25.00	100	83	
Gundremmingen C	25.00	112	95	
<b>Lignite</b>				
Lippendorf S	50.00	533	399	
<b>Hard Coal</b>				
Bexbach 1	8.33	64	60	
Trimble County 1 (U.S.)	75.00	459	176	7
Trimble County 2 (U.S.)	75.00			90
Rostock	50.38	317	292	
<b>Hydroelectric/Wind</b>				
Nymølle Havspark/Rødsand (DK)	20.00	44	7	
Nußdorf	53.00	55	41	
Ering	50.00	31	28	
Egglfing	50.00	47	43	

**c) Financial Assets**

Impairment charges on financial assets during 2006 amounted to 367 million (2005: 47 million; 2004: 230 million). 335 million of this amount relates to interests in minority shareholdings with network operations in Germany, and resulted from the regulation of network charges.

**Shares in Affiliated and Associated Companies Accounted for Under the Equity Method**

The financial information below summarizes income statement and balance sheet data for the investments of the Company's affiliated and associated companies that are accounted for under the equity method. Separate summarized income statement data is presented for RAG, as this investment was considered a significant investment in 2004 under applicable rules of the U.S. Securities and Exchange Commission.

in millions	2006	thereof RAG	2005	thereof RAG	2004	thereof RAG
Sales	49,475	18,177	59,533	21,670	55,790	18,240
Net income	3,763	726	1,782	91	2,415	
	1,332	284	550	36	881	

E.ON's share of net income/loss					
Other (1)	(496)	(284)	(117)	(36)	(233)
<b>Income from companies accounted for under the equity method</b>	<b>836</b>		<b>433</b>		<b>648</b>

(1) Other primarily includes adjustments to conform with E.ON accounting policies, amortization of fair value adjustments due to purchase price allocations and intercompany eliminations.

The increase in 2005 in income from companies accounted for under the equity method primarily related to the following one-time charges from the preceding year that did not recur. The equity-method accounting for E.ON's directly held 42.9 percent share of Degussa resulted in a net loss to E.ON of \$215 million, mainly caused by the impairment of Degussa's Fine Chemicals division. In 2004, income from companies accounted for under the equity

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method included a gain of 107 million from the equity-method treatment of Degussa. The equity-method accounting of RAG Aktiengesellschaft ( RAG ), Essen, Germany, whose consolidated financial statements include Degussa, did not result in additional losses, as the carrying amount of E.ON's investment in RAG had already been written down to zero in 2003. Furthermore, included in the 2005 amounts are valuation adjustments of deferred tax assets at another at-equity holding of the Corporate Center of 96 million.

In 2006, the losses from companies accounted for under the equity method also included 81 million (2005: 1 million; 2004: 86 million) in impairment charges on goodwill of companies accounted for under the equity method. These impairment charges primarily related to companies with network operations, and they arose in connection with network regulation in Germany. Included in the 2006 amounts are 190 million in impairment charges recorded for minority shareholdings accounted for under the equity method in Germany as a result of the regulation of network charges.

Dividends received from affiliated and associated companies accounted for under the equity method were 912 million in 2006 (2005: 824 million; 2004: 834 million).

<b>in millions</b>	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Fixed assets	43,469	47,547
Non-fixed assets and prepaid expenses	27,348	32,165
Provisions	24,333	28,611
Liabilities and deferred income	26,863	30,307
Minority interests	736	2,152
<b>Net assets</b>	<b>18,885</b>	<b>18,642</b>
E.ON's share in equity	5,934	6,788
Other (1)	2,033	2,901
<b>Investment in companies accounted for under the equity method</b>	<b>7,967</b>	<b>9,689</b>

(1) Other primarily includes adjustments to conform to E.ON accounting policies, goodwill, fair value adjustments due to purchase price allocations, intercompany eliminations and impairments.

The decrease in investments in companies accounted for under the equity method is due primarily to the sale of the interest in Degussa in 2006 (see also Note 4).

The book value of affiliated and associated companies accounted for under the equity method whose shares are marketable amounts to a total of 850 million (2005: 2,536 million). The fair value of E.ON's share in these companies is 2,401 million (2005: 5,493 million).

Additions of investments in associated and affiliated companies accounted for under the equity method resulted in a total goodwill of 57 million in 2006 (2005: 44 million).

Investments in associated companies totaling 76 million (2005: 71 million) were restricted because they were pledged as collateral for financing as of the balance sheet date.





**Table of Contents****Other Share Investments and Non-Current Available-for-Sale Securities**

The amortized costs, fair values and gross unrealized gains and losses for other share investments and non-current available-for-sale securities, as well as the maturities of fixed-term securities as of December 31, 2006 and 2005, are summarized below:

in millions	December 31, 2006				December 31, 2005			
	Amortized cost	Fair value	Gross unrealized loss	Gross unrealized gain	Amortized cost	Fair value	Gross unrealized loss	Gross unrealized gain
<b>Fixed-term securities</b>								
Between 1 and 5 years	2,962	2,941	25	4	2,472	2,490	5	23
More than 5 years	3,310	3,241	72	3	2,747	2,865	3	121
<b>Subtotal</b>	<b>6,272</b>	<b>6,182</b>	<b>97</b>	<b>7</b>	<b>5,219</b>	<b>5,355</b>	<b>8</b>	<b>144</b>
<b>Non-fixed-term securities</b>	<b>2,600</b>	<b>13,207</b>		<b>10,607</b>	<b>2,624</b>	<b>10,032</b>	<b>1</b>	<b>7,409</b>
<b>Total</b>	<b>8,872</b>	<b>19,389</b>	<b>97</b>	<b>10,614</b>	<b>7,843</b>	<b>15,387</b>	<b>9</b>	<b>7,553</b>

The gross unrealized losses for these share investments and non-current available-for-sale securities are as follows:

in millions	December 31, 2006					
	less than 12 months		12 months or greater		Total	
	Fair value	Gross unrealized loss	Fair Value	Gross unrealized loss	Fair value	Gross unrealized loss
<b>Fixed-term securities</b>						
Between 1 and 5 years	2,265	25	3		2,268	25
More than 5 years	2,499	72			2,499	72
<b>Subtotal</b>	<b>4,764</b>	<b>97</b>	<b>3</b>		<b>4,767</b>	<b>97</b>
<b>Non-fixed-term securities</b>			<b>3</b>		<b>3</b>	
<b>Total</b>	<b>4,764</b>	<b>97</b>	<b>6</b>		<b>4,770</b>	<b>97</b>

In 2006, amortized costs were written down in the amount of 112 million (2005: 15 million; 2004: 36 million).

The disposal of other share investments as well as non-current and current available-for-sale securities generated proceeds of 5,521 million in 2006 (2005: 5,350 million; 2004: 4,949 million) and capital gains of 651 million (2005: 398 million; 2004: 231 million). Included in this item are the gains from the derecognition of institutional securities

funds as part of the transfer to the CTA in the amount of 159 million. The Company uses the specific identification method as a basis for determining these amounts.

Non-fixed-term securities include non-marketable investments or securities of 803 million (2005: 767 million).

For the other share investments that are marketable, gross unrealized gains of 10,582 million were recorded as of December 31, 2006 (2005: 6,814 million). The increase in fair value of other share investments that are marketable in 2006 was primarily attributable to the marking to market of the investment in OAO Gazprom (Gazprom), Moscow, Russia.

1,169 million in non-current available-for-sale securities is restricted for the fulfillment of legal insurance obligations of VKE toward companies of the E.ON Group.

**Table of Contents****(12) Inventories**

The following table provides details of inventories as of the dates indicated:

<b>in millions</b>	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Raw materials and supplies by segment</b>		
Central Europe	1,165	904
Pan-European Gas	25	28
U.K.	646	326
Nordic	257	223
U.S. Midwest	189	237
<b>Total</b>	<b>2,282</b>	<b>1,718</b>
<b>Work in progress</b>	<b>67</b>	<b>58</b>
<b>Finished products</b>	<b>1</b>	<b>10</b>
<b>Goods purchased for resale</b>	<b>1,640</b>	<b>671</b>
<b>Inventories</b>	<b>3,990</b>	<b>2,457</b>

Raw materials, finished products and goods purchased for resale are generally valued at average cost. Where this is not the case, the LIFO method is used, particularly for the valuation of natural gas inventories. In 2006, inventories valued according to the LIFO method amounted to 1,478 million (2005: 502 million). The increase in LIFO-method inventories is primarily due to the gas storage business of E.ON Földgáz Trade purchased in 2006.

Raw materials and supplies contain various emission rights that have a book value of 136 million (2005: 3 million).

The difference between valuation according to LIFO and higher replacement costs is 524 million (2005: 332 million).

**Table of Contents****(13) Receivables, Other Assets and Prepaid Expenses**

The following table provides details of receivables, other assets and prepaid expenses:

in millions	December 31, 2006		December 31, 2005	
	With a remaining term up to 1 year	With a remaining term of more than 1 year	With a remaining term up to 1 year	With a remaining term of more than 1 year
Financial receivables from affiliated companies	287	159	115	251
Financial receivables from associated companies and other share investments	164	435	87	452
Other financial assets	966	800	858	1,356
<b>Financial receivables and other financial assets</b>	<b>1,417</b>	<b>1,394</b>	<b>1,060</b>	<b>2,059</b>
Trade receivables	9,756		8,179	90
Operating receivables from affiliated companies	70		62	
Operating receivables from associated companies and other share investments	970	6	748	
Reinsurance claim due from the mutual insurance fund Versorgungskasse Energie VVaG			80	1,495
U.S. regulatory assets	47	232	52	69
Other operating assets	7,065	3,105	8,832	1,747
<b>Operating receivables and other operating assets</b>	<b>17,908</b>	<b>3,343</b>	<b>17,953</b>	<b>3,401</b>
Prepaid expenses	429	210	227	129
<b>Receivables, other assets and prepaid expenses</b>	<b>19,754</b>	<b>4,947</b>	<b>19,240</b>	<b>5,589</b>

In 2006, other financial assets include receivables from owners of minority interests in jointly owned power plants of 609 million (2005: 688 million) and margin account deposits receivable of 135 million (2005: 30 million). In addition, in connection with the application of SFAS 143, other financial assets include a claim for a refund from the Swedish nuclear fund in the amount of 427 million (2005: 394 million) in connection with the decommissioning of nuclear power plants. Since this asset is designated for a particular purpose, E.ON's access to it is restricted.

As part of the elimination of intra-group balances, reinsurance claims within the E.ON Group with VKE were eliminated in consolidation.

In accordance with SFAS 71, assets that are subject to U.S. regulation are disclosed separately. For further information, please see Note 2.

Other operating assets include the positive fair values of derivative financial instruments in the amount of 4,450 million (2005: 7,349 million). The decrease in the positive fair values of the derivatives is primarily due to a decline in market prices. Also included here are tax refund claims of 2,983 million (2005: 553 million). Of this,

1,279 million consists of the initial capitalization of corporate tax credits under the SEStEG (see also Note 7). This line item further includes receivables related to E.ON Benelux's cross-border lease transactions for power plants amounting to 883 million (2005: 1,011 million) and accrued interest receivables of 555 million (2005: 544 million).

In 2005, other operating assets also included the excess of 309 million in the plan assets of the E.ON UK pension plans over the benefit obligations. Following the adoption of SFAS 158 effective December 31, 2006, plan assets in the Group exceeded benefit obligations by a total of 2 million. See Note 22 for additional information.

**Table of Contents****Valuation Allowances for Doubtful Accounts**

The valuation allowances for doubtful accounts comprise the following for the periods indicated:

in millions	2006	2005
<b>Balance as of January 1</b>	<b>550</b>	<b>456</b>
Changes affecting income	139	37
Changes not affecting income	(64)	57
<b>Balance as of December 31</b>	<b>625</b>	<b>550</b>

Changes not affecting income are related to changes in the scope of consolidation, utilization and currency translation adjustments.

**(14) Restricted Cash**

Restricted cash, of which 18 million (2005: 31 million) has a maturity greater than three months, includes 74 million (2005: 54 million) in collateral deposited at banks, the purpose of which is to prevent the exhaustion of credit lines in connection with the marking to market of derivative transactions. The increase in restricted cash in 2006 was due primarily to the full consolidation of VKE, which contributed 458 million.

**(15) Current Securities and Fixed-Term Deposits**

The following table provides details of investments in securities and fixed-term deposits as of the dates indicated:

in millions	December 31, 2006	2005
Current securities with an original maturity greater than 3 months	4,399	3,996
Fixed-term deposits with an original maturity greater than 3 months	49	1,457
<b>Current securities and fixed-term deposits</b>	<b>4,448</b>	<b>5,453</b>

The amortized costs, fair values, gross unrealized gains and losses, as well as the maturities of the current available-for-sale securities as of the dates indicated, break down as follows:

in millions	December 31, 2006				December 31, 2005			
	Amortized cost	Fair value	Gross unrealized loss	Gross unrealized gain	Amortized cost	Fair value	Gross unrealized loss	Gross unrealized gain
<b>Fixed-term securities</b>								
Less than 1 year	259	257	2		406	433	1	28

Between 1 and 5 years	10	10						
<b>Subtotal</b>	<b>269</b>	<b>267</b>	<b>2</b>		<b>406</b>	<b>433</b>	<b>1</b>	<b>28</b>
<b>Non-fixed-term securities</b>	<b>2,604</b>	<b>4,172</b>	<b>22</b>	<b>1,590</b>	<b>2,823</b>	<b>3,605</b>	<b>23</b>	<b>805</b>
<b>Total</b>	<b>2,873</b>	<b>4,439</b>	<b>24</b>	<b>1,590</b>	<b>3,229</b>	<b>4,038</b>	<b>24</b>	<b>833</b>

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The gross unrealized losses attributable to these current available-for-sale securities break down as follows:

in millions	less than 12 months		December 31, 2006 12 months or greater		Total	
	Fair value	Gross unrealized loss	Fair value	Gross unrealized loss	Fair value	Gross unrealized loss
<b>Fixed-term securities</b>						
Less than 1 year	221	2			221	2
Between 1 and 5 years	10				10	
<b>Subtotal</b>	<b>231</b>	<b>2</b>			<b>231</b>	<b>2</b>
<b>Non-fixed-term securities</b>	<b>137</b>	<b>22</b>			<b>137</b>	<b>22</b>
<b>Total</b>	<b>368</b>	<b>24</b>			<b>368</b>	<b>24</b>

In 2006, amortized costs were written down in the amount of 7 million (2005: 32 million).

Non-fixed-term securities classified as current include 35 million in non-marketable securities (2005: 39 million).

The proceeds and gains from the disposal of available-for-sale securities are described in Note 11(c).

Current securities with an original maturity greater than three months include 566 million in securities held by VKE that are restricted for the fulfillment of legal insurance obligations toward companies of the E.ON Group.

**(16) Cash and Cash Equivalents**

Cash and cash equivalents include checks, cash on hand and balances in Bundesbank accounts and at other banking institutions with an original maturity of less than three months. Also included here are 40 million (2005: 42 million) in securities with an original maturity of less than three months.

**(17) Capital Stock**

The Company's authorized capital stock of 1,799,200,000 remains unchanged and consists of 692,000,000 ordinary shares issued without nominal value. The number of outstanding shares as of December 31, 2006, totaled 659,597,269 (2005: 659,153,552; 2004: 659,153,403).

Pursuant to a shareholder resolution approved at the Annual Shareholders Meeting held on May 4, 2006, the Board of Management is authorized to buy back outstanding shares up to an amount of 10 percent of E.ON AG's capital stock through November 4, 2007.

During 2006, E.ON AG purchased a total of 366 shares on the open market (2005: 344,304). These shares were distributed to employees. A further 443,717 own shares held by E.ON (2005: 308,704) were also distributed to employees. Of these, 443,290 went into the employee stock program. As of December 31, 2006, E.ON AG thus held a total of 3,930,537 treasury shares (2005: 4,374,254) having a book value of 230 million (equivalent to 0.57 percent or

10,219,396 of the capital stock). See Note 9 for further information on the employee stock purchase plan.

E.ON Energie AG acquired a total of 6,700 E.ON AG shares on the open market that were immediately tendered in lieu of payments to third parties.

An additional 28,472,194 shares of E.ON AG are held by one of its subsidiaries as of December 31, 2006 (2005: 28,472,194). These shares held by subsidiaries were acquired at the time of the VEBA/VIAG merger and considered treasury shares with no purchase price allocated to them.

**Table of Contents***Authorized Capital*

At the Annual Shareholders Meeting on April 27, 2005, the Board of Management was authorized, subject to the Supervisory Board's approval, to increase the Company's capital stock by up to 540 million (Article 202 ff. AktG Authorized Capital) through one or more issuances of new ordinary shares without nominal value in return for contributions in cash and/or in kind (with the option to exclude shareholders' subscription rights). This capital increase is authorized until April 27, 2010. Subject to the Supervisory Board's approval, the Board of Management is authorized to exclude shareholders' subscription rights.

At the Annual Shareholders Meeting of April 30, 2003, conditional capital (with the option to exclude shareholders' subscription rights) in the amount of 175.0 million (Conditional Capital) was authorized until April 30, 2008. This Conditional Capital may be used to issue bonds with conversion or option rights and to fulfill conversion obligations towards creditors of bonds containing conversion obligations. The securities underlying these rights and obligations are either E.ON AG shares or those of companies in which E.ON AG directly or indirectly holds a majority stake.

**(18) Additional Paid-in Capital**

Additional paid-in capital results exclusively from share issuance premiums. As of December 31, 2006, additional paid-in capital amounts to 11,760 million (2005: 11,749 million). This represents an increase of 11 million since December 31, 2005. This increase is due to the issuance of 443,290 E.ON AG shares to employees.

The 3 million increase in 2005 resulted from the execution of the exchange offer for minority shareholders of Contigas.

**(19) Retained Earnings**

The following table provides details of the E.ON Group's retained earnings as of the dates indicated:

<b>in millions</b>	<b>December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Legal reserves	45	45	45
Other retained earnings	26,259	25,816	19,958
<b>Total</b>	<b>26,304</b>	<b>25,861</b>	<b>20,003</b>

According to German securities law, E.ON AG shareholders can only receive distributions from the retained earnings of E.ON AG as defined by German GAAP, which are included in the Group's retained earnings under U.S. GAAP. As of December 31, 2006, these German-GAAP retained earnings amount to 4,593 million (2005: 4,231 million). Of these, legal reserves of 45 million (2005: 45 million) pursuant to Article 150 (3) and (4) AktG and reserves for own shares of 230 million (2005: 256 million) pursuant to Article 272 (4) HGB were not distributable on December 31, 2006. Accordingly, an amount of 4,318 million (2005: 3,930 million) is in principle available for dividend payments.

The Group's retained earnings as of December 31, 2006, include accumulated undistributed earnings of 910 million (2005: 617 million) from companies that have been accounted for under the equity method.



**Table of Contents****(20) Other Comprehensive Income**

The components of other comprehensive income and the related tax effects as of the dates indicated are as follows:

in millions	December 31, 2006			December 31, 2005			December 31, 2004		
	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Foreign currency translation adjustments	55	(20)	35	536	78	614	139	(25)	114
Reclassification adjustments affecting income	132		132	6		6	11		11
<b>Subtotal</b>	<b>187</b>	<b>(20)</b>	<b>167</b>	<b>542</b>	<b>78</b>	<b>620</b>	<b>150</b>	<b>(25)</b>	<b>125</b>
Unrealized holding gains/(losses) from available-for-sale securities	4,161	(642)	3,519	5,709	(851)	4,858	1,349	(243)	1,106
Reclassification adjustments affecting income	(394)	14	(380)	(169)	9	(160)	(107)	(5)	(112)
<b>Subtotal</b>	<b>3,767</b>	<b>(628)</b>	<b>3,139</b>	<b>5,540</b>	<b>(842)</b>	<b>4,698</b>	<b>1,242</b>	<b>(248)</b>	<b>994</b>
Additional minimum pension liability	922	(576)	346	(580)	268	(312)	(935)	337	(598)
Cash flow hedges	(329)	108	(221)	65	(8)	57	89	(33)	56
<b>Total</b>	<b>4,547</b>	<b>(1,116)</b>	<b>3,431</b>	<b>5,567</b>	<b>(504)</b>	<b>5,063</b>	<b>546</b>	<b>31</b>	<b>577</b>

The change in unrealized gains from available-for-sale securities was primarily attributable to a 3,776 million (before tax) increase in the fair value of the investment in Gazprom.

Included in the 2006 reclassification adjustment recognized in income are gains totaling 159 million from the disposal of institutional securities funds carried out as part of the funding of the CTA (see also Note 22).

**(21) Minority Interests**

Minority interests as of the dates indicated are attributable to the following segments:

**December 31,**

<b>in millions</b>	<b>2006</b>	<b>2005</b>
Central Europe	2,722	2,618
Pan-European Gas	289	255
U.K.	63	81
Nordic	1,698	1,659
U.S. Midwest	78	85
Corporate Center	67	36
<b>Total</b>	<b>4,917</b>	<b>4,734</b>

**(22) Provisions for Pensions**

E.ON and its subsidiaries maintain both defined benefit pension plans and defined contribution plans. Some of the latter are part of a multi-employer pension plan under EITF 90-3, *Accounting for Employers' Obligations for Future Contributions to a Multi-employer Pension Plan*, for approximately 6,000 beneficiaries at the Nordic market unit.

Pension benefits are primarily based on compensation levels and years of service. Most Germany-based employees who joined the Company prior to 1999 participate in a final-pay arrangement, under which their retirement benefits depend in principle on their final salary (averaged over the last years of employment) and on

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years of service, but years of service beyond 2004 are now often no longer considered in these plans. Employees who joined the Company in or after 1999 and years of service beyond 2004 are mostly covered by a cash balance pension plan, under which regular payroll deductions are actuarially converted into pension units. For employees in defined contribution pension plans, under which the Company pays fixed contributions to an outside insurer or pension fund, the amount of the benefit depends on the value of each employee's individual pension claim at the time of retirement from the Company.

SFAS 158, which was adopted at the end of 2006, requires recognition of the overfunded or underfunded status of a defined benefit pension plan, measured as the difference between the fair value of plan assets and the benefit obligation. In adopting SFAS 158, as illustrated in the following table, unrecognized actuarial gains or losses that have not been recognized to date and prior unrecognized service costs were recognized, net of tax, as a component of accumulated other comprehensive income. This resulted in an increase in deferred tax assets of \$254 million.

<b>in millions</b>	<b>December 31, 2006 Before adjustment of minimum liability and adoption of SFAS 158</b>	<b>Adjustment of minimum liability</b>	<b>Adoption of SFAS 158</b>	<b>December 31, 2006 After adjustment of minimum liability and adoption of SFAS 158</b>
Intangible assets	10		(10)	
Other operating assets	405		(403)	2
Provisions for pensions	3,920	(529)	494	3,885
Accumulated other comprehensive income	(1,402)	346	(550)	(1,606)

\$2,372 million of the amounts recognized as accumulated other comprehensive income before tax effects is attributable to actuarial losses, while \$19 million is the result of prior service cost. Of these amounts, it is expected that actuarial losses of \$73 million and prior service cost in the amount of \$5 million in total net pension costs will be recorded in income through amortization in 2007.

The following table illustrates the change in the benefit obligation, as measured by the projected benefit obligation, for the periods indicated.

<b>in millions</b>	<b>Total</b>	<b>2006</b>		<b>Total</b>	<b>2005</b>	
		<b>Domestic</b>	<b>Foreign</b>		<b>Domestic</b>	<b>Foreign</b>
<b>Projected benefit obligation as of January 1</b>	<b>17,712</b>	<b>9,144</b>	<b>8,568</b>	<b>15,918</b>	<b>8,255</b>	<b>7,663</b>
Employer service cost	288	173	115	232	144	88
Interest cost	767	361	406	777	372	405
Change in scope of consolidation	1	8	(7)	(375)	(197)	(178)
Prior service cost	9		9	32	15	17
Actuarial gains (-)/losses	(739)	(433)	(306)	1,618	958	660

Exchange rate differences	51		51	352		352
Other	5	3	2			
Pensions paid	(847)	(416)	(431)	(842)	(403)	(439)
<b>Projected benefit obligation as of December 31</b>	<b>17,247</b>	<b>8,840</b>	<b>8,407</b>	<b>17,712</b>	<b>9,144</b>	<b>8,568</b>

The disposals of Viterra ( 228 million) and Ruhrgas Industries ( 179 million) were mainly responsible for the change shown as Change in scope of consolidation in 2005.

Actuarial gains in 2006 resulted primarily from the increase of the discount rate. This led to a relative decrease of the projected benefit obligation.

The amount disclosed for 2005 was not adjusted for discontinued operations in order to maintain comparability. Accordingly, this gives rise to differences in the presentation of net periodic pension costs for 2005.

Of the entire benefit obligation, 164 million (2005: 187 million) is related to health care benefits.



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The changes in plan assets are shown in the following table:

in millions	2006			2005		
	Total	Domestic	Foreign	Total	Domestic	Foreign
<b>Fair value of plan assets as of January 1</b>	<b>8,097</b>	<b>307</b>	<b>7,790</b>	<b>6,399</b>	<b>316</b>	<b>6,083</b>
Actual return on plan assets	489	80	409	1,198	15	1,183
Company contributions	5,241	5,126	115	733		733
Employee contributions	21		21	17		17
Change in scope of consolidation	(3)		(3)	(58)	(11)	(47)
Exchange rate differences	86		86	262		262
Pensions paid	(575)	(146)	(429)	(451)	(13)	(438)
Other	8		8	(3)		(3)
<b>Fair value of plan assets as of December 31</b>	<b>13,364</b>	<b>5,367</b>	<b>7,997</b>	<b>8,097</b>	<b>307</b>	<b>7,790</b>
<b>Funded status</b>	<b>3,883</b>	<b>3,473</b>	<b>410</b>	<b>9,615</b>	<b>8,837</b>	<b>778</b>

Foreign plan assets are primarily attributable to the E.ON UK pension plans ( 7,423 million; 2005: 7,197 million).

In 2005, E.ON Pension Trust e.V. and Pensionsabwicklungstrust e.V., both registered in Grünwald, Germany, were formed in order to establish a so-called Contractual Trust Arrangement (CTA) for German subsidiaries. The purpose of these trusts is the fiduciary administration of funds to provide for future retirement benefits to employees of certain German Group companies, as well as former employees and their beneficiaries. During 2006, assets in the form of fixed-term deposits and existing institutional securities funds ( Spezialfonds ) with a total value of 5.1 billion were contributed into the CTA.

Company contributions for 2005 include payments of 629 million to the E.ON Holding Group of the Electricity Supply Pension Scheme (ESPS) as part of the merger of four previously autonomous pension plans of E.ON UK. The payment covered a significant portion of the actuarial deficit and improved financing across the pension plan.

For 2007, it is expected that the overall Company contribution to plan assets will include 76 million (2005: 47 million) to guarantee the minimum plan asset values stipulated by law or by-laws, as well as 310 million in voluntary contributions (2005: 40 million), of which 234 million represents planned subsequent funding of the CTA.

The deconsolidation of Viterra ( 13 million) and Ruhrgas Industries ( 40 million) were mainly responsible for the change shown as Change in scope of consolidation in 2005.

The investment objective for the pension plan assets is to provide full coverage of benefit obligations at all times for the corresponding pension plans. Plan assets do not include any shares in E.ON Group companies.

In particular in the United Kingdom and in Germany, a liability-driven investments (LDI) approach is used, that is, the majority of plan assets is invested in long-term interest-bearing investments for purposes of hedging interest-rate risks arising from pension liabilities. In addition, appropriate instruments (inflation-indexed bonds, inflation swaps) may be used to hedge inflation risks. The long-term investment strategy and the associated expected rate of return on plan

assets for the various pension plans takes into consideration, among other things, the duration (maturity structure), the benefit obligations, the minimum capital reserve requirements and, if applicable, other relevant factors. In the future, in order to improve the funded status, i.e., the difference between the projected benefit obligations for all pension plans and the fair value of plan assets, a portion of the funds will be invested in asset classes that provide for returns in excess of those of fixed-income investments.

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The following returns were achieved on the different plan assets in 2006:

<b>in %</b>	
Germany	3.0
United Kingdom	4.9
United States	11.0

The determination of the target portfolio structure is based on regular asset-liability studies. In these studies, the target portfolio structure is reviewed under consideration of market and obligation developments and is adjusted as necessary.

The current allocation of plan assets to asset categories and the target portfolio structure are as follows:

	<b>Target portfolio</b>		<b>December 31, 2006</b>		<b>December 31, 2005</b>	
<b>in %</b>	<b>Domestic</b>	<b>Foreign</b>	<b>Domestic</b>	<b>Foreign</b>	<b>Domestic</b>	<b>Foreign</b>
Equity securities	11	23	1	29	13	46
Debt securities	69	68	3	63	76	47
Real estate	10	9	4	5	3	5
Fixed-term deposits			91			2
Other	10		1	3	8	

Investments in debt securities are undertaken either in the form of bonds or synthetically, by combining money-market investments and interest-rate swaps.

As of December 31, 2006, the fair value of plan assets equaled 77 percent of the projected benefit obligation (2005: 46 percent).

The funded status is reconciled with the provisions shown on the balance sheet as follows:

<b>in millions</b>	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Funded status (represents in 2006 net amount recognized)	3,883	9,615
Unrecognized actuarial loss		(3,192)
Unrecognized prior service cost		(27)
<b>Net amount recognized</b>	<b>3,883</b>	<b>6,396</b>

The amounts recognized on the balance sheet are as follows:

**December 31,**

<b>in millions</b>	<b>2006</b>	<b>2005</b>
Provisions for pensions	3,885	8,720
thereof current	116	430
thereof non-current	3,769	8,290
Intangible assets		(29)
Accumulated other comprehensive income		(1,986)
Other operating assets	(2)	(309)
<b>Net amount recognized</b>	<b>3,883</b>	<b>6,396</b>

Because under SFAS 158 the funded status is reported on the balance sheet, the obligation to recognize a minimum pension liability no longer applies; in the past, if an intangible asset was not to be capitalized, it was recognized as accumulated other comprehensive income.

The accumulated benefit obligation for all defined benefit pension plans amounted to 16,126 million (2005: 16,475 million) on December 31, 2006.

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Provisions for pensions shown on the balance sheet as of December 31, 2006, include obligations from postretirement health care benefits in the amount of 145 million (2005: 153 million), mainly for Market Unit U.S. companies. Allowances are made for increases in the costs of health care benefits amounting to 10.0 percent in the short term and 5.0 percent in the long term.

The total net periodic defined benefit pension cost is detailed in the table below. Amounts for 2005 are adjusted to reflect effects of discontinued operations.

<b>in millions</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Employer service cost	268	214	189
Interest cost	767	777	783
Expected return on plan assets	(536)	(448)	(422)
Prior service cost	16	33	25
Net amortization of actuarial gains (-)/losses	125	85	40
<b>Total</b>	<b>640</b>	<b>661</b>	<b>615</b>

The net periodic pension cost shown includes an amount of 14 million in 2006 (2005: 13 million; 2004: 17 million) for retiree health care benefits. A one-percentage-point increase or decrease in the assumed health care cost trend rate would affect the interest and service components and result in a change in net periodic pension cost of + 0.7 million or - 0.7 million, respectively. The resulting accumulated post retirement benefit obligation would change by + 7.4 million or - 6.6 million, respectively.

In addition to total net periodic pension cost, an amount of 54 million in 2006 (2005: 54 million; 2004: 52 million) was incurred for defined contribution pension plans and other retirement provisions, under which the Company pays fixed contributions to external insurers or similar institutions.

Prospective undiscounted pension payments for the next ten years are shown in the following table:

<b>in millions</b>	
2007	883
2008	909
2009	938
2010	958
2011	985
2012-2016	5,117
<b>Total</b>	<b>9,790</b>

The Company uses the 2005 revisions of the Klaus Heubeck biometric tables ( Richttafeln ), the industry standard for calculating company pension obligations in Germany, for the valuation of domestic pension liabilities.

The discount rate assumptions used by E.ON reflect the rates available for high-quality fixed-income investments during the period to maturity of the pension benefits in the respective market units at the end of the respective fiscal year.

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Actuarial values of the pension obligations of the principal German, U.K. and U.S. subsidiaries were computed based on the following average assumptions for each region:

in %	December 31, 2006				December 31, 2005			
	Germany		United Kingdom	United States	Germany		United Kingdom	United States
	CTA plans	Other			CTA plans	Other		
Discount rate	4.50	4.50	5.10	5.95	4.00	4.80	5.50	
Salary increase rate	2.75	2.75	4.00	5.25	2.75	4.00	5.25	
Expected return on plan assets	4.90	4.50	5.90	8.25	4.00	5.50	8.25	
Pension increase rate	1.50	1.50	3.00		1.50	2.80		

The expected return on plan assets is based on external asset liability management studies, which are updated on a regular basis. Returns are estimated using the building block method for each asset category.

The calculation of the expected return on assets for the CTA plans takes into account the gradual implementation of the investment process in 2007; the long-term objective is a return on plan assets of 5.4 percent.

**(23) Other Provisions**

Immediately below is a brief description of the asset retirement obligations in accordance with SFAS 143. The subsequent sections contain more detailed information about the other provisions as a whole.

**Description of Asset Retirement Obligations**

As of December 31, 2006, E.ON's asset retirement obligations included:

retirement costs shown in sub-items 1ab) and 1ba) for decommissioning of nuclear power plants in Germany in the amount of 8,515 million (2005: 8,400 million) and in Sweden in the amount of 473 million (2005: 403 million),

reclamation measures reported under sub-item 8) related to the sites of non-nuclear power plants, including removal of electricity transmission and distribution equipment in the amount of 390 million (2005: 388 million), and

reclamation at gas storage facilities in the amount of 157 million (2005: 90 million) and at opencast mining facilities in the amount of 59 million (2005: 61 million) as well as the decommissioning of oil and gas field infrastructure in the amount of 354 million (2005: 319 million). These obligations are also reported under sub-item 8).

in millions	2006	2005
<b>Balance as of January 1</b>	<b>9,661</b>	<b>9,348</b>
Liabilities incurred in the current period	68	37
Liabilities settled in the current period	(161)	(181)

Changes in scope of consolidation	24	33
Accretion	524	511
Revision in estimated cash flows	(187)	(126)
Other changes	19	39
<b>Balance as of December 31</b>	<b>9,948</b>	<b>9,661</b>

Interest resulting from the accretion of asset retirement obligations is shown in financial earnings, net (see Note 6).



**Table of Contents****Other Provisions**

The following table lists other provisions as of the dates indicated:

in millions	December 31, 2006		December 31, 2005	
	current	non-current	current	non-current
Provisions for nuclear waste management (1)	375	13,271	431	12,931
<i>Disposal of nuclear fuel rods</i>	202	4,883	279	4,724
<i>Asset retirement obligation (SFAS 143)</i>	165	8,823	143	8,660
<i>Waste disposal</i>	8	459	9	416
<i>less advance payments</i>		(894)		(869)
Provisions for taxes (2)	1,721	2,330	1,948	1,052
Provisions for personnel costs (3)	726	637	729	811
Provisions for supplier-related contracts (4)	2,802	268	1,949	201
Provisions for customer-related contracts (5)	229	43	254	52
U.S. regulatory liabilities (6)	27	467		505
Provisions for environmental remediation (7)	14	516	16	293
Provisions for environmental improvements, including land reclamation (8)	310	1,462	47	1,678
Miscellaneous (9)	1,598	1,412	656	1,589
<b>Total</b>	<b>7,802</b>	<b>20,406</b>	<b>6,030</b>	<b>19,112</b>

Of these other provisions, 14,833 million (2005: 14,457 million) bear interest.

**1) Provisions for Nuclear Waste Management****a) Germany**

Provisions for nuclear waste management comprise costs for the disposal of spent nuclear fuel rods, the retirement and decommissioning of nuclear and non-nuclear power plant components and the disposal of low-level nuclear waste.

The provisions for nuclear waste management stated above are net of advance payments of 894 million in 2006 (2005: 869 million). The advance payments are prepayments to nuclear fuel reprocessors and to other waste management companies, as well as to governmental authorities, relating to reprocessing of spent fuel rods and the construction of permanent storage facilities. Provisions for the costs of nuclear fuel rod disposal, of nuclear power plant decommissioning, and of the disposal of low-level nuclear waste also include the costs for the permanent storage of radioactive waste.

Permanent storage costs include investment, operating and financing costs for the planned permanent storage facilities Gorleben and Konrad and are based on Germany's ordinance on advance payments for the establishment of federal facilities for the safe custody and final storage of radioactive wastes ( Endlagervorausleistungsverordnung ) and on data from the German Federal Office for Radiation Protection ( Bundesamt für Strahlenschutz ). Advance payments are made each year in the amount spent by the Bundesamt für Strahlenschutz.

In calculating the provisions for nuclear waste management, the Company has also taken into account the effects of the nuclear energy agreement reached by the German government and the country's major energy utilities on June 14, 2000, and the related agreement signed on June 11, 2001.

*aa) Management of Spent Nuclear Fuel Rods*

The requirement for spent nuclear fuel reprocessing and disposal/storage is based on the German Nuclear Power Regulations Act ( Atomgesetz ). Operators may, in general, either reprocess or permanently store nuclear waste. The option to ship material for reprocessing ended on June 30, 2005; since then, spent nuclear fuel rods have been disposed of exclusively through permanent storage.

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There are contracts in place between E.ON Energie and two large European fuel reprocessing firms, British Nuclear Group Sellafield Ltd, Daresbury, Warrington, United Kingdom, and AREVA NC S.A. (formerly Cogema), Vélizy, France, for the reprocessing of spent nuclear fuel from its German nuclear plants. The radioactive waste that results from reprocessing will be returned to Germany to be temporarily stored in an authorized storage facility. Permanent storage is also expected to occur in Germany.

The provision for the unsettled costs of reprocessing nuclear fuel rods transported through June 30, 2005, includes the costs for all components of the reprocessing requirements, particularly

the costs of fuel reprocessing and

the costs of outbound transportation and the intermediate storage of nuclear waste.

The cost estimates are based primarily on existing contracts.

Provisions for the costs of permanent storage of used fuel rods primarily include

contractual costs for procuring intermediate containers and intermediate on-site storage on the plant premises, and

costs of transporting spent fuel rods to conditioning facilities, conditioning costs, and costs for procuring permanent storage containers as determined by external studies.

The provision for the management of used fuel rods is provided over the period in which the fuel is consumed to generate electricity.

### ***ab) Nuclear Plant Decommissioning***

The obligation with regard to the nuclear portion of nuclear plant decommissioning is based on the aforementioned Atomgesetz, while the obligation for the non-nuclear portion depends upon legally binding civil agreements and public regulations, as well as other agreements.

The provision for the costs of nuclear plant decommissioning includes the expected costs for run-out operation, closure and maintenance of the facility, dismantling and removal of both the nuclear and non-nuclear components of the plant, conditioning, and temporary and final storage of contaminated waste. The expected decommissioning and storage costs are based upon studies performed by external specialists and are updated regularly.

### ***ac) Waste from Plant Operations***

The provision for the costs of the disposal of low-level nuclear waste covers all expected costs for the conditioning of low-level waste that is generated in the operation of the facilities.

### **b) Sweden**

Under Swedish law, E.ON Sverige is required to pay fees to the country's national fund for nuclear waste management. Each year, the Swedish Nuclear Power Inspectorate calculates the fees for the disposal of high-level radioactive waste and nuclear power plant decommissioning based on the amount of electricity produced at the particular nuclear power plant. The proposed fees are then submitted to government offices for approval. Upon approval, E.ON Sverige makes the corresponding payments.

***ba) Decommissioning***

Due to the adoption of SFAS 143 on January 1, 2003, an asset retirement obligation for decommissioning was recognized. Since in the past, fees have been paid to the national fund for nuclear waste management, a compensating receivable relating to these decommissioning costs was recorded under *Other assets* on January 1, 2003.

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***bb) Nuclear Fuel Rods and Nuclear Waste in Sweden***

The required fees for high-level radioactive waste paid to the national fund for nuclear waste management are shown as an expense.

In the case of low-level and medium-level radioactive waste, a joint venture owned by Swedish nuclear power plant operators charges annual fees based on actual waste management costs. The Company records the corresponding payments to this venture as an expense.

**c) United Kingdom and United States**

Neither the U.K. nor the U.S. Midwest Market Unit operates any nuclear power plants. They are therefore not required to make payments or record liabilities similar to those described above with respect to Germany.

**2) Taxes**

Provisions for taxes relate primarily to domestic and foreign corporate income taxes due in the current year, and also to any tax obligations that might arise from preceding years. Tax obligations from preceding years consist of provisions for audit periods that are still open and relate primarily to the tax recognition of provisions for the disposal of radioactive waste in Germany. Tax provisions are generally calculated on the basis of the respective tax legislation of the countries in which the Company operates, and due consideration is given to all known circumstances.

**3) Personnel Liabilities**

Provisions for personnel expenses primarily cover provisions for vacation pay, early retirement benefits, anniversary obligations, share-based compensation and other deferred personnel costs.

**4) Supplier-Related Liabilities**

Provisions for supplier-related liabilities consist primarily of provisions for goods and services received but not yet invoiced and for potential losses from purchase obligations. Provisions for goods and services received but not yet invoiced represent obligations related to the purchase of goods that have been received and services that have been rendered, but for which an invoice has not yet been received.

**5) Customer-Related Liabilities**

Provisions for customer-related liabilities consist primarily of potential losses on open sales contracts. Also included are provisions for warranties, as well as for rebates, bonuses and discounts.

**6) U.S. Regulatory Liabilities**

Pursuant to SFAS 71 (see Note 2), liabilities that result from U.S. regulation are reported separately.

**7) Environmental Remediation**

Provisions for environmental remediation refer primarily to redevelopment and water protection measures and to the rehabilitation of contaminated sites.

**8) Environmental Improvements and Similar Liabilities, including Land Reclamation**

Provisions for environmental improvements and similar liabilities primarily include asset retirement obligations pursuant to SFAS 143 in the amount of 960 million (2005: 858 million). Also included are provisions for reversion of title, other environmental improvements and reclamation liabilities.

In addition, there are certain conditional asset retirement obligations. The type, scope, timing and associated probabilities cannot be estimated reasonably, meaning that even the application of an expected present value

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technique would not produce reasonable estimates of fair values. Under FIN 47, no provisions are recognized for such circumstances.

**9) Miscellaneous**

Miscellaneous other provisions primarily include provisions arising from the electricity and gas business, of which 551 million relates to the risk of retroactive application of lower network charges resulting from the regulation of network charges in Germany. They further include provisions for obligations arising from the acquisition and disposal of businesses, provisions from emissions trading systems and provisions for tax-related interest expenses.

**(24) Liabilities and Deferred Income**

in millions	December 31, 2006		December 31, 2005	
	current	non-current	current	non-current
Financial liabilities	3,440	9,959	3,807	10,555
Operating liabilities	14,287	4,927	13,302	5,750
Deferred income	317	919	202	615
<b>Total</b>	<b>18,044</b>	<b>15,805</b>	<b>17,311</b>	<b>16,920</b>

The following table provides details of liabilities as of the dates indicated:

in millions	Total	December 31, 2006 With a remaining term			Average interest rate up to 1 Year (in %)	Total	December 31, 2005 With a remaining term			Average interest rate up to 1 Year (in %)
		of up to 1 Year	1 to 5 Years	over 5 Years			of up to 1 Year	1 to 5 Years	over 5 Years	
Bonds (including Medium Term Note programs)	9,003	540	5,005	3,458	6,1	9,538	732	5,195	3,611	5,7
Commercial paper	366	366			3,9					
Bank loans/Liabilities to banks	1,237	353	691	193	4,6	1,530	424	729	377	5,0
Bills payable	35	33	2		4,8	42		42		
Other financial liabilities	751	177	144	430	4,7	1,306	742	165	399	2,7
<b>Financial liabilities to banks and third parties</b>	<b>11,392</b>	<b>1,469</b>	<b>5,842</b>	<b>4,081</b>		<b>12,416</b>	<b>1,898</b>	<b>6,131</b>	<b>4,387</b>	

Financial liabilities to affiliated companies	154	147	1	6	4.3	134	128	6	3.1	
Financial liabilities to associated companies and other share investments	1,853	1,824	12	17	5.0	1,812	1,781	12	19	4.4
<b>Financial liabilities to group companies</b>	<b>2,007</b>	<b>1,971</b>	<b>13</b>	<b>23</b>		<b>1,946</b>	<b>1,909</b>	<b>12</b>	<b>25</b>	
<b>Financial liabilities</b>	<b>13,399</b>	<b>3,440</b>	<b>5,855</b>	<b>4,104</b>		<b>14,362</b>	<b>3,807</b>	<b>6,143</b>	<b>4,412</b>	
Accounts payable	5,305	5,305				5,288	5,272	16		
Operating liabilities to affiliated companies	123	75	3	45		105	59	3	43	
Operating liabilities to associated companies and other share investments	222	201	13	8		188	98	70	20	
Capital expenditure grants	267	23	83	161		270	19	96	155	
Construction grants from energy consumers	3,471	361	1,279	1,831		3,674	420	736	2,518	
Advance payments	409	400	1	8		488	488			
Other operating liabilities	9,417	7,922	1,256	239		9,039	6,946	668	1,425	
thereof taxes	871	871				614	614			
thereof social security contributions	108	108				63	63			
<b>Operating liabilities</b>	<b>19,214</b>	<b>14,287</b>	<b>2,635</b>	<b>2,292</b>		<b>19,052</b>	<b>13,302</b>	<b>1,589</b>	<b>4,161</b>	
<b>Liabilities</b>	<b>32,613</b>	<b>17,727</b>	<b>8,490</b>	<b>6,396</b>		<b>33,414</b>	<b>17,109</b>	<b>7,732</b>	<b>8,573</b>	



**Table of Contents****Financial Liabilities**

The following is a description of the E.ON Group's significant credit arrangements and debt issuance programs. Outstanding amounts under credit lines and bank loans are disclosed in the table above as Bank loans/Liabilities to banks. Issuances under a Medium Term Note program ( MTN program ) and issuances of commercial paper are disclosed in the corresponding line item.

These financing arrangements contain affirmative and negative covenants and provide for various events of default that are generally in line with industry standard terms for similar borrowings. In general, E.ON's most significant financial arrangements do not include financial covenants. E.ON and its subsidiaries were in compliance with all such covenants as of December 31, 2006 and 2005, and no cross-default clauses had been triggered as of such dates.

In addition, E.ON has numerous additional financing arrangements that are not individually significant and that are summarized below grouped by segment and type of arrangement. These other arrangements also include covenants and provide for various events of default that are generally in line with industry standard terms for similar borrowings. E.ON and its subsidiaries were in compliance with all such covenants as of December 31, 2006 and 2005, and no cross-default clauses had been triggered as of such dates.

**Corporate Center*****20 billion Medium Term Note Program***

The existing 20 billion MTN program allows E.ON AG and certain wholly owned subsidiaries, under the unconditional guarantee of E.ON AG, to periodically issue debt instruments through public and private placements to investors. Notes issued under the program are listed on the Luxembourg Stock Exchange. At year-end 2006, the following bonds were outstanding:

4.25 billion issued by E.ON International Finance with a coupon of 5.75 percent and a maturity in May 2009

0.9 billion issued by E.ON International Finance with a coupon of 6.375 percent and a maturity in May 2017

GBP 500 million or 746 million issued by E.ON International Finance with a coupon of 6.375 percent and a maturity in May 2012

GBP 0.975 billion or 1.455 billion issued by E.ON International Finance with a coupon of 6.375 percent and a maturity in June 2032

The MTN documentation and the documentation of the outstanding bonds are customary for such financing programs and instruments.

***10 billion Commercial Paper Program***

The existing 10 billion commercial paper program allows E.ON AG and certain wholly owned subsidiaries, under the unconditional guarantee of E.ON AG, to periodically issue commercial paper with maturities of up to 729 days to investors. As of December 31, 2006, 123 million in commercial paper was outstanding under the program (2005: 0 million).

***10 billion Syndicated Multi-Currency Revolving Credit Facility Agreement***

Under the existing 10 billion revolving credit facility, E.ON AG and certain subsidiaries, each under the unconditional guarantee of E.ON AG, may make borrowings in various currencies in an aggregate amount of up to 10 billion. The facility is divided into Tranche A, a revolving credit facility in the amount of 5 billion, and Tranche B, a revolving credit facility also in the amount of 5 billion. Tranche A has a maturity date of November 29, 2007. Tranche B was extended to December 2, 2011 (with an amount of 4.847 billion maturing in 2011 and an amount of 0.153 billion maturing in 2010). Drawings under Tranche A bear interest equal to EURIBOR or LIBOR for the respective currency plus a margin of 12.5 basis points and drawings under Tranche B

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bear interest equal to EURIBOR or LIBOR for the respective currency plus a margin of 15 basis points. As of December 31, 2006, there were no borrowings outstanding under this facility (2005: 0 million).

***37.1 billion Syndicated Term and Guarantee Facility Agreement***

In order to finance the offer for Endesa, E.ON entered into a Euro syndicated term and guarantee facility agreement on February 20, 2006, for a total amount of 32 billion. Following the announcement by E.ON that it intends to increase its offer, a new Euro syndicated term and guarantee facility agreement for a total amount of 37.1 billion was entered into by E.ON as borrower on October 16, 2006. Advances under the facility agreement may only be used for the settlement of the offer for Endesa and related costs, as well as for the repayment of Endesa's indebtedness. The initial purpose of the facility is the issue of guarantees (Avales). Spanish law requires that public bids be supported by unconditional financial guarantees issued in favor of the Spanish stock market regulator CNMV for the full amount of the cash offer. For further information please refer to Note 33.

The facility is divided into two tranches: Tranche A (2/3 of the facility amount or 24.7 billion) with a maturity date of February 18, 2008, and Tranche B (1/3 of the facility amount or 12.4 billion) with a maturity date of February 20, 2009. In respect of utilization for Avales, the guarantee commission is equal to EURIBOR plus a margin of 22.5 basis points. The rate of interest for advances will be determined based on a rating ratchet. As of December 31, 2006, the facility was used for Avales with an outstanding amount of 26.9 billion.

***Bilateral Credit Lines***

At year-end 2006, E.ON AG had committed short-term credit lines of 180 million (2005: 180 million) with maturities of up to one year and variable interest rates of up to 25 basis points above EURIBOR. In addition, E.ON AG had several uncommitted short-term credit lines. E.ON AG had no outstanding balances under these lines at the end of 2006 and 2005.

As of December 31, 2006, E.ON North America Inc., New York, U.S., a wholly-owned subsidiary of E.ON AG, had a USD 50 million credit facility. This is an overdraft loan facility to be used for short-term overnight general corporate use. The rate charged on the daily loan balance is 8 basis points over the Federal Funds Rate. There was no outstanding balance under this line at the end of 2006 and 2005.

**Central Europe*****Bank Loans, Credit Facilities***

As of December 31, 2006, the Central Europe market unit had committed credit lines of 201.7 million (2005: 348 million). The credit lines may be used for general corporate purposes. In particular, they serve as back-up facilities for letters of credit and bank guarantees. In addition, Central Europe had uncommitted short-term credit lines with various banks. Under the credit lines, 1.2 million was outstanding at year-end 2006 (2005: 180 million). Most of the credit lines do not have a specific maturity. Interest rates for unanticipated drawdowns of facilities reach up to 8 percent. Planned use of the facilities is subject to interest at variable money-market rates plus a margin of up to 175 basis points.

Bank loans have been used by the Central Europe market unit primarily to finance specific projects or investment programs and include subsidized credit facilities from national and international financing institutions. Bank loans (including short-term credit lines) amounted to 1,039 million as of December 31, 2006 (2005: 1,109 million).

**Pan-European Gas**

***Long-Term Loans***

In the period from 1997 to 2003, Pan-European Gas subsidiary Ferngas Nordbayern GmbH obtained long-term loans from banks totaling 84 million. The loans each have a maturity of up to 10 years with annual or quarterly repayments. The outstanding amount as of December 31, 2006, was approximately 11.6 million (2005: 15 million). The interest rates for these loans vary between 4.1 and 5.98 percent (on average, about 5.1 percent).

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In addition, E.ON Ruhrgas obtained four long-term bilateral loans from banks since 1999 in the aggregate amount of 280 million with original maturities of 5 to 15 years and repayable at maturity. The entire amount of 140 million outstanding under the loans as of January 1, 2005, was repaid prior to maturity during 2005. The corresponding loss on extinguishment in 2005 totaled 18 million.

**U.K.*****Bonds***

As of December 31, 2006, the U.K. market unit had several outstanding bonds. Only a portion of the bonds still outstanding was held by investors external to the E.ON Group, as detailed below:

GBP 250 million or 373 million bond issued by E.ON UK plc with a coupon of 6.25 percent maturing in April 2024, of which GBP 8 million or 12 million was held by external investors

GBP 150 million or 224 million issued by Central Networks plc (previously Midlands Electricity plc, a wholly-owned subsidiary of E.ON UK plc) with a coupon of 7.375 percent maturing in November 2007, of which GBP 0.4 million or approximately 0.6 million was held by external investors

500 million Eurobond issued by E.ON UK plc with a coupon of 5.0 percent maturing in July 2009, of which 264 million was held by external investors

USD 410 million or 311 million Yankee Bond issued by Powergen (East Midlands) Investments, London, U.K., with a coupon of 7.45 percent maturing in May 2007, of which USD 173 million or 131 million was held by external investors

**Nordic*****E.ON Sverige Medium Term Note Program***

A domestic MTN program was established by Sydkraft, now E.ON Sverige, in 1999 and was increased in 2003 to a maximum allowed outstanding amount of SEK 13 billion. The facility is renewed every year and allows for borrowings in various currencies with a maturity of up to 15 years with various interest rate structures. The outstanding amount as of December 31, 2006, was SEK 5,707 million or 631 million (2005: SEK 6,601 million or 703 million).

***E.ON Sverige Commercial Paper Programs***

Established in 1990, the domestic commercial paper program of Sydkraft, now E.ON Sverige, was increased in 1999 to a maximum allowed outstanding amount of SEK 3 billion and again in 2006 increased to a maximum outstanding amount of SEK 5 billion. Borrowings can be made for terms of up to 360 days. The outstanding amount as of December 31, 2006, was SEK 1,691 million or 187 million (2005: SEK 0 million or 0 million).

A Euro commercial paper program was established by Sydkraft, now E.ON Sverige, in 1990 with a maximum allowed outstanding amount of USD 200 million. Borrowings can be made in various currencies for terms of up to 360 days. The outstanding amount as of December 31, 2006, was 56 million (2005: 0 million).

***Bank Loans, Credit Facilities***

E.ON Sverige has obtained bilateral loans from credit institutions at variable money-market rates, with a floating rate spread of 21.5 and 42.5 basis points over the Stockholm Interbank Offered Rate (STIBOR), respectively, and maturities of up to ten years. As of December 31, 2006, the aggregate amount outstanding was SEK 489 million or 54 million (2005: SEK 1,349 million or 144 million). These loans have mainly been used to finance specific investments.

**Table of Contents****U.S. Midwest*****Bonds and Medium Term Note Programs***

E.ON U.S. Capital Corp. ( E.ON U.S. Capital ), Louisville, Kentucky, U.S., has an MTN program under which it was authorized to issue initially up to USD 1.05 billion in bonds. Amounts repaid may not be reborrowed. As of December 31, 2006, the amount outstanding under the program was USD 26 million or 20 million (2005: USD 300 million or 254 million), leaving USD 400 million available for future issuance. The average interest rate for issues under this program for 2006 was 7.00 percent, and maturities range from 2008 to 2011. In July 2006 E.ON U.S. Capital completed a tender offer and consent in which USD 274 million of the notes were repurchased. As part of this process, virtually all covenants of the MTN program were eliminated.

In addition, as of December 31, 2006, bonds in the amount of USD 574 million or 436 million (2005: USD 574 million or 486 million) were outstanding at LG&E and bonds in the amount of USD 359 million or 273 million (2005: USD 362 million or 307 million) were outstanding at Kentucky Utilities, with fixed interest rates as well as with variable interest rates. The one remaining fixed rate bond has an interest rate of 7.92 percent, while the average interest rate on the variable rate bonds was less than 3.50 percent in 2006. On the LG&E bonds, maturities range from 2013 to 2035, and on the Kentucky Utilities bonds, maturities range from 2007 to 2036. The LG&E and Kentucky Utilities bonds are collateralized by a lien on substantially all of the assets of the respective companies.

***Bilateral Credit Lines, Bank Loans***

LG&E has five revolving lines of credit with banks totaling USD 185 million or 140 million. These credit facilities expire in June 2007, and there was no outstanding balance under any of these facilities on December 31, 2006 (2005: 0 million).

As of December 31, 2006, E.ON's financial liabilities to banks and third parties had the following maturities:

<b>in millions</b>	<b>Repayment in 2007</b>	<b>Repayment in 2008</b>	<b>Repayment in 2009</b>	<b>Repayment in 2010</b>	<b>Repayment in 2011</b>	<b>Repayment after 2011</b>	<b>Total</b>
Bonds (including MTN programs)	540	184	4,512	307	2	3,458	9,003
Commercial paper	366						366
Bank loans/Liabilities due to banks	353	80	62	45	504	193	1,237
Bills payable	33	2					35
Other financial liabilities	177	100	22	12	10	430	751
<b>Financial liabilities to banks and third parties</b>	<b>1,469</b>	<b>366</b>	<b>4,596</b>	<b>364</b>	<b>516</b>	<b>4,081</b>	<b>11,392</b>
Used credit lines	125					1	126
Unused credit lines	5,964	1	1	153	4,848	2	10,969
	<b>6,089</b>	<b>1</b>	<b>1</b>	<b>153</b>	<b>4,848</b>	<b>3</b>	<b>11,095</b>

**Used and unused credit  
lines (1)**

- (1) Amount does not include the 37.1 billion syndicated term and guarantee facility agreement, which is described on page F-61.

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The following table shows the interest rates for the Company's financial liabilities to banks and third parties:

in millions	December 31, 2006				Total
	0 - 3%	3.1 - 7%	7.1 - 10%	more than 10%	
Bonds (including MTN programs)		8,869	134		9,003
Commercial paper	132	234			366
Bank loans/Liabilities due to banks	149	1,087	1		1,237
Bills payable		35			35
Other financial liabilities	138	584	14	15	751
<b>Financial liabilities to banks and third parties</b>	<b>419</b>	<b>10,809</b>	<b>149</b>	<b>15</b>	<b>11,392</b>

The following table provides details of the Company's liabilities due to banks as of the dates indicated:

in millions	December 31,	
	2006	2005
Bank loans collateralized by mortgages on real estate	94	141
Other collateralized bank loans	37	51
Uncollateralized bank loans, drawings on credit lines, current loans	1,106	1,338
<b>Total</b>	<b>1,237</b>	<b>1,530</b>

In November 2005, E.ON Ruhrgas issued loan notes in connection with the acquisition of E.ON Ruhrgas UK North Sea for an amount of approximately GBP 402 million, equivalent to \$595 million at that date, with a contractual term of eighteen months. A large portion of these loan notes was converted into USD loan notes in 2005. In November 2006, E.ON Ruhrgas made use of the possibility to redeem 90 percent of the issued loan notes after one year. As of December 31, 2006, the remaining amount outstanding was \$54 million (GBP 3.7 million and USD 63.6 million; 2005: \$545 million). The coupon is based on LIBOR.

**Operating Liabilities**

Capital expenditure grants of \$267 million (2005: \$270 million) are paid primarily by customers in the core energy business for capital expenditures made on their behalf, while E.ON retains the assets. The grants are non-refundable and are recognized in other operating income over the period of the depreciable lives of the related assets.

Construction grants of \$3,471 million (2005: \$3,674 million) are paid by customers of the core energy business for costs of connections according to the generally binding linkup terms. These grants are customary in the industry, generally non-refundable and recognized as revenue according to the useful lives of the related assets.

Other operating liabilities primarily include the negative fair values of derivative financial instruments of \$5,938 million (2005: \$5,761 million), E.ON Benelux's cross-border lease transactions for power plants amounting to \$883 million (2005: \$1,011 million) and accrued interest payable of \$672 million (2005: \$638 million).

**(25) Contingencies and Commitments**

E.ON is subject to contingencies and commitments involving a variety of matters, including different types of guarantees, litigation and claims (as discussed in Note 26), long-term contractual and legal obligations and other commitments.

**Financial Guarantees**

Financial guarantees include both direct and indirect obligations (indirect guarantees of indebtedness of others). These require the guarantor to make contingent payments based on the occurrence of certain events or changes in an underlying instrument that is related to an asset, a liability, or the equity of the guaranteed party.

The Company's financial guarantees include nuclear-energy related items. Obligations also include direct financial guarantees to creditors of related parties and third parties. Direct financial guarantees with specified terms extend as far as 2023. Maximum potential undiscounted future payments could total up to 370 million (2005:

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427 million). 284 million of this amount involves guarantees issued on behalf of related parties (2005: 304 million). Alongside obligations in connection with cross-border lease transactions, indirect guarantees consist primarily of obligations to provide financial support mainly to related parties. Indirect guarantees have specified terms up to 2030. Maximum potential undiscounted future payments could total up to 582 million (2005: 431 million). 262 million of this amount involves guarantees issued on behalf of related parties (2005: 67 million). The Company has recorded provisions of 5 million (2005: 25 million) as of December 31, 2006, with respect to financial guarantees. In addition, E.ON has commitments under which it assumes joint and several liability arising from its stakes in the civil-law companies ( GbR ), non-corporate commercial partnerships and consortia in which it participates.

With the entry into force on April 27, 2002, of the Atomgesetz, as amended, and of the ordinance regulating the provision for coverage under the Atomgesetz ( Atomrechtliche Deckungsvorsorge-Verordnung or AtDeckV ), as amended, German nuclear power plant operators are required to provide nuclear accident liability coverage of up to 2.5 billion per incident.

The coverage requirement is satisfied in part by a standardized insurance facility in the amount of 255.6 million. The institution Nuklear Haftpflicht Gesellschaft bürgerlichen Rechts ( Nuklear Haftpflicht GbR ) now only covers costs between 0.5 million and 15 million for claims related to officially ordered evacuation measures. Group companies have agreed to place their subsidiaries operating nuclear power plants in a position to maintain a level of liquidity that will enable them at all times to meet their obligations as members of the Nuklear Haftpflicht GbR, in proportion to their shareholdings in nuclear power plants.

To provide liability coverage for the additional 2,244.4 million per incident required by the above-mentioned amendments, E.ON Energie AG and the other parent companies of German nuclear power plant operators reached a Solidarity Agreement ( Solidarvereinbarung ) on July 11, July 27, August 21, and August 28, 2001. If an accident occurs, the Solidarity Agreement calls for the nuclear power plant operator liable for the damages to receive after the operator's own resources and those of its parent company are exhausted financing sufficient for the operator to meet its financial obligations. Under the Solidarity Agreement, E.ON Energie's share of the liability coverage currently stands at 42.0 percent (2005: 43.0 percent), with an additional 5.0 percent charge for the administrative costs of processing damage claims.

In accordance with Swedish law, the Nordic market unit has issued guarantees to governmental authorities. The guarantees, which are also included in the aforementioned direct financial guarantees, were issued to cover possible additional costs related to the disposal of high-level radioactive waste and to nuclear power plant decommissioning. These costs could arise if actual costs exceed accumulated funds. In addition, Nordic is also responsible for any costs related to the disposal of low-level radioactive waste. In Sweden, owners of nuclear facilities are liable for damages resulting from accidents occurring in those nuclear facilities and for accidents involving any radioactive substances connected to the operation of those facilities. The liability per incident as of December 31, 2006, was limited to SEK 3,102 million or 343 million (2005: SEK 3,401 million or 362 million), which amount must be insured according to the Law Concerning Nuclear Liability. The Nordic market unit has purchased the necessary insurance for its nuclear power plants. The Swedish government is currently in the process of reviewing the regulatory framework for nuclear obligations. The extent to which this review will result in changes to the Swedish regulations on the limitation of nuclear liabilities is still unclear at present.

Neither the U.K., nor the Pan-European Gas nor the U.S. Midwest market units operate nuclear power plants; they therefore do not have comparable contingent liabilities.

**Indemnification Agreements**

Contracts in connection with the disposal of shareholdings concluded throughout the Group include indemnification agreements and other guarantees with terms up to 2041 in accordance with contractual arrangements and local legal requirements, unless shorter terms were contractually agreed. The maximum undiscounted amounts potentially payable in respect of the circumstances expressly set forth in these agreements could total up to 6,865 million (2005: 6,623 million). The indemnities ( Freistellungen ) typically relate to customary representations and warranties, environmental damages and taxes. In some cases the buyer is required to either share costs or cover a certain amount of costs before the Company is required to make any payments. Some

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obligations are to be covered first by insurance contracts or provisions of the disposed companies. The Company has recorded provisions of 270 million (2005: 296 million) as of December 31, 2006, with respect to all indemnities and other guarantees included in sales agreements. Guarantees issued by companies that were later sold by E.ON AG (or VEBA AG and VIAG AG before their merger) are included in the final sales contracts in the form of indemnities.

### **Other Guarantees**

Other guarantees with an effective period through 2021 consist primarily of market value guarantees and warranties that could result in maximum potential undiscounted future payments of 104 million (2005: 130 million).

### **Long-Term Obligations**

As of December 31, 2006, the principal long-term contractual obligations in place relate to the purchase of fossil fuels such as gas, lignite and hard coal.

Gas is usually procured on the basis of long-term purchase contracts with large international producers of natural gas. Such contracts are generally of a take-or-pay nature. The prices paid for natural gas are normally tied to the prices of competing energy sources, as dictated by market conditions. The conditions of these long-term contracts are reviewed at certain specific intervals (usually every 3 years) as part of contract negotiations and may thus change accordingly. In the absence of an agreement on a pricing review, a neutral board of arbitration makes a final binding decision. Financial obligations arising from these contracts are calculated based on the same principles that govern internal budgeting. Furthermore, the take-or-pay conditions in the individual contracts are also considered in the calculations.

The increase in contractual obligations in place for the purchase of gas is mainly due to the higher purchasing costs of gas in 2006, which led to an adjustment of planning assumptions, to the extension of existing contracts and the conclusion of new purchase contracts.

The contractual obligations in place for the purchase of electricity relate especially to purchases from jointly operated power plants. The purchase price of electricity from jointly operated power plants is determined by the supplier's production cost plus a profit margin that is generally calculated on the basis of an agreed return on capital.

Long-term contractual obligations have also been entered into by the Central Europe market unit for the procurement of services in the area of reprocessing and storage of spent fuel elements delivered through June 30, 2005.

Other purchase commitments/obligations include primarily obligations for investments not yet implemented in connection with new power plant construction projects as well as modernizations of existing power plant installations.

Other financial obligations amount to 3,631 million (2005: 4,299 million). They consist primarily of obligations arising from the acquisition of investments.

There is a put option agreement in place since October 2001 allowing a minority shareholder of E.ON Sverige to exercise its right to sell its remaining stake for approximately 2 billion. In 2003, the term of this option was extended to the end of 2007.

The Central Europe market unit has entered into put option agreements related to various acquisitions that allow other shareholders to exercise rights to sell their remaining stakes for an aggregate total of approximately 0.6 billion.

In addition, there is a conditional obligation to acquire up to 100 percent of the shares of Endesa. For further information, see Note 33.



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Expected payments arising from long-term obligations totaled 245,331 million on December 31, 2006, and break down as follows:

in millions	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	After 5 Years
<b>Long-term purchase commitments/obligations</b>					
<b>Fossil fuel purchase obligations</b>					
Natural gas	221,358	21,309	37,383	38,883	123,783
Oil	75	10	27	25	13
Coal	3,280	1,203	1,378	687	12
Lignite and other fossil fuels	1,089	33	66	66	924
<b>Subtotal, fossil fuels</b>	<b>225,802</b>	<b>22,555</b>	<b>38,854</b>	<b>39,661</b>	<b>124,732</b>
Electricity purchase obligations	7,915	3,209	2,137	661	1,908
Other purchase obligations	2,462	485	439	254	1,284
<b>Subtotal, long-term purchase commitments/obligations</b>	<b>236,179</b>	<b>26,249</b>	<b>41,430</b>	<b>40,576</b>	<b>127,924</b>
<b>Other purchase commitments/obligations</b>					
Major repairs	82	64	18		
Environmental protection measures					
Other (e.g., capital expenditure commitments)	5,182	2,160	2,127	638	257
<b>Subtotal</b>	<b>5,264</b>	<b>2,224</b>	<b>2,145</b>	<b>638</b>	<b>257</b>
<b>Other financial obligations</b>	<b>3,631</b>	<b>2,477</b>	<b>991</b>	<b>1</b>	<b>162</b>
<b>Loan commitments</b>	<b>257</b>	<b>249</b>	<b>1</b>	<b>4</b>	<b>3</b>
<b>Total</b>	<b>245,331</b>	<b>31,199</b>	<b>44,567</b>	<b>41,219</b>	<b>128,346</b>

**Rental, Tenancy and Lease Agreements**

Nominal values of other commitments arising from rental, tenancy and lease agreements are due as follows:

in millions	
2007	205
2008	142
2009	89

2010	84
2011	63
Thereafter	237
<b>Total</b>	<b>820</b>

Expenses arising from such contracts reflected in the Consolidated Statements of Income amounted to 223 million in 2006 (2005: 102 million; 2004: 71 million).

## **(26) Litigation and Claims**

A number of different court actions (including product liability lawsuits), governmental investigations and proceedings, and other claims are currently pending or may be instituted or asserted in the future against companies of the E.ON Group. This in particular includes legal actions and proceedings concerning alleged price-fixing agreements and anti-competitive practices. In addition, there are lawsuits pending against E.ON AG and U.S.



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subsidiaries in connection with the disposal of VEBA Electronics in 2000. E.ON Ruhrgas is a party to a number of different arbitration proceedings in connection with the acquisition of Europgas a.s. and in connection with gas delivery contracts entered into with Norsk Hydro Produksjon AS and Gas Terra B.V. Lastly, E.ON AG and one E.ON subsidiary are parties to or participants in various court and regulatory proceedings in Spain and in the United States, among other venues, in connection with the offer for Endesa S.A. Since litigation or claims are subject to numerous uncertainties, their outcome cannot be ascertained; however, in the opinion of management, any potential obligations arising from these matters will not have a material adverse effect on the financial condition, results of operations or cash flows of the Company.

The U.S. Securities and Exchange Commission ( SEC ) has requested that E.ON provide it with information for an investigation focusing in particular on the preparation of its financial statements for the fiscal years 2000 through 2003, including the accounting treatment and depreciation of its power plant assets, its accounting for and consolidation of former subsidiaries (Degussa and Viterra) and their shareholdings, the nature of the services performed by the independent public accountants appointed by E.ON, disclosures with regard to the Company's long-term fuel procurement contracts, and its 2002 Annual Report on Form 20-F, in particular the process of its preparation and its conformity with U.S. GAAP. E.ON is in close contact with the SEC and will cooperate fully. A similar request that also covers additional items, including aspects of E.ON's 2003 Annual Report on Form 20-F, has been made to the independent public accountants appointed by E.ON.

**(27) Supplemental Disclosure of Cash Flow Information**

The following table indicates supplemental disclosures of cash flow information:

in millions	2006	2005	2004
<b>Cash paid during the year for</b>			
Interest, net of amounts capitalized	1,029	965	1,100
Income taxes, net of refunds	837	1,052	1,352
<b>Non-cash investing and financing activities</b>			
Exchanges and contributions of assets as part of acquisitions	138	171	
Funding of external fund assets for pension obligations through transfer of fixed-term deposits and securities	5,126		
Loan notes issued in lieu of cash purchase price payments for E.ON Ruhrgas U.K. North Sea		595	
Increase of stakes in subsidiaries in exchange for distribution of E.ON AG shares to minority shareholders		35	182

The deconsolidation of shareholdings and activities resulting from divestments led to reductions of 1,523 million (2005: 7,160 million; 2004: 231 million) related to assets and 589 million (2005: 4,510 million; 2004: 186 million) related to provisions and liabilities. Cash and cash equivalents divested herewith amounted to 550 million (2005: 45 million; 2004: 19 million).

Purchase prices for acquisitions of subsidiaries totaled 550 million (2005: 1,336 million, including 595 million in non-cash purchase price components for E.ON Ruhrgas UK North Sea Ltd.; 2004: 1,004 million). Cash and cash equivalents acquired in connection with the acquisitions amounted to 57 million (2005: 275 million; 2004: 110 million). These purchases resulted in assets amounting to 1,929 million (2005: 3,892 million; 2004: 2,680 million) and in provisions and liabilities totaling 1,350 million (2005: 1,922 million; 2004: 2,569 million).

Cash provided by operating activities was higher in 2006 than in the preceding year. The increase was generated primarily by the Central Europe and U.K. market units, where improved operations and one-time effects such as the full consolidation of VKE made positive contributions in 2006, while the negative influences of the prior year, e.g. the effect of pension fund contributions, did not recur. An additional positive contribution came from the reduction of receivables at the U.S. Midwest market unit. Negative effects in 2006 were generated at the Pan-European Gas market unit as a result of the full consolidation of E.ON Földgáz Trade, payments for gas storage capacity at E.ON Ruhrgas AG and payment extensions. In 2005, cash provided by operating activities increased

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significantly over the preceding year. The increase was due primarily to changes in tax payments, and in particular to the change in the VAT treatment of gas transactions in the Pan-European Gas market unit. Other positive influences were provided by higher prepayments by customers in December at the Pan-European Gas market unit, the increase in gross margin at the Central Europe market unit and by effects resulting from the elimination of currency swaps in the Corporate Center. These improvements were partly offset by pension fund contributions at the U.K. market unit, increased contributions to the VKE fund at the Central Europe market unit, and storm damage payments at the Nordic market unit.

Cash flows from investing activities was negative in 2006. With declining proceeds from sales of shareholdings, cash used for investment activities rose significantly over the previous year. Moreover, more funds were used for fixed-term deposits and securities purchases than in 2005. Some of these financial investments were transferred during the course of the year to external fund assets for pension obligations.

The additional reduction of financial debts and the distribution of the special dividend for the 2005 fiscal year are reflected in the negative cash flow from financing activities.

## **(28) Derivative Financial Instruments and Hedging Transactions**

### **Strategy and Objectives**

During the normal course of business, the Company is exposed to foreign currency risk, interest rate risk, and commodity price risk. These risks create volatility in earnings, equity, and cash flows from period to period. The Company makes use of derivative financial instruments in various strategies to eliminate or limit these risks.

The Company's policy generally permits the use of derivatives if they are associated with underlying assets or liabilities, forecasted transactions, or legally binding rights or obligations. Some of the companies in the market units also conduct proprietary trading in commodities within the risk management guidelines described below.

E.ON AG has enacted general risk management guidelines for the use of derivative interest and foreign currency instruments as well as for commodity risk management that constitute a comprehensive framework for the entire Group. The market units have also adopted specific risk management guidelines to eliminate or limit risks arising from their respective activities. The market units' guidelines operate within the general risk management guidelines of E.ON AG. As part of the Company's framework for interest rate, foreign currency and commodity risk management, an enterprise-wide reporting system is used to monitor each reporting unit's exposures to these risks and their long-term and short-term financing needs. The creditworthiness of counterparties is monitored on a regular basis.

Commodity derivatives are used for price risk management, system optimization, load balancing and margin improvement. Any use of derivatives is only allowed within limits that are established and monitored by a board independent from the trading operations. Proprietary trading activities are subject to particularly strict limits. The risk ratios and limits used mainly include Profit at Risk and Value at Risk figures, as well as volume, credit and book limits. Additional key elements of risk management are the clear division of duties between scheduling, trading, settlement and control, as well as a risk reporting independent from the trading operations.

Interest, currency and equity-related derivatives are only used for hedging purposes.

Hedge Accounting in accordance with SFAS 133 is used primarily for interest rate derivatives regarding hedges of long-term debts, for foreign currency derivatives regarding hedges of net investments in foreign operations and long-term receivables and debts denominated in foreign currencies. For commodities, potentially volatile future cash flows resulting primarily from planned purchases and sales of electricity and from gas supply requirements are

hedged. Forward transactions are used to hedge price risks on equities.

### **Fair Value Hedges**

Fair value hedges are used to protect against the risk from changes in market values. The Company uses fair value hedge accounting specifically in the exchange of fixed-rate commitments in long-term receivables and liabilities denominated in foreign currencies and Euro for variable rates. The hedging instruments used for such exchanges are interest rate and cross-currency interest rate swaps. Gains and losses on these hedges are generally

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reported in that line item of the income statement which also includes the respective hedged transactions. The loss from the ineffective portion of all fair value hedges as of December 31, 2006, was 1 million (2005: 1 million gain; 2004: 2 million gain) and is included in other operating income. Interest rate fair value hedges are reported under Interest and similar expenses (net).

## **Cash Flow Hedges**

Cash flow hedges are used to protect against the risk arising from variable cash flows. Interest rate and cross-currency interest rate swaps are the principal instruments used to limit interest rate and currency risks. The purpose of these swaps is to maintain the level of payments arising from long-term interest-bearing receivables and liabilities denominated in foreign currencies and euro by using cash flow hedge accounting in the functional currency of the respective E.ON company.

To reduce cash flow fluctuations arising from electricity and gas transactions effected at variable spot prices, futures and forward contracts are concluded and also accounted for using cash flow hedge accounting.

As of December 31, 2006, the hedged transactions in place included foreign currency cash flow hedges with maturities of up to eleven years (2005: up to twelve years) and up to 26 years (2005: up to 27 years) for interest rate cash flow hedges. Share price risk is hedged up to one year. Planned commodity cash flow hedges have maturities of up to four years (2005: up to three years).

The amount of ineffectiveness for cash flow hedges recorded for the year ended December 31, 2006, was a loss of 3 million (2005: 1 million gain; 2004: 1 million gain). For the year ended December 31, 2006, reclassifications from accumulated other comprehensive income for cash flow hedges resulted in a gain of 26 million (2005: 208 million loss; 2004: 117 million gain). The Company estimates that reclassifications from accumulated other comprehensive income for cash flow hedges in the next twelve months will result in a gain of 227 million. Gains and losses from reclassification are generally reported in that line item of the income statement which also includes the respective hedged transaction. Gains and losses from the ineffective portion of cash flow hedges are classified as other operating income or other operating expenses. Interest rate cash flow hedges are reported under Interest and similar expenses (net).

## **Net Investment Hedges**

The Company uses foreign currency loans, foreign currency forwards, FX swaps and cross-currency swaps to protect the value of its net investments in its foreign operations denominated in foreign currencies. For the year ended December 31, 2006, the Company recorded an amount of 989 million (2005: 825 million) in accumulated other comprehensive income within stockholders' equity due to changes in fair value of derivative and foreign currency transaction results of non-derivative hedging instruments.

## **Valuation of Derivative Instruments**

The fair value of derivative instruments is sensitive to movements in underlying market rates and other relevant variables. The Company assesses and monitors the fair value of derivative instruments on a periodic basis. Fair values for each derivative financial instrument are determined as being equal to the price at which one party would assume the rights and duties of another party, and calculated using common market valuation methods with reference to available market data as of the balance sheet date.

The following is a summary of the methods and assumptions for the valuation of utilized derivative financial instruments in the Consolidated Financial Statements.

Currency, electricity, gas, oil and coal forward contracts, swaps, and emissions-related derivatives are valued separately at their forward rates and prices as of the balance sheet date. Forward rates and prices are based on spot rates and prices, with forward premiums and discounts taken into consideration.

Market prices for currency, electricity and gas options are valued using standard option pricing models commonly used in the market. The fair values of caps, floors and collars are determined on the basis of quoted market prices or on calculations based on option pricing models.

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The fair values of existing instruments to hedge interest rate risk are determined by discounting future cash flows using market interest rates over the remaining term of the instrument. Discounted cash values are determined for interest rate, cross-currency and cross-currency interest rate swaps for each individual transaction as of the balance sheet date. Interest exchange amounts are considered with an effect on current results at the date of payment or accrual.

Equity forwards are valued on the basis of the stock prices of the underlying equities, taking into consideration any financing components.

Exchange-traded energy futures and option contracts are valued individually at daily settlement prices determined on the futures markets that are published by their respective clearing houses. Paid initial margins are disclosed under other assets. Variation margins received or paid during the term of such contracts are stated under other liabilities or other assets, respectively.

Certain long-term energy contracts are valued by the use of valuation models that use internal data.

Losses of 49 million (2005: 39 million; 2004: 0 million) and gains of 96 million (2005: 0 million; 2004: 0 million) from the initial measurement of derivative financial instruments at the inception of the contract were deferred and will be recognized in income during subsequent periods as the contracts are fulfilled.

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The following two tables include both derivatives that qualify for SFAS 133 hedge accounting treatment and those that do not qualify.

<b>Total Volume of Foreign Currency, Interest Rate and Equity-Based Derivatives Remaining maturities in millions</b>	<b>Total volume of derivative financial instruments</b>			
	<b>December 31, 2006</b>		<b>December 31, 2005</b>	
	<b>Nominal value</b>	<b>Fair value</b>	<b>Nominal value</b>	<b>Fair value</b>
FX forward transactions				
Buy	4,532.7	(27.1)	4,091.3	79.2
Sell	6,982.4	19.4	8,331.2	(81.7)
FX currency options				
Buy	7.4	0.1	227.7	32.8
Sell			139.6	(39.0)
<b>Subtotal</b>	<b>11,522.5</b>	<b>(7.6)</b>	<b>12,789.8</b>	<b>(8.7)</b>
Cross-currency swaps				
up to 1 year	1,457.8	9.7	1,734.7	34.7
1 year to 5 years	10,812.9	(22.8)	8,163.2	57.8
more than 5 years	6,228.6	20.5	6,358.4	66.6
Cross-currency interest rate swaps				
up to 1 year			125.0	13.1
1 year to 5 years	321.9	(17.0)	316.4	5.0
more than 5 years				
<b>Subtotal</b>	<b>18,821.2</b>	<b>(9.6)</b>	<b>16,697.7</b>	<b>177.2</b>
Interest rate swaps				
Fixed-rate payer				
up to 1 year	150.9	0.8	612.2	(11.8)
1 year to 5 years	1,221.8	(3.1)	1,294.9	(44.1)
more than 5 years	919.8	(14.1)	1,033.5	(18.0)
Fixed-rate receiver				
up to 1 year	55.1			
1 year to 5 years	5,263.9	(75.5)	5,364.4	64.3
more than 5 years	759.3	(14.3)	1,196.4	(20.7)
<b>Subtotal</b>	<b>8,370.8</b>	<b>(106.2)</b>	<b>9,501.4</b>	<b>(30.3)</b>
Other derivatives	636.7	31.0		
<b>Subtotal</b>	<b>636.7</b>	<b>31.0</b>		
<b>Total</b>	<b>39,351.2</b>	<b>(92.4)</b>	<b>38,988.9</b>	<b>138.2</b>







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1 year to 3 years	32.2	0.4				
4 years to 5 years						
more than 5 years						
<b>Subtotal</b>	<b>58.9</b>	<b>(1.1)</b>				
Oil derivatives						
up to 1 year	1,036.7	(24.4)	277.2	0.1	845.0	106.1
1 year to 3 years	176.7	(6.2)	53.3	0.2	341.7	59.1
4 years to 5 years						
more than 5 years						
<b>Subtotal</b>	<b>1,213.4</b>	<b>(30.6)</b>	<b>330.5</b>	<b>0.3</b>	<b>1,186.7</b>	<b>165.2</b>
<b>Carryover</b>	<b>39,747.1</b>	<b>(1,130.8)</b>	<b>24,025.3</b>	<b>(120.6)</b>	<b>27,793.5</b>	<b>(127.0)</b>

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<b>Total</b>	<b>56,197.4</b>	<b>(1,395.8)</b>	<b>28,694.8</b>	<b>(70.2)</b>	<b>43,950.0</b>	<b>1,474.3</b>
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### Counterparty Risk from the Use of Derivative Financial Instruments

The Company is exposed to credit (or repayment) risk and market risk through the use of derivative financial instruments. If the counterparty fails to fulfill its performance obligations under a derivative contract, the Company's counterparty risk will equal the positive market value of the derivative. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, assumes no repayment risk.

In order to minimize the credit risk in derivative financial instruments, the Company enters into transactions only with counterparties such as financial institutions, commodities exchanges, energy distributors and broker-dealers that satisfy the Company's internally-established minimum requirements for the creditworthiness of counterparties.

The credit-risk management policy that has been established throughout the Group entails the systematic monitoring of the creditworthiness of counterparties and a regular assessment of credit risk. The credit ratings of all counterparties to derivative financial instruments are reviewed using the Company's established credit approval criteria. The subsidiaries involved in electricity, gas, coal, oil and emissions-related derivatives also perform thorough credit checks on their counterparties and monitor creditworthiness on a regular basis. The Company

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receives and pledges collateral in connection with long-term interest and currency hedging derivatives in the banking sector. Furthermore, collateral is required when entering into transactions in commodity derivatives with counterparties of a low degree of creditworthiness. Derivative transactions are generally executed on the basis of standard agreements that allow for the netting of all outstanding transactions with individual counterparties. For currency and interest rate derivatives in the banking sector, this netting option is reflected in the accounting treatment. Exchange-traded electricity forward and option contracts and emission rights having an aggregate nominal value of 8,198 million as of December 31, 2006, bear no counterparty risk.

The continuing netting of outstanding transactions with positive and negative market values is not shown in the table below, even though the greater part of the transactions was completed on the basis of contracts that do allow netting. The counterparty risk is the sum of the positive fair values.

In summary, as of December 31, 2006, the Company's derivative financial instruments had the following credit structure and lifetime:

Rating of Counterparties Standard & Poor's and/or Moody's in millions	December 31, 2006							
	Total Nominal value	Counter- party risk	Up to 1 year Nominal value	Counter- party risk	1 to 5 years Nominal value	Counter- party risk	More than 5 years Nominal value	Counter- party risk
A and Aaa through AA-								
Aa3	34,301.2	1,910.2	13,508.4	918.1	14,971.5	608.8	5,821.3	383.1
B+ and A1 or A+ and Aa3 through and A3	22,051.6	1,359.9	9,062.5	873.9	11,085.7	436.0	1,903.4	500.0
B and Baa1 or BBB+ and A3								
through BBB- or Baa3	3,511.6	279.8	2,181.4	218.1	1,084.5	61.7	245.7	
B- and Ba1 or BB+ and Baa3								
through BB- and Ba3	2,005.1	148.9	1,179.2	106.3	817.6	42.6	8.3	
Other (1)	25,481.4	395.9	11,124.3	200.3	6,332.5	93.2	8,024.6	102.0
<b>Total</b>	<b>87,350.9</b>	<b>4,094.7</b>	<b>37,055.8</b>	<b>2,316.7</b>	<b>34,291.8</b>	<b>1,242.3</b>	<b>16,003.3</b>	<b>535.0</b>

(1) This position consists primarily of parties to contracts with respect to which E.ON has received collateral from counterparties with ratings of the above categories or with an equivalent internal rating.

**(29) Non-Derivative Financial Instruments**

The Company estimates the fair value of its non-derivative financial instruments using available market information and appropriate valuation methodologies. Fair values have been calculated for these financial instruments using valuation methodologies customary in the market and are based on market information that was available on the balance sheet date. Accordingly, the fair values shown are not necessarily indicative of the amounts E.ON could realize on its non-derivative financial instruments under current market conditions.

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The estimated book values and fair values of non-derivative financial instruments as of December 31, 2006 and 2005, are summarized in the following table:

in millions	December 31, 2006		December 31, 2005	
	Book value	Fair value	Book value	Fair value
<b>Assets</b>				
At-cost investments	1,450	1,848	1,503	1,880
Marketable investments	11,941	11,941	8,243	8,243
Securities	11,383	11,383	10,420	10,420
Financial receivables and other financial assets	2,811	2,676	3,119	3,131
Cash and deposits at banking institutions	1,748	1,748	5,859	5,859
<b>Total</b>	<b>29,333</b>	<b>29,596</b>	<b>29,144</b>	<b>29,533</b>
<b>Liabilities</b>				
Financial liabilities	13,399	13,099	14,362	15,421

The Company used the following methods and assumptions to estimate the fair value of each class of financial instruments whose value it is practicable to estimate:

The carrying amounts of cash and cash equivalents are reasonable estimates of their fair values. The Company calculates the fair value of loans and other financial instruments by discounting the future cash flows by the current interest rate for comparable instruments. The fair values of funds and of marketable securities and investments are based on their quoted market prices or on other appropriate valuation techniques.

Fair values for financial liabilities are estimated by discounting expected cash flows for payments on principal and interest payments, using market interest rates currently available for debt with similar terms and remaining maturities. The carrying amount of commercial paper and borrowings under revolving short-term credit facilities is assumed as the fair value due to the short maturities of these instruments.

The Company believes that the overall credit risk related to its non-derivative financial instruments is insignificant. The counterparties with whom agreements on non-derivative financial instruments are entered into are also subjected to regular credit checks as part of the Group's credit risk management policy. There is also regular reporting on counterparty risks in the E.ON Group.

**(30) Transactions with Related Parties**

E.ON exchanges goods and services with a large number of companies as part of its continuing operations. Some of these companies are related companies accounted for under the equity method or reported at cost. Transactions with related parties are summarized as follows:

in millions	2006	2005
Income	7,467	5,408

Expenses	3,804	2,913
Receivables	1,892	2,263
Liabilities	2,440	2,161

Income from transactions with related companies is generated mainly through the delivery of gas and electricity to distributors and municipal entities, especially municipal utilities. The relationships with these entities do not generally differ from those that exist with municipal entities in which E.ON does not have an interest.

Expenses from transactions with related companies are generated mainly through the procurement of gas, coal and electricity.

Accounts receivable from related companies consist mainly of trade receivables and of a subordinated loan to ONE GmbH ( ONE ), Vienna, Austria, in the amount of 122 million (2005: 162 million). Interest income



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recognized on this loan amounted to 5 million in 2006 (2005: 11 million). In 2006, ONE repaid 45 million in shareholder loans to E.ON.

Liabilities of E.ON payable to related companies include 286 million (2005: 241 million) in trade payables to operators of jointly-owned nuclear power plants. These payables bear interest at 1.0 percent per annum (2005: 1.0 percent) and have no fixed maturity. E.ON procures electricity from these power plants both under a cost-transfer agreement and under a cost-plus-fee agreement. The settlement of such liabilities occurs mainly through clearing accounts. In addition, E.ON reported financial liabilities in 2006 of 1,255 million (2005: 1,253 million) resulting from fixed-term deposits undertaken by the jointly-owned nuclear power plants at E.ON.

The transfer of E.ON's minority stake in Degussa into RAG Projektgesellschaft mbH and the subsequent forward sale of that company to RAG produced a gain of 376 million. For additional information, see Note 4.

### **(31) Segment Information**

The reportable segments of the E.ON Group are presented in line with the Company's internal organizational and reporting structure. E.ON's business is subdivided into energy business and other activities. The core energy business includes the market units Central Europe, Pan-European Gas, U.K., Nordic and U.S. Midwest, as well as the Corporate Center. The 42.9 percent interest in Degussa accounted for at equity was reported under other activities until its disposal in July 2006 (see also Note 4).

The Central Europe market unit, led by E.ON Energie AG, Munich, Germany, focuses on E.ON's integrated electricity business and the downstream gas business in central Europe.

Pan-European Gas is responsible for the upstream and midstream gas business. Additionally, this market unit holds a number of minority shareholdings in the downstream gas business. The lead company of this market unit is E.ON Ruhrgas AG, Essen, Germany.

The U.K. market unit encompasses the integrated energy business in the United Kingdom. This market unit is led by E.ON UK plc, Coventry, U.K.

The Nordic market unit, which is led by E.ON Nordic AB, Malmö, Sweden, focuses on the integrated energy business in Northern Europe. It operates through the integrated energy company E.ON Sverige AB, Malmö, Sweden, primarily in Sweden.

The U.S. Midwest market unit, led by E.ON U.S. LLC, Louisville, Kentucky, U.S., is primarily active in the regulated energy market in the U.S. state of Kentucky.

The Corporate Center contains those interests managed directly by E.ON AG that have not been allocated to any of the other segments, E.ON AG itself, and consolidation effects at the Group level.

In accordance with U.S. GAAP requirements, E.ON reports segments or material business units to be disposed of as discontinued operations.

In 2006, this primarily includes E.ON Finland, which was sold in June, and WKE, which has not yet been sold. The corresponding figures as of December 31, 2006, as well as those for the preceding period, have been adjusted for all components of the discontinued operations.

Adjusted EBIT is used as the key figure at E.ON for purposes of internal management control and as an indicator of a business's long-term earnings power. Adjusted EBIT is derived from income/loss before interest and taxes and adjusted to exclude certain special items. The adjustments include book gains and losses on disposals, restructuring expenses, and other non-operating income and expenses. Due to the adjustments accounted for under non-operating earnings, the key figures by segment may differ from the corresponding U.S. GAAP figures reported in the Consolidated Financial Statements.

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Below is the reconciliation of adjusted EBIT to Income/(Loss) from continuing operations before income taxes and minority interests as shown in the Consolidated Financial Statements:

in millions	2006	2005	2004
<b>Adjusted EBIT</b>	<b>8,150</b>	<b>7,293</b>	<b>6,747</b>
Adjusted interest income (net)	(1,081)	(1,027)	(1,032)
Net book gains	1,205	491	589
Cost-management and restructuring expenses		(29)	(100)
Other non-operating earnings	(3,141)	424	128
<b>Income/(Loss) from continuing operations before income taxes and minority interests</b>	<b>5,133</b>	<b>7,152</b>	<b>6,332</b>
Income taxes	323	(2,261)	(1,852)
Minority interests	(526)	(536)	(469)
<b>Income/(Loss) from continuing operations</b>	<b>4,930</b>	<b>4,355</b>	<b>4,011</b>
Income/(Loss) from discontinued operations, net	127	3,059	328
Cumulative effect of changes in accounting principles, net		(7)	
<b>Net income</b>	<b>5,057</b>	<b>7,407</b>	<b>4,339</b>

Net book gains in 2006 were generated primarily from the sale of institutional securities funds ( 619 million) and in connection with the sale of the remaining interest in Degussa ( 376 million). In 2005, net book gains resulted primarily from the sale of securities ( 371 million) and from the merger of Gasversorgung Thüringen and TEAG ( 90 million). The 2004 amounts primarily reflect gains from the sale of E.ON's interests in EWE and VNG ( 317 million), the sale of securities ( 221 million) and the sale of Degussa shares ( 51 million).

There were no cost management and restructuring expenses in 2006. In 2005, cost management and restructuring expenses totaled 29 million. As in 2004 they arose primarily in the U.K. market unit as a result of the integration of Midlands Electricity.

Other non-operating earnings consist primarily of expenses from the fulfillment of derivative gas supply contracts and from the marking to market of energy derivatives, primarily at the U.K. market unit. These derivatives are used to hedge against fluctuations in prices. As of the end of 2006, this marking to market resulted in a loss of approximately 2.7 billion. The regulation of network charges enforced by the German Federal Network Agency ( Bundesnetzagentur ) necessitated the performance of impairment tests at the Central Europe and Pan-European Gas market units for the network infrastructure and certain shareholdings. The tests resulted in impairment charges totaling 374 million in the area of gas distribution networks and in minority shareholdings with activities in the area of networks. No impairments were necessary for the electricity grids. Additional impairments were recorded in the area of generation, specifically cogeneration facilities at the U.K. market unit ( 35 million), as well as for intangible assets and property, plant and equipment at the Pan-European Gas, U.K. and Nordic market units ( 139 million in total).

In 2005, the marking to market of derivatives resulted in a gain of approximately 1.2 billion. This gain was almost completely offset by the costs associated with the severe storm in Sweden at the beginning of 2005, and by an impairment charge recorded by Degussa at its Fine Chemicals division. The 2004 value primarily reflected the positive effects from the marking to market of derivatives (approximately 290 million). This gain was offset by

impairment charges on real estate and securities at the Central Europe market unit and by non-recurring charges on investments at the Central Europe and U.K. market units, among others.

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8,591    9,296    7,643    (10,056)    (4,381)    (5,794)    127,232    126,562    106,381

in millions	2006	E.ON Group 2005 (1)	2004 (1)
External sales	67,759	56,141	46,489
Intersegment sales			
<b>Total sales</b>	<b>67,759</b>	<b>56,141</b>	<b>46,489</b>
Depreciation and amortization	(2,930)	(2,820)	(2,620)
Impairments (3)	(273)	(81)	
<b>Adjusted EBIT</b>	<b>8,150</b>	<b>7,293</b>	<b>6,747</b>
Thereof: earnings from companies accounted for at equity (4)	957	882	697
Intangible assets and property, plant and equipment	4,083	2,956	2,574
Share investments	1,078	985	2,203
<b>Investments (5)</b>	<b>5,161</b>	<b>3,941</b>	<b>4,777</b>
<b>Total assets</b>	<b>127,232</b>	<b>126,562</b>	<b>114,062</b>

(1) Adjusted for discontinued operations, except for total assets.

(2) Included among the other activities was the 42.9 percent interest in Degussa accounted for at equity until its disposal in July 2006.

(3) In 2006 and 2005, the impairment charges recognized in adjusted EBIT differed from the impairment charges recorded in accordance with U.S. GAAP. In 2006, non-operating earnings can be traced to regulatory impairments on property, plant and equipment and on shareholdings at the Central Europe and Pan-European Gas market units. In addition, impairments have again been recorded in the area of generation, specifically

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cogeneration facilities at the U.K. market unit. Additional impairments concern intangible assets and property, plant and equipment at the Pan-European Gas, U.K. and Nordic market units. In 2005, the difference was the result of impairments recorded in the area of generation, specifically cogeneration facilities at the U.K. market unit.

(4) In 2006 and 2005, the earnings contributing to adjusted EBIT from companies accounted for under the equity method differed from the at-equity results recorded in accordance with U.S. GAAP. In 2006, this was the result of impairment charges included in non-operating earnings. The impairments related to property, plant and equipment and to shareholdings at the Central Europe and Pan-European Gas market units. In 2005, the impairments related to the Fine Chemicals division of Degussa and to deferred tax assets of an at-equity company in the Corporate Center.

(5) Excluding other financial assets

An additional adjustment in the internal profit analysis relates to interest income, which is adjusted on an economic basis. In particular, the interest component of expenses resulting from increases in provisions to pensions is reclassified from personnel costs to interest income. The interest components of allocations to other long-term provisions are treated in the same way to the extent that, in accordance with U.S. GAAP, these provisions are reported on different lines in the income statement.

Net interest income experienced a decline of 54 million from 2005. The primary factor behind this decline was the increased interest expense resulting from provisions related to nuclear power. This was partially offset by reduced interest expense from provisions for pensions at the Central Europe and Pan-European Gas market units and at the Corporate Center.

in millions	2006	2005	2004
<b>Interest and similar expenses (net) as shown in Note 6</b>	<b>(687)</b>	<b>(736)</b>	<b>(1,063)</b>
(+) Non-operating interest income (net) (1)	(5)	(39)	151
(-) Interest portion of long-term provisions	389	252	120
<b>Adjusted interest income (net)</b>	<b>(1,081)</b>	<b>(1,027)</b>	<b>(1,032)</b>

(1) This figure is calculated by adding interest expenses and subtracting interest income. In 2005, non-operating interest income primarily related to an eliminated provision for interest that had been recognized in previous years.

Transactions within the E.ON Group are generally effected at market prices.

**Geographic Segmentation**

The following table details external sales (by location of customers and by location of the company making the sale) and property, plant and equipment information by geographic area:

2004	Europe (Eurozone excluding Germany)			Europe (other)			United States			Other		
	2006	2005	2004	2006	2005	2004	2006	2005	2004	2006	2005	2004

28,621	3,796	2,772	1,926	23,389	17,743	14,110	1,901	1,990	1,770	630	79	6
30,028	2,053	1,218	1,209	21,630	16,243	13,482	1,897	1,980	1,711	50	65	5
23,171	1,104	1,339	1,283	18,965	16,819	15,327	3,896	4,072	3,693	73	83	8

**Information on Major Customers and Suppliers**

E.ON's customer structure in 2006 and 2005 did not result in any major concentration in any given geographical region or business area. Due to the large number of customers the Company serves and the variety of its business activities, there are no individual customers whose business volume is material compared with the Company's total business volume.

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Gas is procured primarily from Russia, Norway, the United Kingdom, the Netherlands and Germany.

### **(32) Compensation of Supervisory Board and Board of Management**

#### **Supervisory Board**

Provided that E.ON's shareholders approve the proposed dividend at the Annual Shareholders Meeting on May 3, 2007, total remuneration to members of the Supervisory Board will be 4.1 million (2005: 3.8 million).

There were no loans to members of the Supervisory Board in 2006.

The Supervisory Board's compensation structure and the amounts for each member of the Supervisory Board are presented in Item 6: Directors, Senior Management and Employees.

#### **Board of Management**

Total remuneration to members of the Board of Management in 2006 amounted to 21.7 million (2005: 22.5 million). This consisted of base salary, bonuses, other compensation elements and share based payments.

Total payments to former members of the Board of Management and their beneficiaries amounted to 11.7 million (2005: 5.4 million). Provisions of 99.9 million (2005: 89.0 million) have been established for the pension obligations to former members of the Board of Management and their beneficiaries.

There were no loans to members of the Board of Management in the 2006 fiscal year.

The Board of Management's compensation structure and the amounts for each member of the Board of Management are presented in Item 6: Directors, Senior Management and Employees.

### **(33) Subsequent Events**

At the end of 2006, Thüga agreed with EnBW Energie Baden-Württemberg AG (EnBW) to sell the shares it owns in GSW Gasversorgung Sachsen Ost Wärmeservice GmbH & Co. KG (76.5 percent), GSW Gasversorgung Sachsen Ost Wärmeservice Verwaltungsgesellschaft mbH (76.5 percent), EnSO Energie Sachsen Ost GmbH (14.5 percent) and Erdgas Südwest GmbH (28.0 percent) to EnBW Group companies. The transfer of the shares is to take place in the first quarter of 2007.

On January 14, 2007, a storm in southern Sweden caused substantial damage to the electricity distribution grid in some areas. Approximately 170,000 E.ON customers ended up without power, some for extended periods. The costs of repair work and compensation of customers is currently estimated at 95 million. The costs resulting from the storm will not affect adjusted EBIT as this event was exceptional in nature.

On February 2, 2007, E.ON submitted to the Spanish stock market regulator CNMV as part of the sealed envelope process its final offer price of 38.75 per ordinary share and ADR for the announced acquisition of Endesa S.A. This corresponds to a total consideration of 4.1 billion for 100 percent of Endesa. In this connection, E.ON has established an additional credit facility to finance the higher offer, which in combination with the existing 3.7 billion facility amounts to a total credit volume of 7.8 billion. The new offer price per share represents a premium of 109 percent over the price of Endesa's shares on September 2, 2005, the last trading day before the announcement of the former competing Gas Natural offer. If Endesa S.A. distributes any dividends to its shareholders prior to completion of the transaction, the offer price of 38.75 per share will be reduced accordingly. The E.ON tender offer was initially subject

to the following conditions:

- a) E.ON acquires at least 529,481,934 shares of Endesa, representing 50.01 percent of its capital stock, through the tender offer.
- b) The shareholders of Endesa vote in favor of the following amendments of the by-laws at Endesa's Extraordinary General Shareholders Meeting: amendment of Article 32 of the by-laws in order to eliminate the limitation of voting rights; amendment of further articles of the by-laws in order to remove the requirements concerning the composition of the Board of Directors and the qualifications on the appointment of a director or a chief executive officer.

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On February 6, 2007, the CNMV officially authorized this final E.ON offer, and the Board of Directors of Endesa has stated its position in favor of the offer. The Endesa board further resolved to convene an Extraordinary General Shareholders Meeting to be held on March 20, 2007, at which the removal of the aforementioned by-law provisions will be voted on. The CNMV has set March 29, 2007, as the end date of the offer period.

On March 6, 2007, E.ON withdrew condition b) requiring Endesa's shareholders to approve the specified changes to the articles of association.

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Date: March 7, 2007

E.ON AG

Dr. Marcus Schenck  
Member of the Board of Management and  
Chief Financial Officer

By: /s/ Dr. Marcus Schenck

Michael C. Wilhelm  
Senior Vice President Accounting

/s/ Michael C. Wilhelm