

# **E.ON UK PLC**

## **GROUP REPORT AND ACCOUNTS**

**for the year ended 31 December 2007**

**Registered No: 2366970**

## E.ON UK PLC

### Directors' report for the year ended 31 December 2007

The directors present their report and the audited accounts of E.ON UK plc ("the Company") and its subsidiaries ("the Group" or "E.ON UK") for the year ended 31 December 2007.

#### **Principal activities, review of business and future developments**

The Group's principal activities are electricity generation, distribution, energy trading and retailing. E.ON UK's aim is to maintain its position as a leading integrated player in the UK's electricity and gas markets. E.ON UK's strategy in the UK is to build on this position, to sustain and develop its distribution and generation asset businesses and to further build competitive trading and retail businesses.

The underlying level of the business during the year was good, reflected by a substantial increase in cash generated from operations to £1,332 million. The profit of £744 million for the year is largely driven by net commodity derivative gains of £424 million, compared to losses of £958 million in 2006, an increase of £1,382 million. These gains are primarily non-cash and were caused by higher forward gas and power prices.

The Group's funding is substantially through loans from the parent undertaking, E.ON AG and other financing entities within the E.ON AG group. At present, a high proportion of these facilities mature within one year and as a result the Group continues to hold net current liabilities at the year end. It is intended that these facilities will be refinanced with further loan facilities or other financing provided directly or indirectly by E.ON AG. During the year an equity injection of £1 billion was made by the Company's parent, Powergen Group Investments.

On 31 May 2007, E.ON AG set out its new strategic direction which included the decision to establish a new market unit to combine all of its European trading operations. The new unit is called E.ON Energy Trading ("EET"). Following the announcement, E.ON UK commenced work to implement this new strategic direction. Ultimately, the establishment of EET will result in the centralisation of many of E.ON UK's trading activities at EET's new headquarters in Düsseldorf, Germany. Excellent progress is being made to allow the E.ON UK trading business to become established within EET.

Also, as part of this new strategic direction, the E.ON AG Group is working to consolidate all of its renewable power assets and operations within one market unit called E.ON Climate and Renewables ("ECR"). The E.ON UK element of ECR will remain within E.ON UK for statutory reporting.

Descriptions of the development of the Group's businesses during the financial year under report and the outlook for the future are given below.

The Group is one of the UK's leading integrated electricity and gas companies with a business built on:

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### Directors' report for the year ended 31 December 2007 (continued)

- Marketing electricity, gas and other services to domestic and business customers;
- Asset management in electricity production and distribution; and
- Energy trading to support these activities.

#### Retail

E.ON UK sells electricity, gas and other energy-related products to residential, business and industrial customers throughout Great Britain. As of 31 December 2007, E.ON UK supplied approximately 8.0 million customer accounts, of which 7.4 million were residential customer accounts and 0.6 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 0.4 million as some customers switched suppliers partly as a consequence of E.ON UK's retail price position in the market. E.ON UK continues to focus on reducing the costs of its retail business, through efficiency improvements, more economical procurement of services and the utilisation of lower cost sales channels. During the year £35 million worth of costs were incurred relating to restructuring of the business.

During 2008, the directors agreed to transfer a section of the meter reading business from the Energy Services business to the Retail business in order to improve customer service and increase efficiencies.

#### *Residential Customers*

The residential business had approximately 7.4 million customer accounts as of 31 December 2007. 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 24.6 TWh of electricity and 48.3 TWh of gas in 2007, as compared with 26.5 TWh of electricity and 52.4 TWh of gas in 2006. The lower volumes reflected both lower customer numbers and warmer weather.

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. During 2007, there was a gradual transition from the former Powergen brand to the E.ON brand, with the E.ON brand being used exclusively since December. E.ON UK 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 football competition, which commences each year in August. E.ON UK also sponsors the Tour of Britain cycle race and its King

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### **Directors' report for the year ended 31 December 2007 (continued)**

of the Mountain's jersey. E.ON UK is in the last year of sponsoring Ipswich Town, a football team playing in the English Championship league.

Initially, 2007 saw an environment of falling wholesale energy prices, which drove reductions in electricity and gas retail prices across the industry, although specific decreases varied by supplier. In January 2007, E.ON UK reduced gas and electricity prices for average customers by 16 percent and 5 percent, respectively. The fall in wholesale prices was partially offset by increases in transport costs, distribution costs and environmental costs, and in the final quarter of 2007 wholesale prices rose significantly, putting upward pressure on retail prices. Wholesale costs (calculated during the first quarter of 2008) have increased by 60 percent for gas and 88 percent for electricity between February 2007 and December 2007. As a consequence, a number of suppliers increased their prices during the first quarter of 2008: RWE NPower announced price rises of 17.2 percent for gas and 12.7 percent for electricity; EDF Energy announced price rises of 12.9 percent for gas and 7.9 percent for electricity; British Gas announced price rises of 15.4 percent for both gas and electricity; Scottish Power announced price rises of 15 percent for gas and 14 percent for electricity; and Scottish & Southern announced price rises of 15.8 percent for gas and 14.2 percent for electricity. E.ON UK also announced price rises of 15 percent for gas and 9.7 percent for electricity effective from 8 February 2008. Approximately 550,000 customers on price protection, fixed price or Staywarm products were unaffected by these price rises.

E.ON UK has implemented a package of measures to limit the effects of rising wholesale costs, by offering subsidised energy efficient products including cavity wall and loft insulation to a significant proportion of its customers and delaying the price increases to vulnerable customers until after the winter months. Some of these initiatives contribute to the requirements placed on suppliers in relation to the Energy Efficiency Commitment.

#### *Small and Medium-Sized Business and Industrial and Commercial Customers*

The number of accounts in this sector totalled approximately 0.6 million as of 31 December 2007. In this sector, E.ON UK sold 27.9 TWh of electricity and 30.6 TWh of gas in 2007, as compared with 29.7 TWh of electricity and 40.1 TWh of gas in 2006. E.ON UK's focus in this area remains on acquiring and retaining the most profitable contracts available.

**Directors' report for the year ended 31 December 2007 (continued)**

**Energy Wholesale**

During 2007, E.ON UK's power generation and energy trading activity was operated and managed under the name of "Energy Wholesale". This has been the case since 2004, a measure 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 commodities used in the production of energy from the generation portfolio. The trading business is best positioned to decide whether E.ON UK should generate or purchase electricity to cover its retail obligations, depending upon the prevailing market price of electricity. 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 31 December 2007, E.ON UK owned either wholly, or through joint ventures, power stations in the UK with an attributable registered generating capacity of 10,581 MW, including 359 MW of combined heat and power ("CHP") plants and 50 MW of hydroelectric plant, while its attributable portfolio of operational wind capacity stood at 201 MW. E.ON UK's share of the generation market in Great Britain remained relatively stable in 2007, at approximately 12 percent.

E.ON UK generates electricity from a diverse portfolio of fuel sources. In 2007, approximately 52.3 percent of E.ON UK's electricity output was fuelled by coal and approximately 46.2 percent by gas, of which approximately 1.9 percent was from CHP schemes, with the remaining 1.5 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 minimise costs. E.ON UK also regularly monitors the economic status of its plant in order to respond to changes in market conditions.

E.ON UK is currently looking at options to develop further power plants in the UK over the next few years. The objective is to deliver secure energy supplies, reduce CO<sub>2</sub> emissions to tackle the challenge of climate change and keep energy as affordable as possible for our customers.

E.ON UK is progressing with 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 2007, E.ON UK started construction of one of the largest gas fired CHP stations in the UK at the Isle of Grain in Kent. The scheme is expected to generate 1,275 MW of

**Directors' report for the year ended 31 December 2007 (continued)**

power and export up to 340 MW of heat and is due to be commissioned in 2009. Progress was also made on consents to build two new highly efficient coal-fired units at Kingsnorth power station in Kent. The new supercritical coal-fired units would be built next to the existing four units and are expected to come online during 2012. Our planning application has been approved by the local authority and submitted to the UK government for its approval.

*Renewable Energy*

E.ON UK is one of the leading developers and owner/operators of wind farms in the UK, with interests in 21 operational onshore and offshore wind farms with total capacity of 212 MW, of which 201 MW is attributable to E.ON UK.

Potential onshore and offshore projects with an aggregate capacity of approximately 1,134 MW are now in the development phase. In 2007, E.ON UK completed construction of the 18 MW Stags Holt onshore wind farm in Cambridgeshire which became operational in the third quarter.

E.ON UK also commenced construction of the Robin Rigg offshore wind farm in the Solway Firth on the northwest coast of England. Due for completion in the second quarter of 2009, the 180 MW wind farm is expected to be one of the UK's largest offshore wind farms to date, with plans for 60 turbines, each with a capacity of 3 MW. In terms of generating capacity, Robin Rigg is expected to generate 550 GWh each year.

In addition to the planned expansion of its wind farm portfolio, E.ON UK generated from biomass in 2007 (co-firing with coal at the Kingsnorth and Ironbridge power stations), generating a total of 192 GWh of renewable energy by this method during the year. During 2007, work was completed on the construction of a 44 MW wood-burning plant at Steven's Croft, near Lockerbie in southwest Scotland. Steven's Croft was officially opened in March 2008 and is one of the UK's largest dedicated biomass plants with annual generation of 330 GWh.

During 2008, E.ON UK expects to continue to develop its capability in marine generation (using tidal, stream and wave power) to position itself to capture future opportunities in this area.

As a part of its balanced approach, E.ON UK seeks to fulfil its renewables obligation through a combination of its own generation, renewable energy purchased from other generators under tradeable Renewable Obligation Certificate ("ROC") contracts, and direct payment of any residual obligation into the buy-out fund. For the period from 1 April 2006 to 31 March 2007, E.ON UK achieved 46 percent of its renewables obligation through own generation and purchases.

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### Directors' report for the year ended 31 December 2007 (continued)

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, sterilising and heating. E.ON UK's total operational CHP electricity capacity at 31 December 2007 was 359 MW. Clients range across a number of sectors, including healthcare, pharmaceuticals, chemicals, paper and oil refining.

As noted earlier, the E.ON AG Group is working to consolidate all of its renewable power assets and operations within the ECR market unit. From 1 January 2008, management responsibility for these activities was transferred to the new market unit. The UK activities of ECR will remain within E.ON UK for statutory reporting.

#### *Energy Trading*

During 2007, E.ON UK's energy trading unit engaged in asset-based energy trading in gas and electricity markets to assist E.ON UK in commercial risk management and the optimisation of its UK gross margin.

As noted earlier, E.ON has established a new market unit to centralise all of its European trading operations. The performance of the E.ON UK trading business will continue to be included in the results of the Group until it is legally transferred to EET. Excellent progress is being made to allow the E.ON UK trading business to become established within EET.

The Energy Trading business 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 optimisation and risk management activities. The following table sets forth E.ON UK's electricity and gas proprietary trading volumes for 2007 and 2006:

<u>Proprietary Trading Volumes</u>	<b>2007</b> <b>Electricity</b> <b>billion</b> <b>kWh(1)</b>	<b>2006</b> <b>Electricity</b> <b>billion</b> <b>kWh</b>	<b>2007</b> <b>Gas</b> <b>billion</b> <b>kWh(1)</b>	<b>2006</b> <b>Gas</b> <b>billion</b> <b>kWh</b>
Energy bought	<b>32.3</b>	14.0	<b>127.4</b>	57.7
Energy sold	<b>32.3</b>	14.0	<b>127.4</b>	57.7
Gross volume	<b><u>64.6</u></b>	<u>28.0</u>	<b><u>254.8</u></b>	<u>115.4</u>

(1) The increase in traded gas and electricity volumes in 2007 was primarily attributable to favourable market opportunities.

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### **Directors' report for the year ended 31 December 2007 (continued)**

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 AG's risk management policies for energy trading. From 1 January 2008, management responsibility for these activities was transferred to the new EET market unit.

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 UK and overseas ensure that supplies are secured for E.ON UK's coal-fired plants, while maintaining enough flexibility to minimise 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 Combined Cycle Gas Turbine ("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.

#### **Central Networks**

The electricity distribution business in the UK 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.

Within the UK there are 14 licensed distribution network operators ("DNO"), each responsible for a distribution services area. E.ON UK's Central Networks business owns and manages two DNO licenses through Central Networks East plc and Central Networks West plc. 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



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### **Directors' report for the year ended 31 December 2007 (continued)**

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 centralised management team and uses the same methodology and staff to operate both networks.

Distribution charges are billed on the basis of published tariffs and adhere to Ofgem's price control formulas. The current 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.

Central Networks continued to increase its capacity to safely deliver a reliable electricity network across Central England. We achieved this in a year when the region experienced exceptional storms in January and the worst summer flooding for a number of years. To meet the challenge of a larger capital work program (which in the current five-year price control review period is 60 per cent higher in the East and 44 per cent higher in the West than in the previous period), our internal workforce has been supplemented by re-trainees, apprentices and graduate trainees.

#### **E.ON Energy Services**

E.ON UK's Energy Services business includes the new connections, metering and home installation activities with the vision of providing customers with all the services they need to get connected to energy supplies, heat their homes and understand their energy use.

The Metering business continued to deliver its main strategic aim of in-sourcing metering activities. The New Connections business provided network connections for the Central Networks business. The Home Installation business completed around 100,000 business to business jobs and around 15,000 residential jobs during 2007. This business also launched its Sustainable Energy Solutions function which will deliver low-carbon solutions to customers.

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### Directors' report for the year ended 31 December 2007 (continued)

#### Other activities

The UK Services business provides a single shared service function delivering facilities management, HR, procurement, insurance, property and finance support for all of E.ON UK's UK operations.

E.ON UK's engineering and scientific development activities, carried out at its Power Technology Centre, are focused on supporting E.ON UK's strategic business objectives and technology challenges in the UK through delivery of R&D programmes, providing innovative services and products and growing profitable new income streams.

E.ON UK acquired minority equity stakes in companies operating electricity generation plants in England, Pakistan and Turkey as part of its Midlands Electricity acquisition. 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.

#### **Results and dividends**

The profit attributable to shareholders for the financial year to 31 December 2007 was £738 million (2006: loss of £332 million).

The directors do not recommend payment of a final dividend (2006: £nil). During the year, an interim dividend of £240 million was paid (2006: £nil).

#### **Directors and their interests**

The following directors served on the Board during the year and after the year end:

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Dr Paul Golby	
Graham Bartlett	
Robert Taylor	
John Crackett	(appointed 4 July 2007)
Brian Tear	(appointed 18 March 2008)

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Dr Anthony Cocker	(resigned 4 July 2007)
Nicholas Horler	(resigned 31 August 2007)
Dr Burckhard Bergmann	(resigned 1 December 2007)
Dr Wulf Bernotat	(resigned 1 December 2007)
Dr Johannes Teysen	(appointed 1 May 2007, resigned 1 December 2007)
Jarri Sandstrom	(resigned 31 March 2008)

Information on directors' emoluments is given in Note 6 to the Accounts.

**Directors' report for the year ended 31 December 2007 (continued)**

**Employees**

The Group provides an environment in which communication is open and constructive. There are well established arrangements for communication and consultation with employees and their representatives at local and Company level which covers a wide range of business and employment issues including those considered by the E.ON AG European Works Council, which provides a forum for consultation on major issues affecting E.ON AG Group companies in Europe.

The Group is committed to offering equal opportunities to both current and prospective employees. The Group continues to review and develop best practices and procedures to ensure that all staff are treated fairly in all aspects of employment. It also strives for a diverse environment that is supportive of all staff. Individual differences which do not relate to job performance such as gender, marital status, sexual orientation, race, colour, ethnic origin, nationality, religion, age or disability are respected.

The Group believes in ensuring that disabled people can compete fairly for job opportunities, training and development, through the promotion and development of best practices. Links and contacts with external disability networks and organisations are maintained to identify best practices in the employment of people with disabilities and to provide work experience placements for disabled people. In the event of existing employees becoming disabled, the Group will seek to maintain their employment through training, redeployment and adjustments to the job role and workplace, where it is reasonable and practicable to do so.

Training and development of staff remains a key priority in achieving the UK growth strategy and ensuring that all staff perform at the highest level.

The Group believes it is important that employees understand the link between their own contribution and the overall performance of the business. Therefore all eligible employees are able to participate in the E.ON UK Share Incentive Plan. This is a share incentive plan that enables employees to develop a greater involvement in E.ON AG, through share ownership. Share schemes of this kind help to reinforce that link and give employees the opportunity to share in the success of the company they work for.

**Directors' report for the year ended 31 December 2007 (continued)**

**Contributions for political and charitable purposes**

Donations to charitable organisations during the financial year by the Group amounted to £130,055 (2006: £28,943). It is the Group's policy not to make cash donations to any political party. However, the Group does undertake activities, such as event sponsorship, which are not designed to support or influence support for any particular political party; which are covered under *The Political Parties, Elections and Referendums Act 2000* and must be disclosed. During the year, the Group sponsored an event at the Labour party conference. The total cost required to be disclosed as political donations was £10,000 (2006: £8,155).

**Policy on payment of creditors**

Where appropriate in relation to specific contracts, the Group's practice is to:

- settle the terms of payment with the supplier when agreeing the terms of each transaction;
- ensure that those suppliers are made aware of the terms of payment by inclusion of relevant terms in the contracts; and
- pay in accordance with its contractual and other legal obligations.

The Group supports the Better Payments Practice Code and has in place well developed arrangements with a view to ensuring that this is observed in all other cases. Group companies operating overseas are encouraged to adopt equivalent arrangements by applying local best practices. The average number of days taken to pay the Group's trade suppliers calculated in accordance with the requirements of the Companies Act is 20 days (2006: 35 days).

**Going concern**

Notwithstanding the fact that the Group has net current liabilities, the directors have prepared the financial statements on the going concern basis. The directors have in place sufficient borrowing facilities such that the Group and the Company can meet their obligations as they fall due for a period of at least twelve months from the date of the directors' approval of these financial statements. Borrowing facilities are shown in Notes 17, 18 and 19.

The Board has reviewed the Group's budget and cash flow forecasts for the year ended 31 December 2007 and the outline projections for the two subsequent years. The directors confirm that they have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, the directors continue to adopt the going concern basis in preparing the Company's consolidated financial statements.

**Directors' report for the year ended 31 December 2007 (continued)**

**Directors' responsibilities**

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare the financial statements for each financial year. Under that law the directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period.

In preparing these financial statements the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRSs as adopted by the European Union; and
- prepare the consolidated financial statements on the going concern basis, unless it is inappropriate to presume that the Group will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

So far as each of the directors are aware, there is no relevant audit information of which the Group's auditors are unaware and they have taken all the steps that they ought to have taken in order to make themselves aware of any relevant audit information and to establish that the Group's auditors are aware of such information.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985 and, as regards the Group financial statements, article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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### Directors' report for the year ended 31 December 2007 (continued)

#### **Auditors**

A resolution to reappoint the auditors, PricewaterhouseCoopers LLP, and to authorise the directors to fix their remuneration will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Brian Tear  
Director  
E.ON UK plc  
Westwood Way  
Westwood Business Park  
Coventry  
CV4 8LG

24 June 2008

## **E.ON UK PLC**

### **Financial review for the year ended 31 December 2007**

This review is designed to give further financial information concerning the E.ON UK results and financial position for the year.

#### **Overview**

E.ON UK and its associated companies are actively involved in electricity generation and distribution, and gas and electricity retail and trading. As of 31 December 2007, E.ON UK owned or through joint ventures had an attributable interest in 10,581 MW of generation capacity, including 359 MW of CHP plants and 251 MW of operational wind and hydroelectric generation capacity. E.ON UK served approximately 8.0 million electricity and gas customer accounts at 31 December 2007 and its Central Networks business served 4.9 million customer connections. E.ON Energy Services undertook more than 50 million meter readings and carried out work in around 400,000 homes.

#### **Principal risks and uncertainties**

In the normal course of business, the Group is subject to a number of risks that are inseparably linked to the operation of its businesses. To manage these risks, the Group uses a comprehensive risk management system that is embedded within the business and decision making process. The risk management system is designed to enable management to recognise risks early and take the necessary countermeasures. The process is continuously reviewed to ensure it remains effective and efficient.

The key business risks affecting the Group are set out below.

#### Competition

The electricity and gas markets within which the Group operates are subject to strong competition in both the retail and wholesale sectors. There is competition from both new market entrants and existing participants. This highly competitive market could lead to depressed margins.

#### Commodity prices

A significant portion of the Group's expenses comprise of fuel costs which are heavily influenced by prices in the world market for oil, natural gas, fuel oil and coal. The prices for such commodities have historically been volatile and there is no guarantee that prices will remain within projected levels. Increases in fuel costs could have an adverse effect on the Group's operating results or financial condition.

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### **Financial review for the year ended 31 December 2007 (continued)**

#### Credit risk – financial instruments

The Group is at risk if a counterparty is unable to meet its obligations resulting in potential losses. E.ON UK is subject to the E.ON AG Group finance policy which sets a credit limit for every financial institution with which the Group does a significant amount of business. The creditworthiness of the institutions with which the Group does business is established by the ratings they receive from Moody's and Standard & Poor's. In addition, other counterparty credit risk is subject to the E.ON AG Group Credit Risk Management policy supported by individual business unit policies to establish internal ratings for limit setting. Credit risk assessment involves quantitative and qualitative criteria including ratings by independent rating agencies where these are available.

#### Weather

Gas and electricity sales volumes and commodity prices are affected by temperature and other weather factors. The demand for gas and electricity is seasonal with the Group generally experiencing higher demand during the colder months of October through to March and lower demand during the warmer months of April through September. Revenues and results of the Group can therefore be negatively affected by periods of unseasonably warm weather.

To manage the price risk, the Group has a flexible portfolio. It makes use of storage, LNG, fuel switching for generation and demand management to mitigate weather risk.

#### Asset performance

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

In order to minimise the impact of reduced asset performance, the Group undertakes regular facility and network maintenance and adopts good maintenance practice.

#### Credit risk – customer/debtors

There is a risk that bad debts will exceed the director's expectations. There is also an additional risk to the value of unbilled debt which could lead to write offs.

There are a number of initiatives underway to mitigate against this risk. These include credit vetting and systems investment.



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### Financial review for the year ended 31 December 2007 (continued)

#### Key performance indicators ("KPIs")

Non-financial KPIs for each of the business units are shown below:

KPIs	Results		Commentary
	2007	2006	

#### UK Business

Safety LTIFR (The Lost Time Injury Frequency Rate is measured by the number of lost time injuries per 1,000,000 hours worked)

3.66	2.95
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The LTIFR target of 2.5 was missed in 2007 despite the business working hard to reduce the number of accidents. The safety of people is of vital importance to the business and is a key business priority for 2008.

Total Gas volumes sold/used (TWh)

206	194
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Gas volumes can be segmented into Retail sales, market sales and gas utilised at power stations. Retail sales reduced due to lower customer numbers and warmer weather. This was offset by an increase in market sales reflecting the competitive environment and changes in demand. Gas utilised at power stations increased reflecting the increase in own generation attributable to excellent plant availability and the increased attractiveness of economic conditions.

Total Power volumes sold (TWh)

78	74
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Retail sales were lower in 2007 due to lower customer numbers and warmer weather. An increase in market sales is a result of favourable economic conditions and an increase in own generation.

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### Financial review for the year ended 31 December 2007 (continued)

KPIs	Results		Commentary
	2007	2006	
<b>Energy Wholesale</b>			
Generating capacity (MW)	10,581	10,547	There has been an increase in generating capacity following a compressor upgrade at Enfield and the completion of the Stags Holt onshore wind farm site.
Generation production (TWh)	41	36	The increase in production was primarily due to improved plant availability and a reduction in wholesale prices and charges and more economically attractive market conditions.
<b>Central Networks</b>			
Volumes distributed (TWh)	56	57	The decline in the volume of power distributed reflects declines in usage following retail price increases and warmer weather.
Customer minutes lost	176	147	Unlike the benign conditions of the previous year, severe weather affected the region on a number of occasions for extended periods of time. Lightning storms in July and August and severe winds in January and December caused supply interruptions across the region. Central Networks minimised the impact of these storms by deploying its emergency plans. However, the effect of the severe weather has clearly increased the number of overhead line faults.

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### Financial review for the year ended 31 December 2007 (continued)

KPIs	Results		Commentary
	2007	2006	
<b>Retail</b>			
Customer numbers (million)	8.0	8.4	Customer numbers decreased throughout the year as high levels of customer switching was experienced in the UK market as customers looked for the best deal.
Energy watch complaints (2007 based on customer complaints from Jan-July plus an estimate for the rest of the year. This is due to a change in August to recording customer contacts and not customer complaints)	2,517	6,052	Complaints have significantly decreased as the business has focused on reducing repeat contacts, channelling dissatisfied customers to expert handlers, improving complaint handling by understanding underlying issues that lead to complaints and revising our published customer contact information.
<b>E.ON Energy Services</b>			
Domestic connections	46,405	45,846	Movement in the physical connections is in line with target and also in line with the prior year.
Meter reading performance	95.99%	96.40%	The performance is only marginally below the annual target.

Key financial KPIs within the Group are considered to be revenue and profit before interest and tax. These are discussed below within the Group financial results section.

#### **Group financial results**

The Group's profit before tax and impairment and integration costs and profits less losses on disposal of investments/businesses for the year ended 31 December 2007 was £1,007 million, compared to a loss of £260 million for the same period last year. The profit before tax was £1,007 million compared with a £461 million loss for the previous twelve months.

## E.ON UK PLC

### Financial review for the year ended 31 December 2007 (continued)

#### Revenue

Group revenue grew by £75 million during the year to £8,609 million, an increase of 0.9 percent. This increase was primarily attributable to higher average (retail) prices and higher sales volumes in the Energy Wholesale business in 2007, which were largely offset by lower sales volumes in the Retail business due to warmer weather, consumer behaviour and lower customer numbers. Sales in the regulated distribution business increased to £464 million in 2007 from £443 million in 2006. The sales increase was principally attributable to tariff changes.

External revenue is further analysed below:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
<b>UK Operations</b>		
Energy Wholesale	2,354	2,155
Central Networks	464	443
Retail	5,703	5,857
E.ON Energy Services	88	79
	<b>8,609</b>	<b>8,534</b>

#### Operating costs

Details of the Group's operating costs are set out in Note 3 to the financial statements. The figures are summarised below.

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Fuel costs	942	963
Power purchases and other costs of sales	5,355	5,343
Staff costs	537	442
Depreciation, including relevant impairments	237	248
Intangible asset amortisation, including relevant impairments	62	198
Derivative losses	56	1,006
Other operating charges, including restructuring costs	772	762
	<b>7,961</b>	<b>8,962</b>

Fuel costs fell in 2007 primarily due to lower gas purchase costs driven by lower market prices. E.ON UK's production increased from 35.9 billion kWh in 2006 to 41.2 billion kWh in 2007 primarily attributable to excellent station availability and a reduction in wholesale gas prices which made generation more economically attractive than buying power. The average day ahead gas prices in the UK for 2007 were 30 pence per therm, 28.6% lower than during 2006, therefore more than offsetting the increase in fuel consumed as a result of increased in-house generation.

## E.ON UK PLC

### Financial review for the year ended 31 December 2007 (continued)

Power purchase and other costs of sales were broadly in line with 2006, increasing by 0.2 percent, from £5,343 million in 2006 to £5,355 million in 2007.

Staff costs at £537 million were 21 percent higher than in the previous year because of headcount increases. The Retail business has increased the number of face to face sales personnel by 6.4% over the year. The E.ON Energy Services business has increased metering service staff due to taking on additional service requirements. Staff numbers at 31 December 2007 totalled 16,800 all of which were based in the UK.

The depreciation charge is broadly in line with 2006 decreasing from £248 million in 2006 to £237 million in 2007. Intangible asset amortisation, including relevant impairments decreased from £198 million to £62 million, reflecting that there were no impairment charges during 2007 whereas in 2006 there was an impairment of £132 million in respect of the Group's contractual development rights for the gas storage site at Holford.

Derivative losses have significantly reduced from £1,006 million in 2006 to £56 million in 2007 primarily as a result of higher gas and power forward prices.

Other operating charges included the costs of running the UK businesses and supporting corporate infrastructure. Other operating charges have remained consistent with the prior year.

#### Operating income

Other operating income during 2007 was £575 million compared with £202 million in the year to 31 December 2006. The increase primarily relates to gains from derivative instruments (£480 million compared to £48 million in 2006). There has also been consulting income of £12 million (£12 million in 2006) and income from engineering services of £14 million (£8 million in 2006). The remainder is individually insignificant.

#### Impairment costs

Included in operating costs in 2006 were impairment costs before tax amounting to £219 million. During 2006 certain CHP assets were impaired by £24 million and an onerous contract provision of £52 million was recorded on CHP contracts. The impairments arose as a result of rising wholesale gas prices resulting in increased costs on CHP contracts that receive a relatively fixed price per unit of output. In addition in 2006, impairments of £143 million were made on assets related to the Group's gas storage site at Holford. The impairments arose as costs to complete the project exceeded the costs anticipated when the project commenced.

## E.ON UK PLC

### Financial review for the year ended 31 December 2007 (continued)

#### Operating profit / (loss)

A more detailed analysis of operating profit / (loss) and reconciliation to profit / (loss) before tax is set out below:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
<b>UK Operations</b>		
Energy Wholesale	959	(695)
Central Networks	349	334
Retail	(17)	338
E.ON Energy Services	(2)	7
Central / Unallocated	(66)	(210)
<b>Group operating profit / (loss) after impairment and integration costs</b>	<b>1,223</b>	<b>(226)</b>
Net finance costs	(227)	(239)
Share of results of associates after tax	11	4
<b>Profit / (loss) before tax</b>	<b>1,007</b>	<b>(461)</b>

Group operating profits totalled £1,223 million for the year compared with losses of £226 million in the same period to 31 December 2006. Within this total, wholesale and trading profits were £959 million compared to losses of £695 million in 2006, an increase of £1,654 million. This primarily reflects net commodity derivative gains in 2007 of £424 million, compared to losses of £958 million in 2006, an increase of £1,382 million. Derivative gains are primarily unrealised non-cash movements. This is reflective of an increase in gas and power forward prices.

Central Networks' profits increased from £334 million to £349 million primarily due to higher tariffs and general cost savings.

Within the Retail business, profits decreased by £355 million to a loss of £17 million mainly resulting from the combination of lower retail sales volumes due to warmer weather and lower customer numbers, combined with lower retail margins primarily resulting from the price reductions in February 2007.

Central / Unallocated losses are down to £66 million from £210 million as a result of increased recharges of central costs to specific market units.

#### Interest costs

E.ON UK's interest costs decreased from £239 million to £227 million due primarily to higher net pensions interest income from the Group's defined benefit pension plans.

**Financial review for the year ended 31 December 2007 (continued)**

**Treasury management**

E.ON UK, in common with other major E.ON AG subsidiaries, must comply with E.ON AG financial management and treasury policies and procedures but must also have its own local operational treasury team which services the treasury requirements of the business. The E.ON AG teams liaise closely with E.ON UK to ensure that liquidity and risk management needs are met within the requirements of the E.ON AG policies and procedures.

E.ON AG has a central department that is responsible for financing and treasury strategy, policies and procedure throughout the E.ON AG Group. Major strategic financings and corporate finance actions are planned and executed by the corporate finance team at E.ON AG. There is also a treasury team which co-ordinates currency and interest risk management as well as cash management for the whole E.ON AG Group.

E.ON UK also operates its own specific treasury procedures within the overall E.ON AG treasury framework.

**E.ON AG's central financing strategy**

E.ON AG's financing policy is to centralise external financing at the E.ON AG holding company level and to reduce external debt in subsidiaries wherever possible. E.ON AG has the strongest credit rating in the E.ON AG Group and this allows more beneficial terms for external finance to be negotiated. E.ON AG then funds its subsidiaries with inter-company finance. This finance may be in the form of equity or debt, as appropriate.

The E.ON UK treasury team employs a continuous forecasting and monitoring process to ensure that the Group complies with all its banking and other covenants, and also the regulatory constraints that apply to the financing of the UK business. E.ON UK Treasury works in close liaison with the various operating businesses within the Group, when considering hedging requirements related to their activities. A group-wide cash forecasting and currency exposure reporting process exists which ensures regular reporting into UK treasury of future positions, both short and medium term. Information is submitted to E.ON AG for incorporation into E.ON AG Group forecasting processes on a weekly, monthly and quarterly basis.

E.ON UK does not enter into speculative treasury arrangements. Accordingly, all transactions in financial instruments are matched to an underlying business requirement, such as committed purchases or forecast debt requirements. Treasury activities are reviewed by internal audit on a regular basis.

## E.ON UK PLC

### **Financial review for the year ended 31 December 2007 (continued)**

The year end position described in more detail below is representative of the Group's current position in terms of its objectives, policies and strategies. These will continue to evolve as the Group's business develops in line with the requirements, objectives, policies and strategies of E.ON AG as the parent company of the Group.

#### Foreign exchange risk management

E.ON UK primarily trades in pounds sterling but its principal currency exposures are to the US dollar and the Euro. E.ON UK operates within the framework of E.ON AG's guidelines for foreign exchange risk management. E.ON UK has local policies dealing with transaction exposures (typically cash flows arising on trading and construction contracts and foreign currency denominated debt which impact the income statement) and translation exposures (the value of foreign currency liabilities and assets in the balance sheet). E.ON UK's policy is to hedge all contractually committed transaction exposures, as soon as the commitment arises. E.ON UK will also hedge less certain cash flows if this is appropriate.

E.ON UK's policy towards translation exposures is to hedge these exposures where practicable, with the intention of protecting the Sterling net asset value. These hedges are normally achieved through a combination of borrowing in local currency, forward currency contracts or foreign currency swaps.

Where the foreign currency transaction exposure is hedged, the value of the exposure is translated into Sterling at the exchange rate achieved in the associated hedging contracts. Details of the Group's foreign exchange contracts and swaps are set out in Note 20 to the accounts.

#### Interest rate risk management

E.ON UK operates within the E.ON AG framework for interest rate risk management. The Group has a significant portfolio of debt and is exposed to movements in interest rates. These interest rate exposures are managed primarily through the use of fixed and floating rate borrowings and interest rate swaps.

#### Credit risk management

E.ON UK is subject to the E.ON AG Group Finance policy which sets a credit limit for every financial institution with which the Group does a significant amount of business. The creditworthiness of the institutions with which the Group does business is established by the ratings they receive from Moody's and Standard & Poor's. In addition, other counterparty credit risk is subject to the E.ON AG Group Credit Risk Management policy supported by individual business unit policies to establish internal ratings for limit setting. Credit risk assessment involves quantitative and qualitative criteria including ratings by independent rating agencies where these are available.



## E.ON UK PLC

### **Financial review for the year ended 31 December 2007 (continued)**

#### Liquidity planning, trends and risks

E.ON UK has sufficient committed borrowing facilities to meet planned liquidity needs, through facilities provided by its ultimate parent company E.ON AG. Movements in energy prices have some impact on operating cash flows, and as electricity generation and distribution is a capital intensive business, planned capital spending remains at significant levels. The level of operating cash is affected by the performance of the business, and market prices and margins amongst other things. Some of these factors are outside the Group's control.

E.ON UK's capital market bond financings do not have financial covenants, but a fall in the credit rating below investment grade could, in some circumstances, require repayment of these bonds.

#### Credit rating

E.ON UK's long term credit rating is unchanged over the year, at A- by Standard & Poor's and A3 by Moody's.

#### Borrowings and facilities

Details of the Group's borrowing facilities are set out in Note 18 and 19 to the accounts.

At 31 December 2007, the Group had total borrowings of £3,542 million (2006: £4,409 million) including £2,065 million of long-term loans and £1,477 million of short-term loans and overdrafts. The reduction has been driven by a capital injection during the year from the parent company.

At 31 December 2007, the Group had £46 million of cash and short-term investments (2006: £34 million). E.ON UK's policy is to repay debt where possible and otherwise to place any surplus funds on short-term deposit with approved banks and financial institutions. Strict limits governing the maximum exposure to these banks and financial institutions are applied. These limits are co-ordinated across the E.ON AG Group.

The Group's net borrowing position at 31 December 2007 was £3,496 million, compared to £4,375 million at 31 December 2006. The weighted average interest rate for the year, when compared to average net borrowings, was 6.07 percent compared with 5.74 percent in the previous year.

Gearing (net debt as a percentage of net assets excluding net debt) was 46 percent at 31 December 2007 compared with 64 percent at the end of 2006 as a result of the £1 billion capital injection made during the year.

## E.ON UK PLC

### **Financial review for the year ended 31 December 2007 (continued)**

#### Commodity risk management

As part of its operating activities, E.ON UK engages in energy marketing in the gas, electricity, coal, carbon permit and oil markets. This activity is primarily focused around the commercial risk management and optimisation of both UK electricity and gas assets and to manage the price and volume risks associated with its UK retail business, but also encompasses limited proprietary trading in the UK and some European energy markets.

All of E.ON UK's energy trading operations are subject to E.ON UK's and E.ON AG's risk management policies. These include value and profit at risk, credit limits, segregation of duties and an independent risk reporting system. To achieve its portfolio optimisation E.ON UK uses fixed price bilateral contracts, futures and option contracts traded on commodity exchanges and swaps and options traded in over-the-counter financial markets.

#### **Taxation**

The tax charge amounted to £263 million for the year compared with a £127 million credit for the same period to 31 December 2006. The effective rate was 26 percent compared with 28 percent in the year to 31 December 2006. The main reasons for the effective rate not being 30 percent in either period are adjustments to current and deferred tax provisions in respect of prior year items, non deductible expenses, non taxable income and the impact of the UK headline rate of corporation tax being reduced to 28% from 1 April 2008.

## **E.ON UK PLC**

### **Independent auditors' report to the members of E.ON UK plc**

We have audited the group financial statements of E.ON UK plc for the year ended 31 December 2007 which comprise the Group Income Statement, the Group Balance Sheet, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expense and the related notes. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of E.ON UK plc for the year ended 31 December 2007.

#### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the group financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the Directors' Report and the Financial Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

## **E.ON UK PLC**

### **Independent auditors' report to the members of E.ON UK plc (continued)**

#### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the group financial statements.

#### **Opinion**

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2007 and of its profit and cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the group financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

London

June 2008

**E.ON UK PLC**

**CONSOLIDATED INCOME STATEMENT**  
**for the year ended 31 December 2007**

	Note	Year ended 31 December 2007	Year ended 31 December 2006
		£m	£m
<b>Revenue</b>	2	<b>8,609</b>	8,534
Operating costs excluding impairment costs	3	<b>(7,961)</b>	(8,743)
Impairment costs	4	-	(219)
Total operating costs		<b>(7,961)</b>	(8,962)
Other operating income	3	<b>575</b>	202
<b>Operating profit / (loss)</b>		<b>1,223</b>	(226)
Finance income	7	<b>37</b>	31
Finance costs	7	<b>(264)</b>	(270)
Group's share of associates' profit after tax	11	<b>11</b>	4
<b>Profit / (loss) before tax</b>		<b>1,007</b>	(461)
Taxation	8	<b>(263)</b>	127
<b>Profit / (loss) for the year</b>		<b>744</b>	(334)
<b>Profit / (loss) attributable to:</b>			
Minority interest	30	<b>6</b>	(2)
Shareholder	28	<b>738</b>	(332)
		<b>744</b>	(334)

The results for the year are derived solely from continuing operations.

The accounting policies and the notes on pages 33 to 100 form part of these financial statements.

**E.ON UK PLC**

**GROUP STATEMENT OF TOTAL RECOGNISED INCOME AND EXPENSE**  
**for the year ended 31 December 2007**

	<b>Year ended 31 December 2007</b>	<b>Year ended 31 December 2006</b>
	<b>£m</b>	<b>£m</b>
Profit / (loss) for the year from continuing operations	<b>744</b>	(334)
(Profit) / loss attributable to minority interests	<b>(6)</b>	2
Profit / (loss) attributable to equity shareholder	<b>738</b>	(332)
Cash flow hedge fair value losses	<b>(4)</b>	(269)
Cash flow hedge losses / (gains) transferred to the income statement	<b>147</b>	(54)
Translation losses transferred to the income statement	-	1
Actuarial (losses) / gains on pension scheme arrangements	<b>(101)</b>	155
Tax on items taken directly to equity	<b>(12)</b>	51
<b>Total recognised income / (loss) for the year</b>	<b>768</b>	(448)

The accounting policies and the notes on pages 33 to 100 form part of these financial statements.

**E.ON UK PLC**

**CONSOLIDATED BALANCE SHEET**  
**as at 31 December 2007**

	Note	31 December 2007	31 December 2006
		£m	£m
<b>Non-current assets</b>			
Intangible assets			
Goodwill	9	2,495	2,495
Other	9	409	454
Total intangible assets		2,904	2,949
Property, plant and equipment	10	5,078	4,461
Interests in associates	11	3	8
Available for sale investments	13	18	18
Financial receivables	14	24	13
		8,027	7,449
<b>Current assets</b>			
Inventories	15	193	267
Trade and other receivables	16	1,983	2,508
Commodity and other derivative financial instruments	20	1,723	1,396
Cash and cash equivalents		46	34
		3,945	4,205
<b>Total assets</b>		<b>11,972</b>	<b>11,654</b>

**E.ON UK PLC**

**CONSOLIDATED BALANCE SHEET**  
**as at 31 December 2007 (continued)**

	Note	31 December 2007	31 December 2006
		£m	£m
<b>Current liabilities</b>			
Borrowings	18	1,477	3,446
Commodity and other derivative financial instruments	20	1,661	1,946
Trade and other payables	17	1,431	1,804
Current tax liabilities		227	209
Provisions	23	157	116
		<b>4,953</b>	<b>7,521</b>
<b>Non-current liabilities</b>			
Borrowings	19	2,065	963
Commodity and other derivative financial instruments	20	-	26
Provisions	23	84	90
Deferred tax	24	717	506
Pension liability	22	138	65
		<b>3,004</b>	<b>1,650</b>
<b>Total liabilities</b>		<b>7,957</b>	<b>9,171</b>
<b>Shareholders' equity</b>			
Ordinary shares	25	1,325	325
Share premium	27	97	97
Retained earnings	28	2,019	1,591
Other reserves	29	576	476
<b>Total shareholder equity</b>		<b>4,017</b>	<b>2,489</b>
<b>Minority interest in equity</b>	30	<b>(2)</b>	<b>(6)</b>
<b>Total equity</b>		<b>4,015</b>	<b>2,483</b>
<b>Total liabilities and equity</b>		<b>11,972</b>	<b>11,654</b>

Approved by the Board on 24 June 2008

Brian Tear  
Director

24 June 2008

The accounting policies and the notes on pages 33 to 100 form part of these financial statements.



**E.ON UK PLC**

**CONSOLIDATED CASH FLOW STATEMENT**  
**for the year ended 31 December 2007**

	Note	Year ended 31 December 2007	Year ended 31 December 2006
		£m	£m
<b>Cash flows from operating activities</b>			
Cash generated from operations	31	1,332	772
Interest received		7	6
Interest paid		(197)	(306)
Tax paid		(46)	(65)
Dividends received from associates		16	5
Net cash from operating activities		1,112	412
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment and intangible assets		(940)	(504)
Acquisitions (net of cash acquired)		-	(2)
Purchase of other financial assets		(40)	(11)
Finance lease principal receipts		10	19
Proceeds from sale of property, plant and equipment		6	1
Proceeds from sale of investments		-	16
Net cash used in investing activities		(964)	(481)
<b>Cash flows from financing activities</b>			
Proceeds from issuance of new shares		1,000	-
Proceeds from issue of new borrowings		2,332	3,357
Repayment of borrowings		(3,208)	(3,302)
Finance lease principal payments		(18)	(16)
Dividends paid to minority interests		(2)	(4)
Dividends paid to equity shareholder		(240)	-
Net cash from financing activities		(136)	35
<b>Net increase / (decrease) in cash and cash equivalents</b>			
		<b>12</b>	<b>(34)</b>
Cash and cash equivalents at 1 January		34	68
<b>Cash and cash equivalents at 31 December</b>		<b>46</b>	<b>34</b>

The accounting policies and the notes on pages 33 to 100 form part of these financial statements.

**Notes to the financial statements  
for the year ended 31 December 2007**

**1 Accounting policies**

**Basis of preparation of accounts**

The financial statements are prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the European Union, International Financial Reporting Interpretations Committee (“IFRIC”) interpretations and the Companies Act 1985 applicable to companies reporting under IFRS, except for the accounting policy for customer contributions (see property, plant and equipment below) where an alternative treatment has been adopted in order to present, in the opinion of the directors, a true and fair view. The financial statements are prepared under the historical cost convention, except for derivative financial instruments, available for sale investments, share base payment provisions and liabilities of the Group’s pension schemes that have been measured at fair value.

The International Accounting Standards Board (“IASB”) and the IFRIC have issued standards and interpretations whose application is not yet mandatory in the reporting period. The application of some of these standards and interpretations is at the present time still subject to adoption by the EU.

At the date of authorisation of the these financial statements, the following standards and interpretations were in issue but were not yet effective and have not been applied in these financial statements:

- |          |  |
|----------|--|
| IFRIC 12 | Service Concession Arrangements – effective for the year beginning 1 January 2008<br>(Not currently adopted by the EU) |
| IFRIC 13 | Customer Loyalty Programmes – effective for the year beginning 1 January 2009 (Not currently adopted by the EU)        |

No material impact to the financial statements is expected from the following standards, amendments to standards and interpretations:

- |          |   |
|----------|---|
| IFRS 8   | Operating Segments – effective for the year beginning 1 January 2009  |
| IFRS 2   | Share-based Payment – effective for the year beginning 1 January 2009   |
| IAS 1    | Presentation of Financial Statements – effective for the year beginning 1 January 2009 (Not currently adopted by the EU)  |
| IAS 23   | Borrowing Costs – effective for the year beginning 1 January 2009   |
| IFRIC 11 | IFRS 2—Group and Treasury Share Transactions – effective for the year beginning 1 January 2008  |
| IFRIC 14 | IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction – effective for the year beginning 1 January 2008 (Not currently adopted by the EU) |

## E.ON UK PLC

### **Notes to the financial statements** **for the year ended 31 December 2007 (continued)**

#### **1 Accounting policies (continued)**

The potential effects to the financial statements arising from the following standards and interpretations are currently being assessed:

IFRS 3	Business Combinations (IFRS 3) – effective for the year beginning 1 January 2010 (Not currently adopted by the EU)
IAS 27	Consolidated and Separate Financial Statements – effective for the year beginning 1 January 2010 (Not currently adopted by the EU)
IAS 32 & IAS 1	Puttable Financial Instruments and Obligations Arising on Liquidation – effective for the year beginning 1 January 2009 (Not currently adopted by the EU)

#### **Judgement in applying accounting policies and key sources of estimation uncertainty**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting year. These judgements are based on management's best knowledge of the relevant facts and circumstances, having regard to prior experience, but actual results may differ from the amounts included in the financial statements.

Key sources of estimation that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

#### **Impairment of goodwill and indefinite lived intangible assets**

The Group 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 may be impaired. This requires an estimation of the value in use of the cash generating units to which goodwill and indefinite lived intangibles are allocated. When determining the value in use, the Group utilises appropriate valuation techniques, for which the input data is in principle based on the Group's medium term plan. Estimating the value in use requires the Group to make an estimation of the expected future cash flows from the cash generating unit, discounted by an appropriate weighted average cost of capital. Estimated cash flows are based on the Group's medium term planning data for the next three years and projections for the following years are based on an expected growth rate based on industry and internal projections. Further detail on the assumptions used in determining value-in-use calculations is provided in Note 9.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **1 Accounting policies (continued)**

##### Revenue recognition – unread gas and electricity meters

Revenue for energy supply activities includes an assessment of energy supplied to customers between the date of the last meter reading and the year end. Unread gas and electricity is estimated using historical consumption patterns taking into account the industry reconciliation process for total gas and total electricity usage by supplier. The industry reconciliation process is required as differences arise between the estimated quantity of gas and electricity the Group deems to have supplied and billed customers, and the estimated quantity the industry system operator deems the individual suppliers, including the Group, to have supplied to customers.

##### Determination of fair values of derivatives

Derivative contracts are carried in the Balance Sheet at fair value, with changes in fair value recorded in the Income Statement or Statement of Total Recognised Income and Expense. As quoted market prices for certain derivatives used by the Group are not readily available, the fair values of these derivatives have been calculated using common market valuation methodologies and value influencing market data at the relevant balance sheet date.

The use of valuation models requires the Group 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. Further detail is provided in Note 20.

##### Pensions and other post-retirement benefits

The Group operates three defined benefit pension schemes, the main scheme being the E.ON UK Group of the Electricity Supply Pension Scheme. The cost of providing benefits under the defined benefit schemes is determined separately for each scheme under the projected unit credit actuarial valuation method. The key assumptions used for the actuarial valuation are based on the Group's best estimate of the variables that will determine the ultimate cost of providing post-employment benefits, on which further detail is provided in Note 22.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **1 Accounting policies (continued)**

##### Impairment of the Group's CHP property, plant and equipment and finance lease receivables

Key assumptions used in determining the value in use of the Group's CHP plants, by reference to expected future operating cash flows, for the purposes of the impairment review were as follows:

- Revenues are based on the expected price to be received under the various CHP contracts with customers on an individual site by site basis. These prices are based on the signed contracts for the provision of CHP services.
- Gas purchase price is based on the Group's year end expectation of forward prices.
- Cash flows used in the value in use calculation have been discounted at the Group's weighted average cost of capital.

Areas of judgement that have the most significant effect on the amounts recognised in the financial statements are:

##### Commodity contracts

Certain commodity contracts that the Group has entered into are not accounted for as derivatives under IAS 39 as they are deemed to be entered into and continue to be held for the purpose or receipt of a non-financial item in accordance with managements' judgement of the entity's expected purchase, sale or usage requirements (the "own use exemption").

##### Emissions trading scheme

The Group has been subject to the European Emissions Trading Scheme since 1 January 2005. IFRIC 3, Emission Rights was withdrawn by the IASB in June 2005 and has not yet been replaced by definitive guidance. The Group has adopted an accounting policy which recognises a shortfall in emissions rights within provisions. Expenses incurred for the consumption of emission rights and the recognition of a corresponding provision are reported in cost of goods sold. Forward contracts for sales and purchases of allowances are measured at fair value.

##### **Going concern**

Notwithstanding the fact that the Group has net current liabilities, the directors have prepared the financial statements on the going concern basis. The directors have in place sufficient borrowing facilities such that the Group and the Company can meet their obligations as they fall due for a period of at least twelve months from the date of the directors' approval of these financial statements. Borrowing facilities are shown in Notes 18 and 19.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**1 Accounting policies (continued)**

**Basis of consolidation**

The consolidated accounts include the financial statements of the Company and entities controlled by the Company (its subsidiaries), together with the Group's share of the results and net assets of associated undertakings using the equity method of accounting. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. The results of subsidiaries sold or acquired are included in the consolidated income statement up to, or from, the date on which control passes. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies into line with those used by the Group. Intra-group sales, profits, and balances are eliminated on consolidation.

**Business combinations**

The Group's share of profits less losses of associated undertakings are included in the consolidated income statement using the equity method of accounting. The results of associates sold or acquired are included in the consolidated profit and loss account up to, or from, the date on which significant influence passed. These amounts are taken from the latest audited financial statements of the relevant undertakings, except where the accounting reference date of the undertaking is not coterminous with the parent company, where management accounts are used.

The accounting reference dates of associated undertakings are set out in Note 11. Where the accounting policies of associated undertakings do not conform to those of the Group, adjustments are made on consolidation where the amounts involved are material to the Group.

**Revenue**

Revenue comprises revenue from the trading and wholesale of electricity; revenue from the distribution of electricity; and revenue from the sale of electricity and gas to industrial and commercial and domestic customers. Revenue excludes Value Added Tax.

Revenue from the sale of electricity and gas to industrial, commercial and domestic customers is recognised when earned on the basis of a contractual agreement 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 the year end.

Revenues from the trading and wholesale of electricity to external customers are recognised when the commodity is delivered on the basis of the agreed volumes and rates within the sales contracts.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **1 Accounting policies (continued)**

Revenues relating to the distribution of electricity represent the value of charges for electricity distributed during the year including estimates of the sales value of units distributed to customers between the date of the last meter reading and the year end.

#### **Segmental reporting**

For management purposes, the Group is currently organised into four operating divisions – Energy Wholesale, Central Networks, Retail and E.ON Energy Services. Management has chosen these divisions as the basis on which the Group reports its primary segment information, although the E.ON Energy Services business unit does not meet the thresholds requiring disclosure as a segment under IAS 14 'Segment Reporting'.

All material revenue, profits, liabilities, assets and other segment items arise within the UK. No secondary segments analysed by geographic destination are therefore reported.

#### **Provisions**

Provisions are recognised in the balance sheet when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced to those affected by it.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**1 Accounting policies (continued)**

The fair value of a liability arising from the decommissioning of an asset is recognised in the period in which it is incurred and a reasonable estimate of the fair value can be made. When the provision is recorded, the Group capitalises the costs of the provision by increasing the carrying amount of the property, plant and equipment. In subsequent periods, the provision is accreted to its present value and the carrying amount of the asset is depreciated over its useful life. Changes to estimates arise, particularly when there are deviations from original cost estimates or changes to the payment schedule or the level of relevant obligation. The provision must be adjusted in the case of both negative and positive changes to estimates. Such an adjustment is usually effected through a corresponding adjustment to property, plant and equipment and is not recognised in income.

Future operating costs are not provided for.

**Foreign exchange**

Items included in the financial information for each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (functional currency). The Group's consolidated financial information is presented in Sterling, which is the Group's presentational currency.

Assets and liabilities expressed in foreign currencies, including those of subsidiaries and associated undertakings, are translated to Sterling at rates of exchange ruling at the end of the financial year.

The results of foreign subsidiaries and associated undertakings are translated to Sterling using average exchange rates.

Transactions denominated in foreign currencies are translated to Sterling at the exchange rate ruling on the transaction date.

Differences on exchange arising from the re-translation of the opening net investment in, and results of, subsidiaries and associated undertakings are taken to reserves and, where the net investments are hedged, are matched with differences arising on the translation of related foreign currency borrowings and forward exchange contracts. Any differences arising are reported in the statement of total recognised income and expense. All other realised foreign exchange differences are taken to the income statement in the year in which they arise.



**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**1 Accounting policies (continued)**

**Deferred income**

Amounts received in advance in respect of the provision of services under warranty arrangements are taken to deferred income and recognised in operating income on a straight line basis over the period to which the warranty cover relates.

**Financial instruments**

The first-time adoption of IFRS 7, "Financial Instruments: Disclosures" ("IFRS 7"), became effective in the 2007 fiscal year. The new standard requires both quantitative and qualitative disclosures about the extent of risks arising from financial instruments (eg credit, liquidity and market risks).

Primary financial instruments

Primary financial instruments are recognised at fair value on the settlement date when acquired. Unconsolidated equity investments and securities are measured in accordance with IAS 39. E.ON UK classifies financial assets as held for trading, available for sale, or as loans and receivables. Management determines the classification of the financial assets at initial recognition.

Securities classified as available for sale are carried at fair value on a continuing basis, with any resulting unrealised gains and losses, net of related deferred taxes, reported as a separate component within equity until realised. Realised gains and losses are recorded based on the specific identification method. Unrealised losses previously recognised in equity are recognised in financial results in the case of substantial impairment. Reversals of impairment losses relating to equity instruments are recognised exclusively in equity.

Loans and receivables (including trade receivables) are primary financial assets with fixed or determinable payments that are not traded in an active market. Loans and receivables are reported on the balance sheet under "Trade and other receivables." They are subsequently measured at amortised cost, using the effective interest method. Valuation allowances are provided for identifiable individual risks. If the loss of a certain part of the receivables is probable, valuation allowances are provided to cover the expected loss. Reversals of losses are recognised under "Other operating income".

Primary financial liabilities (including trade payables) within the scope of IAS 39 are measured at amortised cost, using the effective interest method. Initial measurement takes place at fair value plus transaction costs. In subsequent periods, the amortisation and accretion of any premium or discount is included in finance costs/income.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**1 Accounting policies (continued)**

Derivative financial instruments and hedging transactions

Derivative financial instruments and separated embedded derivatives are measured at fair value as of the trade date at initial recognition and in subsequent periods. IAS 39 requires that they be classified as held for trading as long as they are not a component of a hedge accounting relationship. Gains and losses from changes in fair value are immediately recognised in net income.

Instruments commonly used are foreign currency forwards and swaps, as well as interest-rate swaps and cross-currency swaps. In commodities, the instruments used include physically and financially 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.

IAS 39 sets requirements for the designation and documentation of hedging relationships, the hedging strategy, as well as ongoing retrospective and prospective measurement of effectiveness in order to qualify for hedge accounting. The Group does not exclude any component of derivative gains and losses from the measurement 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 risk(s) are recognised in income. If a derivative instrument qualifies as a cash flow hedge, the effective portion of the hedging instrument's gain or loss is recognised in equity (as a component of other reserves) and reclassified into income in the period or periods during which the transaction being hedged affects income. The hedging result is reclassified into income immediately if it becomes probable that the hedged underlying transaction will no longer occur. For hedging instruments used to establish cash flow hedges, the change in fair value of the ineffective portion is recognised immediately in the income statement. To hedge the foreign currency risk arising from the Group'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 recognised separately within equity as currency translation adjustments.

## E.ON UK PLC

### **Notes to the financial statements** **for the year ended 31 December 2007 (continued)**

#### **1 Accounting policies (continued)**

Changes in fair value of derivative instruments that must be recognised in income are classified as other operating income or expenses. Gains and losses from interest-rate derivatives are netted for each contract and included in interest income. Gains and losses from derivative proprietary trading instruments are shown net as either revenues or cost of materials. Certain realised amounts are, if related to the sale of products or services, also included in revenues or cost of materials.

Unrealised gains and losses resulting from the initial measurement of derivative financial instruments at the inception of the contract are not recognised in income. They are instead deferred and recognised in income systematically over the term of the derivative. An exception to the accrual principle applies if unrealised gains and losses from the initial measurement are verified by quoted market prices, observable prices of other current market transactions or other observable data supporting the valuation technique. In this case the gains and losses are recognised in income.

Derivatives embedded within other financial instruments or host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value in their entirety.

See Note 20 for additional information regarding the Group's use of derivative instruments.

#### **Intangible fixed assets**

##### Goodwill

Goodwill arising on consolidation represents the excess of the fair value of the consideration given over the Group's share of the fair value of the identifiable assets and liabilities of an acquired subsidiary, associate or joint venture. Purchased goodwill is capitalised on the balance sheet and reviewed for impairment on at least an annual basis and whenever there is an indicator of impairment. If an indication of impairment exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash generating unit to which the asset belongs.

Goodwill relating to associates is included within 'investments' in the consolidated balance sheet. Goodwill arising on overseas acquisitions is regarded as a currency asset and is re-translated at each period end at the closing rate of exchange.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 1 Accounting policies (continued)

##### Software costs

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (three to five years).

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include the software development employee costs and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised over their estimated useful lives (three to five years).

##### Emission allowances

Emission rights held under national and international emissions rights systems are reported as intangible assets. Emission rights are capitalised at their acquisition costs when issued for the respective reporting period as (partial) fulfilment of the notice of allocation from the responsible national authorities, or purchased from third parties. The consumption of emission rights is recognised at average cost based on emissions made. A shortfall in emission rights is recognised within other provisions at cost. The expenses incurred for the consumption of emission rights and the recognition of a corresponding provision are reported under power purchases and other cost of sales.

As part of operating activities, emission rights are also held for proprietary trading purposes. Emission rights held for proprietary trading are reported under other assets at fair value.

##### Other

Other acquired intangible assets are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets from the date they are available for use. The estimated useful lives are as follows:

<i>Asset</i>	<i>Life in years</i>
Customer Base	7-10

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**1 Accounting policies (continued)**

Emission rights and ROCs generally have maturities of less than one year and are therefore not amortised.

Other intangible assets also include the benefits of land options and development contracts, and capitalised development costs. They will be amortised over the useful economic life of the schemes to which they relate.

**Property, plant and equipment**

Property, plant and equipment is stated at original cost, net of customer contributions, less accumulated depreciation and any provision for impairment. Impairment losses and any subsequent reversals are recognised in the period in which they are identified. This accounting treatment represents a departure from the Companies Act 1985 which requires property, plant and equipment to be included at their purchase price or production cost and therefore any contribution would be presented as deferred income. However it is the opinion of the directors that the treatment adopted is necessary to give a true and fair view as the contributions relate directly to the cost of assets used in the distribution network. Customers' contributions towards distribution network assets are credited to the profit and loss account over the life of the distribution network assets to which they relate by virtue of a reduction in the depreciation charge.

In the case of assets constructed by the Group, directly related overheads and commissioning costs are included in cost.

Major assets in the course of construction are included in property, plant and equipment on the basis of expenditure incurred at the balance sheet date. Where borrowings are used to finance the construction of a major capital project with a long period of development, interest payable is capitalised as part of the cost of the asset and written off over the economic useful life of the asset. Where specific borrowings are used, the amount capitalised is based on actual interest payable.

Where general borrowings are used, the amount capitalised is based on the weighted average cost of capital of the Group, not exceeding the actual expenditure incurred during the relevant period of construction.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 1 Accounting policies (continued)

##### Depreciation

Provision for depreciation of generating and other assets is made so as to write off, on a straight-line basis, the cost (less residual value) of property plant and equipment. Assets are depreciated over their estimated useful lives or, in the case of leased assets, over the lease term if shorter. Estimated useful lives and residual values are reviewed annually. No depreciation is provided on freehold land or assets in the course of construction.

The estimated useful lives for the principal categories of property plant and equipment are:

<i>Asset</i>	<i>Life in years</i>
Generating assets	25-45
Distribution and transmission networks	40-60
Other assets	3-40

##### Overhaul of generation plant

Major periodic overhaul costs on generation plant are capitalised as part of generating assets and depreciated on a straight-line basis over their estimated useful life, typically the period until the next major overhaul. That period is usually four years.

##### Impairment

Impairments of assets are calculated as the difference between the carrying value of the asset and its recoverable amount, if lower. Where an asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash generating unit to which the asset belongs.

Recoverable amount is defined as the higher of fair value less costs to sell and estimated value in use at the date the impairment review is undertaken.

Value in use represents the present value of expected future cash flows, discounted using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Impairments are recognised in the income statement and, where material, are disclosed separately.

##### Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership of the asset to the lessee. All other leases are classified as operating leases.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **1 Accounting policies (continued)**

Assets held under finance leases are recognised at their value at the inception of the lease or the present value of minimum lease payments if lower. A corresponding liability is recognised as a finance lease obligation.

Assets leased under finance leases where the Group is the lessor are derecognised at the date that the asset is delivered. A lease receivable is recognised at the present value of minimum lease payments. Lease receipts are apportioned between finance income and the reduction of the lease receivable so as to achieve a constant rate of return on the lease receivable.

Rents payable under operating leases are charged to the income statement evenly over the term of the lease. Income from operating leases is included within other operating income in the income statement. Income is recognised on a straight-line basis except where income receipts vary with output or other factors. Any variable element is recognised as earned.

#### **Inventories**

Inventories are stated at the lower of cost and net realisable value. In general, inventories are recognised in the income statement on a weighted average cost basis. The Companies Act 1985 requires inventories to be categorised between raw materials, work in progress and finished goods. Fuel stocks and engineering stores are raw materials under this definition.

#### **Cash and cash equivalents**

Cash and cash equivalents include cash at bank and in hand, deposits with a maturity of three months or less and other short term liquid investments that are readily convertible to known amounts of cash.

#### **Taxation**

The tax expense for the year represents the sum of the current tax and deferred tax.

The tax charge for the year is based on the taxable profits or losses on ordinary activities for the year. Deferred tax is provided in full, using the liability method, on temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction at the time of the transactions, that affects neither the tax profit nor the accounting profit.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **1 Accounting policies (continued)**

Deferred tax assets and liabilities are offset when there exists a legal and enforceable right to offset and they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Deferred tax is calculated using the enacted or substantially enacted tax rates that are expected to apply in the period in which the temporary difference is expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognised in income for the period that includes the enactment date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is dealt with in equity.

#### **Pensions**

The Group provides pension benefits through both defined benefit and defined contribution schemes. The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, adjusted for past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. Defined benefit pension scheme costs are attributed to the income statement over the period of service of the employee. Past service costs are recognised immediately to the extent that the benefits are already vested, otherwise are amortised on a straight line basis over the vesting period. Actuarial gains and losses are recognised in full on the balance sheet and pass through retained earnings. Actuarial gains and losses are also recognised through the Statement of Total Recognised Income and Expense as incurred. Details of actuarial valuations, including the frequency and methodology, are set out in Note 22.

Payments to defined contribution schemes are charged against profits as incurred.

#### **Share based payments**

Certain directors and senior management personnel participate in cash settled share based payment schemes administered by the ultimate parent company, E.ON AG. Two schemes are currently in operation – the E.ON Stock Appreciation Rights Scheme and the E.ON Share Performance Scheme. The Group accounts for these schemes in accordance with IFRS 2 “Share-based payment”. The liability is measured initially and at each reporting date, based on fair value, by applying the Monte Carlo option pricing model, taking into account rights granted and service rendered to date. Costs are recognised in the income statement over the expected vesting period.



# E.ON UK PLC

## Notes to the financial statements for the year ended 31 December 2007 (continued)

### 2 Segmental reporting

Year ended 31 December 2007	Energy Wholesale	Central Networks	Retail	E.ON Energy Services	Central / Unallocated	Eliminations	Group
	£m	£m	£m	£m	£m	£m	£m
External revenue	2,354	464	5,703	88	-	-	8,609
Inter-segment revenue	3,812	144	26	323	-	(4,305)	-
<b>Total revenue</b>	<b>6,166</b>	<b>608</b>	<b>5,729</b>	<b>411</b>	<b>-</b>	<b>(4,305)</b>	<b>8,609</b>
Segment result	959	349	(17)	(2)	(66)		1,223
Finance income							37
Finance costs							(264)
Share of results of associates after tax	2	-	-	-	9		11
Profit before tax							1,007
Tax charge							(263)
<b>Profit for the year from continuing activities</b>							<b>744</b>
<b>Total assets</b>	<b>15,399</b>	<b>3,397</b>	<b>4,843</b>	<b>308</b>	<b>(11,975)</b>		<b>11,972</b>
<b>Total liabilities*</b>	<b>11,801</b>	<b>1,155</b>	<b>1,306</b>	<b>286</b>	<b>(6,591)</b>		<b>7,957</b>
<b>Other segment items</b>							
Capital expenditure (including acquisitions)	454	331	-	59	12		856
Intangible expenditure	100	-	13	-	-		113
Depreciation	137	90	1	6	3		237
Amortisation of intangible assets	2	-	60	-	-		62
Goodwill	68	308	1,237	13	869		2,495

\* Interest and tax liabilities are included within central / unallocated.

# E.ON UK PLC

## Notes to the financial statements for the year ended 31 December 2007 (continued)

### 2 Segmental reporting (continued)

Year ended 31 December 2006	Energy Wholesale	Central Networks	Retail	E.ON Energy Services	Central / Unallocated	Eliminations	Group
	£m	£m	£m	£m	£m	£m	£m
External revenue	2,155	443	5,857	79	-	-	8,534
Inter-segment revenue	3,802	141	24	293	-	(4,260)	-
<b>Total revenue</b>	<b>5,957</b>	<b>584</b>	<b>5,881</b>	<b>372</b>	<b>-</b>	<b>(4,260)</b>	<b>8,534</b>
Segment result	(695)	334	338	7	(210)		(226)
Finance income							31
Finance costs							(270)
Share of results of associates after tax	1	-	-	-	3		4
Loss before tax							(461)
Tax credit							127
<b>Loss for the year from continuing activities</b>							<b>(334)</b>
<b>Total assets</b>	<b>11,339</b>	<b>3,269</b>	<b>5,137</b>	<b>115</b>	<b>(8,206)</b>		<b>11,654</b>
<b>Total liabilities*</b>	<b>8,769</b>	<b>742</b>	<b>1,196</b>	<b>92</b>	<b>(1,628)</b>		<b>9,171</b>
<b>Other segment items</b>							
Capital expenditure (including acquisitions)	272	266	-	(37)	8		509
Intangible expenditure	204	-	10	-	-		214
Depreciation	127	97	1	3	1		229
Amortisation of intangible assets	5	-	61	-	-		66
Goodwill	68	308	1,237	13	869		2,495

\* Interest and tax liabilities are included within central / unallocated.

### Secondary format – geographical segments

All material revenue, profits, liabilities, assets and other segment items arise within the UK. No secondary segments analysed by geographic destination are therefore reported.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**3 Operating costs and other operating income**

Operating costs were as follows:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Fuel costs	942	963
Power purchases and other costs of sales	5,355	5,343
Staff costs (Note 6)	537	442
Depreciation, including relevant impairments	237	248
Intangible asset amortisation, including relevant impairments	62	198
Derivative losses	56	1,006
Other operating charges, including restructuring costs	772	762
Operating costs, after impairment and integration costs	<u>7,961</u>	<u>8,962</u>
Operating costs, before impairment and integration costs	7,961	8,743
Impairment and integration costs (Note 4)	-	219

Foreign exchange losses of £31 million were recognised in the profit and loss account (2006: £14 million loss). Other operating charges, including restructuring costs included £35 million of retail restructuring costs.

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Operating costs also include:		
Repairs and maintenance costs	113	120
Research and development costs	8	6
Operating leases charges	49	41
Loss on disposal of property, plant and equipment	2	1
Auditors' remuneration for:		
Audit services: Audit of the Company and consolidated accounts	1.4	1.1
Other services: Audit of the Company's subsidiaries pursuant to legislation	0.6	0.6
Other services pursuant to legislation	0.3	0.3
Tax services	0.5	0.1
All other services	0.2	-

Other operating income:

The largest component of other operating income in 2007 was derivative gains of £480 million. Other operating income also includes PowerTechnology consulting income of £12 million and income from engineering services of £14 million. Gains on disposal of property, plant and equipment of £6 million were also recognised.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 3 Operating costs and other operating income (continued)

The largest component of other operating income in 2006 was derivative gains of £48 million. Other operating income also includes income from meter asset provision and maintenance of £24 million, PowerTechnology consulting income of £12 million, profit on disposal of businesses of £18 million and income from engineering services of £8 million. Gains on disposal of property, plant and equipment of £1 million were also recognised.

#### 4 Impairment costs

Impairment costs comprise:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Impairment and integration costs before taxation	-	219
Tax on impairment costs	-	(66)
Impairment costs after taxation	-	153

##### *Year ended 31 December 2006*

During 2006, finance lease receivables relating to CHP plants were impaired by £16 million and CHP property, plant and equipment was impaired by £8 million. Furthermore, an onerous contract of £52m was recognised with respect to CHP contracts. The impairments and onerous contracts arose as a result of rising wholesale gas prices resulting in increased costs on CHP contracts that receive a relatively fixed price per unit of output. Consequently, in some cases the current estimate of unavoidable costs of meeting the obligations under the contracts exceeds the economic benefits expected to be received under it. A tax credit of £23 million arose as a result of these charges. CHP plants are within the Energy Wholesale segment.

Impairments of £132 million and £11 million which were recognised on intangible assets and property, plant and equipment respectively, related to the Group's gas storage site at Holford. The impairments arose as the costs to complete the project exceed the costs anticipated when the project commenced. As a result, the value assigned to certain intangible contractual development rights was impaired in addition to certain assets in the course of construction. A tax credit of £43 million arose as a result of these charges. All relevant assets are within the Energy Wholesale segment.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **5 Profits less losses on disposal of investments / businesses (including provisions)**

Profits less losses on disposal of investments / businesses (including provisions) comprise:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Profits less losses on disposal of investments / businesses (including provisions) before taxation	-	18
Tax on profits less losses on disposal of investments / businesses (including provisions)	-	(3)
Profits less losses on disposal of investments / businesses (including provisions) after taxation	-	15

#### *Year ended 31 December 2006*

During 2006, E.ON UK disposed of its 100 percent share of Edenderry Power Limited and Edenderry Power Operations Limited for proceeds of £12 million. Net liabilities disposed of totalled £7 million and a cumulative translation loss of £1 million was realised, resulting in a profit of £18 million.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 6 Employee information, including directors' remuneration

The average number of persons employed by the Group, including directors was:

	Year ended 31 December 2007	Year ended 31 December 2006
Total operations (including UK Centre)	<b>16,800</b>	<b>15,621</b>

The salaries and related costs of employees, including directors, were:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Wages and salaries	480	389
Social security costs	46	40
Other pension costs (Note 22)	57	53
	<b>583</b>	482
Capitalised in property plant and equipment	<b>(46)</b>	(40)
Charged in income statement as staff costs	<b>537</b>	442

The key management compensation costs were:

	Year ended 31 December 2007 £	Year ended 31 December 2006 £
Salaries and short-term employee benefits	6,470,661	5,484,521
Post-employment benefits	959,557	816,450
Termination benefits	1,119,938	-
Share based payments	2,451,984	2,556,838
	<b>11,002,140</b>	8,857,809

For details of the highest paid director's remuneration see Note 3 of the parent company financial statements.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**7 Finance income and costs**

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Interest receivable		
From fellow E.ON group undertakings	-	1
Net pensions interest (Note 22)	32	21
Other	5	9
<b>Finance income</b>	<b>37</b>	<b>31</b>
Interest payable		
Loans from fellow E.ON group undertakings	(246)	(240)
Other loans	(16)	(27)
Unwinding of discount in provisions	(2)	(3)
<b>Finance costs</b>	<b>(264)</b>	<b>(270)</b>
<b>Net finance costs</b>	<b>(227)</b>	<b>(239)</b>

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 8 Taxation

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
<b>Current tax:</b>		
United Kingdom Corporation tax at 30%	87	138
(Over)/under provision in prior year	(23)	15
<b>Total current tax charge</b>	<b>64</b>	<b>153</b>
<b>Deferred tax:</b>		
Origination and reversal of temporary timing differences	214	(272)
Impact of change in rate	(51)	-
Under/(over) provision in prior period	36	(8)
<b>Total deferred tax charge/(credit) (Note 24)</b>	<b>199</b>	<b>(280)</b>
<b>Tax charge/(credit) on profit/(loss) on ordinary activities</b>	<b>263</b>	<b>(127)</b>

The difference between the current tax on the profit on ordinary activities for the year and the tax assessed on the profit on ordinary activities for the year assessed at the standard rate of corporation tax in the UK (30 percent) can be explained as follows:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Profit / (loss) on ordinary activities before tax	1,007	(461)
Less Group's share of associates' profit after tax	(11)	(4)
Profit / (loss) on ordinary activities excluding associates' profit	996	(465)
 Tax charge / (credit) on profit / (loss) on ordinary activities at 30%	 299	 (140)
 Effects of:		
Impact of change in rate	(51)	-
Prior year adjustment	13	7
Expenses not deductible for tax purposes	2	10
Non-taxable income	-	(4)
<b>Total tax charge / (credit)</b>	<b>263</b>	<b>(127)</b>

The impact of the rate change occurred due to deferred taxes being calculated at the new statutory rate of corporation tax of 28% in the UK. This is expected to be the effective rate when the timing differences will reverse.

The tax impact of individually material items is given in Note 4.



**E.ON UK PLC**

**Notes to the financial statements  
for the year ended 31 December 2007 (continued)**

**9 Intangible assets**

	Goodwill	Software	Customer lists	Other	Total
	£m	£m	£m	£m	£m
<b>Cost</b>					
At 1 January 2007	2,495	132	464	285	3,376
Additions	-	21	-	92	113
Disposals	-	-	-	(96)	(96)
<b>At 31 December 2007</b>	<b>2,495</b>	<b>153</b>	<b>464</b>	<b>281</b>	<b>3,393</b>
<b>Aggregate impairment &amp; amortisation</b>					
At 1 January 2007	-	99	193	135	427
Amortisation for the year	-	15	47	-	62
<b>At 31 December 2007</b>	<b>-</b>	<b>114</b>	<b>240</b>	<b>135</b>	<b>489</b>
<b>Net book value at 31 December 2007</b>	<b>2,495</b>	<b>39</b>	<b>224</b>	<b>146</b>	<b>2,904</b>

	Goodwill	Software	Customer lists	Other	Total
	£m	£m	£m	£m	£m
<b>Cost</b>					
At 1 January 2006	2,495	133	464	221	3,313
Additions	-	14	-	200	214
Disposals	-	(15)	-	(136)	(151)
<b>At 31 December 2006</b>	<b>2,495</b>	<b>132</b>	<b>464</b>	<b>285</b>	<b>3,376</b>
<b>Aggregate impairment &amp; amortisation</b>					
At 1 January 2006	-	92	145	-	237
Amortisation for the year	-	15	48	3	66
Impairment	-	-	-	132	132
Disposals	-	(8)	-	-	(8)
<b>At 31 December 2006</b>	<b>-</b>	<b>99</b>	<b>193</b>	<b>135</b>	<b>427</b>
<b>Net book value at 31 December 2006</b>	<b>2,495</b>	<b>33</b>	<b>271</b>	<b>150</b>	<b>2,949</b>

Other intangible assets comprise emission rights, ROCs and contractual development rights. Contractual development rights are amortised from the period in which the development is completed.

All amortisation charges in the year have been charged through operating costs.

Goodwill is reviewed annually for impairment or more frequently if there are indications that it may be impaired. Goodwill is allocated to cash-generating units identified according to business segment as per Note 2.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **9 Intangible assets (continued)**

The recoverable amounts of goodwill have been assessed based on value in use calculations using cash flow projections based on approved financial plans. These plans cover periods in excess of five years on account of the long term nature of the Groups' assets. Growth rate assumptions used were based on management's expectations of market development. The annual growth rate used to determine cash flows in the long term ranges from 0 percent to 1 percent. Projected cash flows were discounted at rates of between 6 percent and 7 percent based on risks relevant to the segment. The discount rate used is post tax.

The key assumptions in the value in use calculations determining recoverable amounts for specific cash generating units are:

#### Central Networks

A 20 year cash flow forecast is built up from medium term plans (extended out based on management views on required investment and expected regulatory returns). In addition a terminal value is also applied to the Regulatory Asset Value and included in the value in use calculations.

#### Retail

A 15 year cash flow forecast is built up from medium term plans (extended out based on management views on sustainable retail margins and future volume growth). In addition a terminal value is applied to the annual cash flows in year 15.

#### Energy Wholesale

Value in use calculations are performed for each part of the business. Power Stations and renewable assets are valued by calculating future cash flows over the life of each unit using E.ON AG long term price tracks. Energy contracts are valued at current market prices. Valuations are then reduced by overhead costs for supporting functions.

#### E.ON Energy Services

A 10 year cash flow forecast is built up from medium term plans for each business area, (extended out based on management views on growth). In addition a terminal value is applied to the annual cash flows in year 10.

#### UK Centre

A cash flow forecast is built up from the 3 year medium term plan. In addition a terminal value is applied to the cash flows in year 3 on the assumption that cash flows will continue into perpetuity.

E.ON UK PLC

**Notes to the financial statements  
for the year ended 31 December 2007 (continued)**

**10 Property, plant and equipment**

	Generating assets £m	Distribution and transmission networks £m	Other operating and short-term assets £m	Total £m
<b>Cost</b>				
At 1 January 2007	3,620	4,221	524	8,365
Additions	486	323	47	856
Disposals	(62)	-	(114)	(176)
<b>At 31 December 2007</b>	<b>4,044</b>	<b>4,544</b>	<b>457</b>	<b>9,045</b>
<b>Depreciation</b>				
At 1 January 2007	2,028	1,584	292	3,904
Charge for the year	144	67	26	237
Disposals	(60)	-	(114)	(174)
<b>At 31 December 2007</b>	<b>2,112</b>	<b>1,651</b>	<b>204</b>	<b>3,967</b>
<b>Net book value at 31 December 2007</b>	<b>1,932</b>	<b>2,893</b>	<b>253</b>	<b>5,078</b>

	Generating assets £m	Distribution and transmission networks £m	Other operating and short-term assets £m	Total £m
<b>Cost</b>				
At 1 January 2006	3,609	4,040	593	8,242
Additions	272	183	54	509
Exchange differences	(1)	-	-	(1)
Disposals	(260)	(2)	(123)	(385)
<b>At 31 December 2006</b>	<b>3,620</b>	<b>4,221</b>	<b>524</b>	<b>8,365</b>
<b>Depreciation</b>				
At 1 January 2006	2,098	1,507	370	3,975
Charge for the year	132	77	20	229
Impairment	19	-	-	19
Disposals	(221)	-	(98)	(319)
<b>At 31 December 2006</b>	<b>2,028</b>	<b>1,584</b>	<b>292</b>	<b>3,904</b>
<b>Net book value at 31 December 2006</b>	<b>1,592</b>	<b>2,637</b>	<b>232</b>	<b>4,461</b>

Additions in 2007 include capitalised borrowing costs amounting to £8 million (2006: £2 million). The net book value of property, plant and equipment held under finance leases is £61 million (2006: £65 million).

Group assets include assets in the course of construction at a cost of £386 million (2006: £32 million) primarily relating to generating assets.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**11 Interests in associates**

	Associates - Net Assets £m	Associates - Loans £m	Total £m
<b>Net assets</b>			
At 1 January 2007	7	1	8
Retained profits	11	-	11
Dividends received	(16)	-	(16)
Dividend deferred	5	-	5
Disposals	(4)	(1)	(5)
<b>At 31 December 2007</b>	<b>3</b>	<b>-</b>	<b>3</b>

The disposal balance relates to the step acquisition of Blyth Offshore Wind Limited which is now fully owned by the Group.

No goodwill is recorded within interests in associates.

Details of the Group's principal investment in associates are as follows:

	Accounting reference date	Country of incorporation or registration	Shares held	Percentage of capital held directly or indirectly by the Group
Trakya Electric Uretim ve Ticaret A.S. ("Trakya Electric")	31 December	Turkey	Ordinary shares	31%
E.ON IS UK Limited ("E.ON IS")	31 December	England and Wales	Ordinary shares	49%

The principal activity of Trakya Electric is as the owner and operator of a gas fired power station in Turkey. The principal activity of E.ON IS is to provide shared IT services to the Group. The share capital of E.ON IS is £4 million. The Company sold its investment in E.ON IS to the majority shareholder, E.ON IS GmbH, on 30 April 2008 for its market value of 3,718,000 Euros.

**Group share of balance sheet and results of associates held at year end**

	<b>At 31 December 2007 £m</b>	At 31 December 2006 £m
Share of assets	<b>131</b>	139
Share of liabilities	<b>(128)</b>	(132)
Share of net assets	<b>3</b>	7
Revenue	<b>108</b>	106
Operating profit	<b>23</b>	25

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 12 Interests in Group subsidiary undertakings

Details of the Group's principal investments in subsidiary undertakings are set out below. Principal subsidiaries are those which in the opinion of the directors significantly affect the amount of profit and assets and liabilities shown in these accounts. The directors consider that those companies not listed are not significant in relation to the Group as a whole.

Name	Class of share capital	Proportion of nominal value of issued equity shares and voting rights held by the Group %	Country of incorporation or registration	Principal business activities
Central Networks East plc +	Ordinary shares	100	England and Wales	Distribution of electricity
Central Networks West plc +	Ordinary shares	100	England and Wales	Distribution of electricity
Central Networks plc +	Ordinary shares	100	England and Wales	Holding company for distribution activities
Powergen International Limited *	Ordinary shares	100	England and Wales	Holding company for international activities
Powergen (East Midlands) Loan Notes *+	Ordinary shares	100	England and Wales	Financing
East Midlands Electricity Distribution Holdings +	Ordinary shares	100	England and Wales	Intermediate holding company
Ergon Overseas Holdings Limited +	Ordinary shares	100	England and Wales	Investment company
E.ON Energy Limited *	Ordinary shares	100	England and Wales	Supply of electricity and supply, trading and shipping of gas in the UK
Powergen Holdings BV +	Ordinary shares	100	The Netherlands	Intermediate holding company

\* direct interest

+ indirect interest

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**13 Available for sale investments**

	<b>£m</b>
At 1 January 2007	18
Revaluation	-
<b>At 31 December 2007</b>	<b>18</b>

Available for sale financial assets include the following:

	<b>At 31 December 2007 £m</b>	<b>At 31 December 2006 £m</b>
Listed equity securities – UK	2	2
Listed gilts – UK	16	16
	<b>18</b>	<b>18</b>

**14 Financial receivables: amounts falling due after more than one year**

	<b>At 31 December 2007 £m</b>	<b>At 31 December 2006 £m</b>
Finance lease receivables	24	13
	<b>24</b>	<b>13</b>

Further details are provided in Note 16.

**15 Inventories**

	<b>At 31 December 2007 £m</b>	<b>At 31 December 2006 £m</b>
Fuel stocks	142	197
Stores	51	70
	<b>193</b>	<b>267</b>

The majority of consumed inventories represent fuel costs incurred during the period. Fuel costs are disclosed in Note 3.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**16 Trade and other receivables**

	At 31 December 2007 £m	At 31 December 2006 £m
Trade receivables	1,785	2,457
Less: provision for impairment of receivables	(205)	(182)
Trade receivables - net	1,580	2,275
Other receivables	7	13
Prepayments and accrued income	271	121
Finance lease receivables	6	3
Amounts due from parent undertaking and fellow subsidiaries	119	96
	<b>1,983</b>	<b>2,508</b>

The age analysis of trade receivables is as follows:

	At 31 December 2007 £m	At 31 December 2006 £m
Total trade receivables thereof:	1,580	2,275
Not impaired and not past-due	1,157	1,804
Not impaired and up to 90 days past-due	242	236
Not impaired and 91 to 180 days past-due	95	96
Not impaired and 181 to 360 days past-due	47	65
Not impaired and over 360 days past-due	39	74

Valuation allowances for trade receivables have changed as shown in the following table:

	2007 £m	2006 £m
Balance as at 1 January	(182)	(118)
Impairment	(23)	(64)
<b>Balance as at 31 December</b>	<b>(205)</b>	<b>(182)</b>

The individual impaired receivables are due from a large number of customers from whom it is unlikely that full repayment will ever be received. Receivables are monitored by the various business units. There are no indications that the carrying amounts reported might be impaired.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 16 Trade and other receivables (continued)

In addition to the increase in the provision for impairment of receivables a further £145 million was charged to the income statement during 2007 to write down trade receivables (2006: £86 million).

The finance leases granted by the Group arise on the provision of CHP plants on certain client sites. Each site provides steam and power to one principal client base as well as selling power to the rest of the Group. The lease duration is typically 15-20 years and the lessee generally has the option to acquire the site at the end of the lease. The maturities of the finance leases are set out below:

	At 31 December 2007		At 31 December 2006	
	Gross Investment £m	Net Investment £m	Gross Investment £m	Net Investment £m
Within 1 year	35	35	35	35
Within 1-5 years	115	85	128	72
After 5 years	152	75	174	105
Impairment	(258)	(165)	(285)	(196)
	44	30	52	16

Unearned finance income at 31 December 2007 amounted to £14 million (2006: £36 million).

#### Collateral

Collateral issued to third parties, measured at a fair value, amounts to £36 million (2006: £37 million). This collateral includes amounts pledged to customers if a default in supply of electricity occurs.

There is also collateral held in respect of future open positions on gas and carbon trades. E.ON UK can sell or re-pledge this collateral with no subsidiary conditions.

#### 17 Trade and other payables

	At 31 December 2007 £m	At 31 December 2006 £m
Trade payables	458	908
Amounts owed to parent undertaking and fellow subsidiaries	292	357
Other taxation and social security	9	9
Accruals and other creditors	623	506
Deferred income	49	24
	1,431	1,804



**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**18 Borrowings: amounts falling due within one year**

	At 31 December 2007 £m	At 31 December 2006 £m
Bank overdrafts	1	8
Short-term loans from parent undertaking and fellow subsidiaries	1,458	3,330
Loan notes 2007	-	2
Other short-term loans	-	89
Finance lease payable	18	17
	<b>1,477</b>	<b>3,446</b>

Short-term funding is provided through inter-company facilities that are unsecured and repayable on demand. The weighted average interest rate on all short-term loans during the year was 7.17 percent (2006: 6.25 percent).

**19 Borrowings: amounts falling due after more than one year**

	At 31 December 2007 £m	At 31 December 2006 £m
<b>Amounts owed to external debt holders</b>		
5% Euro Eurobond 2009	194	177
6.25% Sterling Eurobond 2024	8	8
2012 Loan	5	10
Loan notes 2008	-	2
Finance lease payable	-	19
	<b>207</b>	<b>216</b>
<b>Amounts owed to fellow group undertakings</b>		
6.46% US Dollar Yankee Bond 2008	-	126
5% Euro Eurobond 2009	174	159
6.25% Sterling Eurobond 2024	224	222
Long-term loans	1,460	240
	<b>1,858</b>	<b>747</b>
	<b>2,065</b>	<b>963</b>

Long-term loans are unsecured and include an amount of £900 million payable to E.ON International Finance, is repayable in 2037 and incurs interest at 6.075%. The remaining balance is payable to E.ON UK Holding Company, is repayable in 2011 and incurs interest at LIBOR plus 47.5 basis points.

None of the bonds outstanding at 31 December 2007 have any financial covenants (2006: none).

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 19 Borrowings: amounts falling due after more than one year (continued)

##### Maturity of financial liabilities

The maturity profile of the carrying amount of the Group's non-current borrowings was as follows:

	At 31 December 2007 £m	At 31 December 2006 £m
In more than one year but not more than two years	368	143
In more than two years but not more than five years	565	589
In more than five years	1,132	231
	<b>2,065</b>	<b>963</b>

At 31 December 2007 there was £4,096 million of undrawn committed borrowing facilities available to the Group, all of which were inter-company facilities which did not contain any material covenant restrictions and which expire between 2008 and 2011. These facilities comprised:

Facility	Total facility £m	Amount undrawn at 31 December 2007 £m	Expiry date	Fees
E.ON UK plc – committed facility from E.ON AG	870	870	21 December 2010	10bp
E.ON UK plc – committed facility from E.ON UK Holding Company Limited	3,000	2,440	6 March 2011	19bp
E.ON UK plc – committed facility from Powergen Group Investments	300	300	21 December 2010	-
E.ON UK plc – committed facility from Ergon Financial Management Ltd	1,750	486	30 June 2008	8bp
	<b>5,920</b>	<b>4,096</b>		

##### Foreign exchange risk management

The Group enters into foreign exchange contracts in accordance with its hedging policies. These policies are discussed under 'Foreign exchange risk management' in the Financial Review. There are no material monetary assets or liabilities of the Group that are not denominated in the functional currency of the entity concerned, other than certain non-Sterling borrowings which have either been swapped back into Sterling or treated as hedges of net investments in overseas operations.

##### Interest rate risk management

The Group has a portfolio of fixed and floating interest rate debt and, in order to mitigate interest rate risk, arranges interest rate hedges to achieve a desired mix of fixed and floating interest rates, with a range of different maturities. The desired mix is managed by E.ON AG treasury.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**19 Borrowings: amounts falling due after more than one year (continued)**

Interest rate risk profile of financial liabilities:

	Total	Floating rate financial liabilities	Fixed rate financial liabilities		
			Weighted average interest rate	Weighted average period for which rate is fixed	Years
	£m	£m	£m	%	Years
<b>At 31 December 2007</b>					
Sterling	<b>3,049</b>	<b>1,917</b>	<b>1,132</b>	<b>6.1</b>	<b>27.1</b>
Euros	<b>368</b>	<b>174</b>	<b>194</b>	<b>5.0</b>	<b>1.5</b>
Dollars	<b>125</b>	<b>-</b>	<b>125</b>	<b>6.5</b>	<b>0.2</b>
	<b>3,542</b>	<b>2,091</b>	<b>1,451</b>	<b>6.0</b>	<b>21.3</b>

	Total	Floating rate financial liabilities	Fixed rate financial liabilities		
			Weighted average interest rate	Weighted average period for which rate is fixed	Years
	£m	£m	£m	%	Years
<b>At 31 December 2006</b>					
Sterling	3,613	3,231	382	6.7	10.8
Euros	336	159	177	5.0	2.5
Dollars	460	-	460	7.1	0.7
	4,409	3,390	1,019	6.6	4.8

The figures in the above table are stated after taking account of relevant interest rate swap contracts. The floating rate financial liabilities bear interest at variable rates. The floating rates are determined with reference to Sterling LIBOR.

The minimum lease payments under finance leases fall due as follows:

	<b>At 31 December 2007</b>	At 31 December 2006
	<b>£m</b>	£m
Within one year	<b>19</b>	18
Within two to five years	<b>-</b>	20
	<b>19</b>	38
Future finance charges on finance leases	<b>(1)</b>	(2)
Present value of finance lease liabilities	<b>18</b>	36

The Group has one significant finance lease that is secured on the assets of a power station. There are no provisions for renewal of the lease or purchase of the assets by the lessor or any escalation clauses on the payments. The amounts payable are recalculated annually based on prevailing interest rates. Legal ownership of the assets transfer to the Group upon final payment on the lease agreement.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**20 Financial derivatives**

**Treasury instruments**

As part of the financing of its normal operating activities, the Group is permitted to hold a variety of financial instruments including swaps, forwards and options. These may be assets, liabilities or related commitments depending on requirements. These instruments are denominated in Sterling or foreign currencies and have various maturities and interest rates. Active steps are taken to manage treasury risks, both by management of the portfolio of financial instruments themselves, and by the use of derivative financial instruments.

The objectives, policies and strategies connected with the use of financial instruments are discussed in the 'Treasury management' section of the Financial Review.

**Commodity instruments**

Within the ordinary course of business the Group routinely enters into sale and purchase transactions for commodities. Several contracts were entered into and continue to be held for the purpose of the receipt or delivery of the commodity in accordance with the Group's expected sale, purchase or usage requirements. Such contracts are not in the scope of IAS 39.

Certain commodity contracts are held for trading and are within the scope of IAS 39. These are recognised on the balance sheet at fair value with the movements in fair value recognised in the Group income statement. The Group also uses commodity derivative instruments to manage fluctuations in commodity prices. Such contracts include forward contracts and swaps. Where these derivatives have been designated as cash flow hedges of underlying commodity price exposures, certain gains and losses attributable to these instruments are deferred in equity and recognised in the income statement when the hedged transaction crystallises. Commodity derivatives that are not part of a hedging relationship are recognised in the balance sheet at fair value with movements in fair value recognised in the income statement.

**Valuation**

The fair value of derivative instruments is sensitive to movements in underlying market rates and other relevant variables. The Group 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 financial instruments:

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**20 Financial derivatives (continued)**

- Currency and commodity forward contracts, swaps and emission 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.
- 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.
- Certain long-term energy contracts, including options, are valued by the use of valuation models. These models use probability weighted expected values for gas prices and other indices, taking into account individual contract details such as volume and price formula.

**Embedded derivatives**

In accordance with IAS 39, 'Financial instruments: Recognition and measurement', the Group has reviewed all material contracts for embedded derivatives. Embedded derivatives are required to be separately accounted for if they do not meet certain requirements set out in the standard.

The Group has identified several embedded derivatives within its long-term gas contracts. These contracts satisfy the criteria of paragraph 5 of IAS 39 whereby the contracts were entered into and continue to be held for the purpose of the receipt or delivery of gas in accordance with the entity's expected usage requirements. The contracts do not therefore have to be recorded at fair value in their entirety on the balance sheet. The embedded derivative elements of the contracts are required to be valued and recorded as assets or liabilities on the balance sheet. The embedded derivatives relate to price indexation clauses within the contracts that are not deemed to be closely related to the economic characteristics and risks of the host contracts. The contracts were entered into at a time when such indexations were prevalent across the industry.

The fair values of the embedded derivatives are calculated as the difference between the fair value of the entire contract (host plus embedded derivative) and the fair value of the host contract. The total liability related to embedded derivatives is £81 million (2006: £33 million). Gains and losses arising from the movement in the value of embedded derivatives flow through the income statement as hedge accounting is not available.

During 2007, £48 million was charged (2006: £89 million credit) to the income statement in respect of fair value movements related to embedded derivatives.

E.ON UK PLC

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**20 Financial derivatives (continued)**

Maturities of derivative financial instruments designated as cash flow hedges at the balance sheet date were:

	Contracts with positive fair values (£m)		Contracts with negative fair values (£m)	
	At 31 December 2007	At 31 December 2006	At 31 December 2007	At 31 December 2006
Cross-currency swaps				
Less than 1 year	-	-	(15)	(24)
1 to 5 years	-	-	-	(12)
Commodity forward contracts				
Less than 1 year	3	2	(26)	(137)
1 to 5 years	-	-	-	(14)
	<b>3</b>	<b>2</b>	<b>(41)</b>	<b>(187)</b>

Derivative financial instruments not designated as hedges at the balance sheet date and all classified as current were:

	Contracts with positive fair values (£m)		Contracts with negative fair values (£m)	
	At 31 December 2007	At 31 December 2006	At 31 December 2007	At 31 December 2006
Interest rate swaps	-	4	-	-
Cross-currency swaps	41	9	-	(18)
Foreign currency forward contracts	34	4	(16)	(26)
Commodity swaps	440	74	(400)	(80)
Commodity forward contracts	1,202	1,300	(1,119)	(1,626)
Embedded derivatives within long-term gas contracts	-	-	(81)	(33)
Options	3	3	(4)	(2)
	<b>1,720</b>	<b>1,394</b>	<b>(1,620)</b>	<b>(1,785)</b>

Derivative financial instruments are classified within current assets and current liabilities unless they form part of a designated hedge relationship, when they are classified according to the period in which the hedging relationship is expected to expire.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**20 Financial derivatives (continued)**

The notional principal amount of derivatives are as follows:

	<b>At 31 December 2007 £m</b>	At 31 December 2006 £m
Interest rate swaps	515	336
Cross-currency swaps	492	799
Foreign currency forward contracts	1,255	666
Commodity swaps	2,424	1,082
Commodity forward contracts	11,962	10,051
Embedded derivatives within long-term gas contracts	762	682
Options	5	4
	<b>17,415</b>	<b>13,620</b>

Amounts within 1 year include the following instruments that are not designated as hedging instruments and expire over extended periods: Embedded derivatives relating to long-term gas contracts that expire over the period to 2012 and interest rate swaps, cross-currency swaps, foreign currency forward contracts, commodity swaps and commodity forward contracts that expire over the next 5 years.

Pursuant to currently available information, the following effects will accompany the reclassification of cash flow hedges from other reserves to the income statement in subsequent periods:

**Timing of reclassifications from other reserves to the income statement - 2007**

	<b>Carrying Amount £m</b>	<b>2008 £m</b>	<b>2009 £m</b>	<b>2010-2012 £m</b>	<b>&gt; 2012 £m</b>
Other reserves – Currency cash flow hedges	1	1	-	-	-
Other reserves – Commodity cash flow hedges	(12)	(12)	-	-	-

**Timing of reclassifications from other reserves to the income statement - 2006**

	<b>Carrying Amount £m</b>	<b>2007 £m</b>	<b>2008 £m</b>	<b>2009-2011 £m</b>	<b>&gt; 2011 £m</b>
Other reserves – Currency cash flow hedges	7	6	1	-	-
Other reserves – Commodity cash flow hedges	148	148	-	-	-

At 31 December 2007, the Group held £46 million (2006: £34 million) of financial assets in the form of Sterling bank deposits. These deposits earn interest at floating rates, fixed in advance for periods up to three months, by reference to Sterling LIBID.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments**

The following table shows the carrying amounts of the financial instruments, their grouping into IAS 39 categories, their fair values and their measurement sources:

<b>As at 31 December 2007</b>	<b>Carrying amounts</b>	<b>Total carrying amounts within the scope of IFRS 7</b>	<b>IAS 39 measurement category [1]</b>	<b>Fair value</b>	<b>Of which: Determined using market prices</b>
Receivables from finance leases	30	30	-	30	-
Trade receivables	1,580	1,580	L&R	1,580	-
Derivative assets with hedging relationships	3	3	-	3	3
Derivative assets with no hedging relationships	1,720	1,720	HfT	1,720	1,644
Other operating assets	397	119	L&R	119	-
Cash and cash equivalents	46	46	AfS	46	46
Securities and fixed-term deposits	18	18	AfS	18	18
Bonds	(725)	(725)	AmC	(761)	(761)
Bank loans / liabilities to banks	(6)	(6)	-	(6)	(6)
Liabilities from finance leases	(18)	(18)	-	(18)	-
Trade payables	(458)	(458)	AmC	(458)	-
Other operating liabilities	(973)	(973)	AmC	(973)	-
Borrowings: amounts falling due after more than one year	(1,460)	(1,460)	AmC	(1,643)	(1,083)
Borrowings: amounts falling due within one year	(1,333)	(1,333)	AmC	(1,333)	-
Derivative liabilities with no hedging relationships	(1,620)	(1,620)	HfT	(1,620)	(1,509)
Derivative liabilities with hedging relationships	(41)	(41)	-	(41)	(41)

[1] AfS: Available for sale; L&R: Loans and receivables; HfT: Held for trading; AmC: Amortised cost



**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

<b>As at 31 December 2006</b>	<b>Carrying amounts</b>	<b>Total carrying amounts within the scope of IFRS 7</b>	<b>IAS 39 measurement category [1]</b>	<b>Fair value</b>	<b>Of which: Determined using market prices</b>
Receivables from finance leases	16	16	-	16	-
Trade receivables	2,275	2,275	L&R	2,275	-
Derivative assets with hedging relationships	2	2	-	2	2
Derivative assets with no hedging relationships	1,394	1,394	HfT	1,394	1,377
Other operating assets	230	96	L&R	96	-
Cash and cash equivalents	34	34	AfS	34	34
Securities and fixed-term deposits	18	18	AfS	18	18
Bonds	(1,183)	(1,183)	AmC	(1,239)	(1,239)
Bank loans / liabilities to banks	(22)	(22)	-	(22)	(22)
Liabilities from finance leases	(36)	(36)	-	(36)	-
Trade payables	(908)	(908)	AmC	(908)	-
Other operating liabilities	(896)	(896)	AmC	(896)	-
Borrowings: amounts falling due after more than one year	(240)	(240)	AmC	(240)	-
Borrowings: amounts falling due within one year	(2,928)	(2,928)	AmC	(2,928)	-
Derivative liabilities with no hedging relationships	(1,785)	(1,785)	HfT	(1,785)	(1,672)
Derivative liabilities with hedging relationships	(187)	(187)	-	(187)	(187)

[1] AfS: Available for sale; L&R: Loans and receivables; HfT: Held for trading; AmC: Amortised cost

The carrying amounts of cash and cash equivalents, trade receivables and trade payables are considered reasonable estimates of their fair values because of their short maturity.

Where financial instruments are listed on an active market, the respective price quotes at that market constitute the fair value. This applies in particular to equities held and bonds issued.

The fair value of shareholdings in unlisted companies and of debt securities that are not actively traded, such as loans received, loans granted and financial liabilities, is determined by discounting future cash flows. Discounting takes place using current customary market interest rates through the remaining terms of the financial instruments.

The fair value of commercial paper and borrowings under revolving short-term credit facilities and of trade receivables is used as the fair value due to the short maturities of these instruments. See Note 20 for information on the determination of the fair value of derivative financial instruments.

E.ON UK PLC

**Notes to the financial statements  
for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

The following two tables illustrate the contractually agreed (undiscounted) cash outflows arising from the financial liabilities included in the scope of IFRS 7:

<b>As at 31 December 2007</b>	<b>Cash outflows 2008 £m</b>	<b>Cash outflows 2009 £m</b>	<b>Cash outflows 2010-2012 £m</b>	<b>Cash outflows from 2013 £m</b>
Bonds	163	401	47	430
Bank loans / liabilities to banks	6	-	-	-
Liabilities from finance leases with third parties	19	-	-	-
Other financial liabilities	1,963	55	164	2,267
<b>Cash outflows for financial liabilities</b>	<b>2,151</b>	<b>456</b>	<b>211</b>	<b>2,697</b>
Trade payables	458	-	-	-
Derivatives (with/without hedging relationships)	5,093	1,850	297	-
Other operating liabilities	973	-	-	-
<b>Cash outflows for trade payables and other operating liabilities</b>	<b>6,524</b>	<b>1,850</b>	<b>297</b>	<b>-</b>
<b>Total cash outflows for liabilities under IFRS 7</b>	<b>8,675</b>	<b>2,306</b>	<b>508</b>	<b>2,697</b>

<b>As at 31 December 2006</b>	<b>Cash outflows 2007 £m</b>	<b>Cash outflows 2008 £m</b>	<b>Cash outflows 2009-2011 £m</b>	<b>Cash outflows from 2012 £m</b>
Bonds	554	164	399	445
Bank loans / liabilities to banks	20	2	-	-
Liabilities from finance leases with third parties	18	20	-	-
Other financial liabilities	3,278	2	-	-
<b>Cash outflows for financial liabilities</b>	<b>3,870</b>	<b>188</b>	<b>399</b>	<b>445</b>
Trade payables	908	-	-	-
Derivatives (with/without hedging relationships)	3,291	210	348	-
Other operating liabilities	896	-	-	-
<b>Cash outflows for trade payables and other operating liabilities</b>	<b>5,095</b>	<b>210</b>	<b>348</b>	<b>-</b>
<b>Total cash outflows for liabilities under IFRS 7</b>	<b>8,965</b>	<b>398</b>	<b>747</b>	<b>445</b>

For financial liabilities that bear floating interest rates, the rates that were fixed on the balance sheet date are used to calculate future interest payments for subsequent periods as well. Financial liabilities that can be terminated at any time are assigned to the earliest maturity time band in the same way as put options that are exercisable at any time.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

In gross-settled derivatives (usually currency derivatives and commodity derivatives), outflows are accompanied by related inflows of funds or commodities.

Gains and losses on the disposal of available-for-sale securities and equity investments are reported under other operating income and other operating expenses, respectively.

**Risk management**

**Principles**

The prescribed processes, responsibilities and actions concerning financial and risk management are described in detail in internal risk management guidelines applicable throughout the E.ON AG Group. A new department was set up in 2007 at E.ON AG level to manage all risk controlling and reporting in the area of commodities, while risk controlling and reporting in the areas of interest rates and currencies remains the responsibility the Financial Controlling department of E.ON AG.

The Group uses an E.ON AG Group-wide treasury, risk management and reporting system. This system is a standard information technology solution and is both fully integrated and continuously updated. The system is designed to provide for the analysis and monitoring of the E.ON AG Group's exposure to liquidity, foreign exchange and interest risks. The market units employ established systems for commodities. Counterparty risks are monitored on an E.ON AG Group-wide basis by Financial Controlling, with the support of a standard software package.

A separate Risk Committee is responsible for the maintenance and further development of the strategy set by the Board of Management of E.ON AG with regard to commodity and credit risk management policies. See financial review section for further details.

The following discussion of the Group'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, unforeseeable developments in the global financial markets. The methods used by the Group to analyse risks, as discussed below, should not be considered projections of future events or losses. The Group 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.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

**Foreign exchange risk management**

Due to the international nature of some of its business activities, the E.ON AG Group is exposed to exchange risks related to sales, assets, receivables and liabilities denominated in foreign currencies, investments in foreign operations and anticipated foreign exchange payments. The Group's exposure results mainly from transactions in US dollars, Euros, and from net investments in foreign operations.

The foreign exchange risk arising from net investments in foreign operations with a functional currency other than sterling is reduced at E.ON AG Group level as needed through hedges of net investments. In addition, borrowings are made in foreign currency to control foreign exchange risks.

In line with the Group's internal risk-reporting process and 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 (or "VaR") is equal to the maximum potential loss (on the basis of a probability of 99 percent) from foreign-currency 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.

The one day VaR from the translation of deposits and borrowings denominated in foreign currency, plus foreign currency derivatives, amounted to £0.4 million (2006: £0.2 million) and, as in 2006, resulted primarily from the open positions denominated in Euros and US dollars. The increase in the VaR over the previous year is due in particular to the increased volatility of the EUR/GBP exchange rate and to overall higher volumes denominated in foreign currency.

This VaR has been calculated in accordance with the requirements of IFRS 7. In practice, however, another value will result, since certain underlying transactions (eg scheduled transactions and off-balance-sheet own-use agreements) are not considered in the calculation according to IFRS 7.

**Interest risk management**

Several line items on the Consolidated Balance Sheet and certain financial derivatives are based on fixed interest rates, and are therefore subject to changes in fair value resulting from changes in market rates. In the case of balance sheet items and financial derivatives based on floating interest rates, the Group is exposed to profit risks. The Group seeks to maintain an appropriate mix of fixed and floating rate debt in its overall debt portfolio. As of 31 December 2007, the Group has entered into interest rate swaps with a nominal value of £515 million (2006: £336 million).

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

A sensitivity analysis was performed on the Group's short-term and variable-rate borrowings, including interest rate derivatives. A one-percent increase (decline) in the level of interest rates would cause net interest expense to rise (fall) by £21 million per annum (2006: £25 million).

**Commodity price risk management**

The Group is exposed to substantial risks resulting from fluctuations in the prices of commodities, both on the supply and demand side. This risk is measured based on potential negative deviation from the target adjusted Earnings Before Interest and Tax (EBIT).

The maximum permissible risk is determined centrally by the Board of Management of E.ON AG in its medium-term planning and translated into a decentralised limit structure in coordination with the market units. Before fixing any limits, the investment plans and all other known obligations and quantifiable risks have been taken into account.

E.ON UK conducts commodity transactions primarily within the system portfolio, which includes core operations, existing sales and procurement contracts and any energy derivatives used for hedging purposes or for power plant optimisation. The risk in the system portfolio thus arises from the open position between planned procurement and generation and planned sales volumes. The risk of these open positions is measured using the profit-at-risk ("PaR") number, which quantifies the risk by taking into account the size of the open position and the prices, the volatility and the liquidity of the underlying commodities. PaR is defined as the maximum potential negative change in the value of the portfolio at a probability of 95 percent in the event that the open position is closed as quickly as possible.

The principal derivative instruments used by E.ON UK to cover commodity price risk exposures are electricity, gas, coal and oil swaps and forwards, as well as emissions-related derivatives. Commodity derivatives are used by the Group for the purposes of price risk management, system optimisation, equalisation of burdens and improvement of margins. Proprietary trading is permitted only within very tightly defined limits. The risk metric used for the proprietary trading portfolio is a five day VaR with a 95-percent confidence interval.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

The trading limits for proprietary trading as well as for all other trading activities are established and monitored by bodies that are independent from trading operations. Limits used on hedging and proprietary trading activities include five day VaR and PaR numbers, as well as stop-loss limits. Additional key elements of the risk management system are a set of E.ON AG Group-wide commodity risk guidelines, the clear division of duties between scheduling, trading, settlement and controlling, as well as a risk reporting system independent of the trading operations. E.ON AG Group-wide developments in commodity risks are reported to the Risk Committee on a monthly basis.

As of 31 December 2007, E.ON UK has entered into electricity, gas, coal, oil and emissions-related derivatives with a nominal value of £15,153 million (2006: £11,819 million).

The VaR for the proprietary trading portfolio amounted to £4 million as of 31 December 2007 (2006: £6 million). The PaR for the financial instruments included in the scope of IFRS 7 contained in the system portfolio was £27 million as of 31 December 2007 (2006: £4 million).

The restriction to financial instruments included in the scope of IFRS 7 that has been applied in this calculation does not reflect the economic position of the E.ON Group. Consequently, none of the off-balance sheet transactions, such as own-use contracts under normal trading relationships, may be included when calculating the PaR according to IFRS 7, even though such transactions represent a material component of the economic position. The PaR reflecting the actual economic position therefore differs significantly from the PaR determined in accordance with IFRS 7.

**Equity risk**

The value of all exchange-traded equity holdings on the balance sheet date was £2 million (2006: £2 million). This relates to the Group's interest in National Grid. This holding is treated as strategic and is not being hedged at this time. All exchange-traded equity holdings are classified as available for sale. Changes in value are generally shown as a change in other reserves.

**Credit risk management**

Credit risk management involves the identification, measurement and control of credit risks. Credit risk results from non-delivery or partial delivery by a counterparty of the agreed consideration for services rendered or of payments owing on existing accounts receivable and from the additional expenses for replenishment of the funds thus lost.

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

In order to minimise credit risk arising from the use of financial instruments and from operating activities, the Group enters into transactions only with counterparties that satisfy the E.ON AG Group's internally-established minimum requirements. Maximum credit risk limits are set on the basis of internally established credit quality ratings. The setting and monitoring of credit limits is subject to certain minimum requirements applicable throughout the Group. Not included in this process are long-term contracts arising from the operating activities and asset management transactions. Some of these are monitored separately at E.ON UK plc level.

Monthly reports on the levels of credit limits, and on their usage by significant counterparties in the areas of financial and energy trading, are forwarded to the E.ON AG Risk Committee. The carrying amounts of primary and derivative financial assets plus the financial guarantees made represent the maximum credit risk as of the reference date.

Derivative transactions are generally executed on the basis of standard agreements that allow for the netting of all outstanding transactions with individual counterparties. Although the greater part of the transactions was completed on the basis of contracts that do allow netting, the table below does not show netting of positive and negative fair values of continuous transactions. Moreover, collateral received is not taken into account. This means that the counterparty risk is shown to be higher in the following table than it actually is.

The credit ratings and maturities of the Group's derivative financial instruments are shown. The nominal values in the table represent the notional values of the derivatives and the counterparty risk is the positive fair value exposure on the derivatives.

E.ON UK PLC

**Notes to the financial statements  
for the year ended 31 December 2007 (continued)**

**21 Additional disclosures on financial instruments (continued)**

Rating of counterparties <b>31 December 2007</b> <b>(£m)</b>	<b>Total</b>		<b>up to 1 year</b>		<b>1 - 5 years</b>		<b>more than 5 years</b>	
	Nominal	Counter party	Nominal	Counter party	Nominal	Counter party	Nominal	Counter party
	value	risk	value	risk	value	risk	value	risk
AAA and Aaa through AA- and Aa3	5,901	1,167	3,696	474	2,205	693	-	-
AA- and A1 or A+ and Aa3 through A- and A3	6,340	990	4,728	706	1,612	284	-	-
A- and Baa1 or BBB+ and A3 through BBB- and Baa3	1,655	183	1,245	140	410	43	-	-
BBB- and Ba1 or BB+ and Baa3 through BB- and Ba3	644	64	620	59	24	5	-	-
Other	199	21	178	18	21	3	-	-
	<b>14,739</b>	<b>2,425</b>	<b>10,467</b>	<b>1,397</b>	<b>4,272</b>	<b>1,028</b>	-	-

Rating of counterparties <b>31 December 2006</b> <b>(£m)</b>	<b>Total</b>		<b>up to 1 year</b>		<b>1 - 5 years</b>		<b>more than 5 years</b>	
	Nominal	Counter party	Nominal	Counter party	Nominal	Counter party	Nominal	Counter party
	value	risk	value	risk	value	risk	value	risk
AAA and Aaa through AA- and Aa3	5,710	1,137	3,253	518	2,369	619	88	-
AA- and A1 or A+ and Aa3 through A- and A3	4,255	675	2,701	435	1,511	240	43	-
A- and Baa1 or BBB+ and A3 through BBB- and Baa3	1,462	130	838	102	490	28	134	-
BBB- and Ba1 or BB+ and Baa3 through BB- and Ba3	565	28	429	23	130	5	6	-
Other	239	10	178	10	61	-	-	-
	<b>12,231</b>	<b>1,980</b>	<b>7,399</b>	<b>1,088</b>	<b>4,561</b>	<b>892</b>	<b>271</b>	-



## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 22 Pension scheme arrangements

At 31 December 2007, E.ON UK had three registered pension schemes. The main E.ON UK pension scheme is the E.ON UK Group of the Electricity Supply Pension Scheme ("the Scheme"). This is a funded scheme with several different benefit categories, largely defined benefit type. An actuarial valuation of the Scheme is normally carried out every three years by the Scheme's independent actuary, who recommends the rates of contribution payable by participating employers. In intervening years the actuary reviews the continuing appropriateness of the rates. The last actuarial valuation of the Scheme was as at 31 March 2007.

The principal actuarial assumptions used to calculate the defined benefit pension balances in the financial statements were:

	<b>At 31 December 2007</b>	At 31 December 2006
Average nominal rate of annual increase in salaries	4.20%	4.00%
Average nominal rate of annual increase in pensions	3.20%	3.00%
Discount rate	5.80%	5.10%
Inflation rate	3.20%	3.00%

In determining the defined benefit obligation as at 31 December 2007 for the EON UK schemes, mortality assumptions are based on the '00 Series' tables, issued by the Institute and Faculty of Actuaries, updated to calendar year 2007. An allowance has been made for future longevity improvements using an adjustment that is approximately in line with the projections in the CMI Bureau's medium cohort tables. These tables have been adjusted by appropriate scaling factors, taking into account the results of the mortality investigation carried out on behalf of the Trustees of the E.ON Group of the Electricity Supply Pension Scheme. The assumptions used are as follows:

	<b>At 31 December 2007</b>	
Life expectancy at age 65 for a member:	<b>Male</b>	<b>Female</b>
Currently aged 60	26 Years	28 Years
Who retires in 2025	27 Years	29 Years

The indicative impact on scheme liabilities of changing the discount rate assumption by 0.25% is +/- 3.9%. The indicative impact on scheme liabilities of changing pensioner life expectancy by one year is +/- 2.5%.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**22 Pension scheme arrangements (continued)**

The amounts recognised in the balance sheet are as follows:

	<b>At 31 December 2007</b>	At 31 December 2006	At 31 December 2005
	<b>£m</b>	£m	£m
Fair value of plan assets	<b>5,103</b>	4,969	4,917
Present value of funded obligations	<b>(5,226)</b>	(5,014)	(5,135)
	<b>(123)</b>	(45)	(218)
Present value of unfunded obligations	<b>(15)</b>	(20)	(22)
Net liability recognised in the balance sheet	<b>(138)</b>	(65)	(240)

The amounts recognised in the income statement are as follows:

	<b>Year ended 31 December 2007 £m</b>	Year ended 31 December 2006 £m
Current service cost	<b>50</b>	45
Interest cost	<b>253</b>	240
Expected return on plan assets	<b>(285)</b>	(261)
Curtailement	<b>7</b>	8
Net cost recognised in the income statement	<b>25</b>	32

Changes in the present value of the defined benefit obligation are as follows:

	<b>Year ended 31 December 2007 £m</b>	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Opening defined benefit obligation	<b>5,034</b>	5,157	4,704
Service cost	<b>50</b>	45	32
Interest cost	<b>253</b>	240	243
Transfers in	<b>33</b>	-	26
Actuarial losses / (gains)	<b>112</b>	(169)	374
Curtailement	<b>7</b>	8	28
Contributions by plan participants	<b>17</b>	14	12
Benefits paid	<b>(265)</b>	(261)	(262)
Closing defined benefit obligation	<b>5,241</b>	5,034	5,157

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**22 Pension scheme arrangements (continued)**

Changes in the fair value of plan assets are as follows:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Opening fair value of plan assets	4,969	4,917	3,907
Expected return on scheme assets	285	261	263
Transfers in	33	-	26
Actuarial gains / (losses)	11	(14)	484
Contributions by employer	53	52	487
Contributions by plan participants	17	14	12
Benefits paid	(265)	(261)	(262)
	<b>5,103</b>	4,969	4,917

The Group expects to contribute £46 million to its defined benefit pension plans in the year to 31 December 2008. In addition to this, during 2008 to 2013, a special contribution of £61 million a year will be made by the Group to reduce the deficit in the Scheme.

The expected returns on the major categories of plan assets and their fair value as a percentage of total plan assets are as follows:

	Expected return		Fair value of assets	
	At 31 December 2007 %	At 31 December 2006 %	At 31 December 2007 %	At 31 December 2006 %
Equity instruments	8.6	8.6	25	27
Debt instruments	4.9	4.9	64	64
Property	7.7	7.7	7	6
Other assets	-	-	4	3
	<b>5.9</b>	5.9	<b>100</b>	100

E.ON UK employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The overall expected rate of return on assets is derived by aggregating the expected return for each asset class over the benchmark asset allocation. The benchmark asset allocation is 70% bonds, 20% equities and 10% property. No assumption is set for the other assets category.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**22 Pension scheme arrangements (continued)**

The actual return on scheme assets is shown below:

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Expected return on scheme assets	285	261
Actuarial gain / (loss) on scheme assets	11	(14)
Actual return on scheme assets	<b>296</b>	247

In 2006, the Group changed its accounting policy for post retirement benefits in order to be in line with E.ON AG Group policy. This has resulted in annual actuarial gains and losses passing through retained earnings.

**Cumulative actuarial gains and losses recognised in equity:**

	At 31 December 2007 £m	At 31 December 2006 £m
Gain / (loss) at start of year	128	(27)
Actuarial (losses) / gains recognised in the year	(101)	155
Gain at end of year	<b>27</b>	128

**History of experience adjustments:**

	At 31 December 2007 £m	At 31 December 2006 £m	At 31 December 2005 £m	At 31 December 2004 £m
Fair value of scheme assets	5,103	4,969	4,917	3,907
Present value of defined benefit obligations	(5,241)	(5,034)	(5,157)	(4,704)
Deficit in the scheme	(138)	(65)	(240)	(797)
Experience adjustments on plan liabilities				
Amounts (£m)	(112)	169	(374)	(252)
Percentage of scheme liabilities (%)	2.1%	3.4%	7.3%	5.4%
Experience adjustments on plan assets				
Amounts (£m)	11	(14)	484	115
Percentage of scheme assets (%)	0.2%	0.3%	9.8%	2.9%

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 23 Provisions

Movements on provisions comprise:

	At 31 December 2006	Charged / (released) to the income statement	Revision of estimated cash flows	Accretion of discount	Provisions utilised	<b>At 31 December 2007</b>
	£m	£m	£m	£m	£m	<b>£m</b>
Liability and damage claims	1	-	-	-	(1)	-
Decommissioning	65	-	(2)	2	(1)	<b>64</b>
Contract provisions	61	(25)	-	-	-	<b>36</b>
Restructuring	1	-	-	-	-	<b>1</b>
Emissions obligations	60	103	-	-	(60)	<b>103</b>
ROCs	14	33	-	-	(14)	<b>33</b>
Share based payments	4	4	-	-	(4)	<b>4</b>
	<b>206</b>	<b>115</b>	<b>(2)</b>	<b>2</b>	<b>(80)</b>	<b>241</b>

Provisions have been analysed between current and non-current as follows:

	<b>At 31 December 2007 £m</b>	At 31 December 2006 £m
Current	<b>157</b>	116
Non-current	<b>84</b>	90
	<b>241</b>	206

Decommissioning provisions comprise amounts set aside for the estimated costs of terminating power station grid connections, decommissioning power stations and subsequent site restoration costs at UK power stations which will be utilised as each power station closes.

Contract provisions at 31 December 2007 primarily relate to certain out of the money CHP contracts. The provisions will be utilised over the onerous portions of the contracts, currently estimated to be years up to and including 2020.

Restructuring provisions relate to the acquisition of Midlands Electricity and subsequently merging it with Central Networks East plc.

Emissions obligations provisions represent amounts payable to national authorities for emissions made during the year.

ROCs represent the value of certificates payable to national authorities for the Group's activities during the year.

Share based payments are fully described in Note 26.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 23 Provisions (continued)

The Group's provisions include £36 million (2006: £61 million) for contract provisions which meet the definition of financial liabilities under IAS 39. These financial liabilities are considered to be floating rate liabilities as, in establishing the provisions, the cash flows have been discounted. The discount rate is re-appraised at each reporting date to ensure that it reflects current market assessments of the time value of money and the risks specific to the liability.

#### 24 Deferred tax

An analysis of the provision for deferred tax recognised at 31 December 2007 is as follows:

	At 31 December 2007 £m	At 31 December 2006 £m
Accelerated capital allowances	782	800
Other temporary differences	(65)	(294)
Provision for deferred tax	<u>717</u>	<u>506</u>
Provision at 1 January	506	841
Acquisitions and disposals	-	(5)
Deferred tax charge / (credit) for year	199	(280)
Taken to equity	12	(50)
Provision at end of year	<u>717</u>	<u>506</u>

The deferred tax on items charged directly to equity is that arising on the current year movements in cashflow hedges and actuarial gains and losses.

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**24 Deferred tax (continued)**

	At 31 December 2007 £m	At 31 December 2006 £m
Intangibles	21	10
Investments	(7)	(7)
Property, plant and equipment	782	800
Receivables	(11)	(7)
Derivatives	15	(176)
Financial liabilities	3	16
Operating liabilities	(1)	(2)
Pensions provision	(72)	(90)
Other provisions	1	(12)
ACT	-	(33)
Unrealised capital losses	7	8
Windfarm PPA	(18)	-
Other	(3)	(1)
Deferred tax liability	<u>717</u>	<u>506</u>

The deferred tax liability due after more than one year is £717 million (2006: £506 million).

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 25 Share capital

The share capital of the Company comprises:

	At 31 December 2007 £m	At 31 December 2006 £m
<b>Authorised</b>		
3,050,000,002 ordinary shares of 50p each (2006: 1,050,000,002 ordinary shares of 50p each)	<b>1,525</b>	525
<b>Allotted, called-up and fully paid</b>		
2,649,241,799 ordinary shares of 50p each (2006: 649,241,799 ordinary shares of 50p each)	<b>1,325</b>	325

On 21 December 2007, the authorised share capital of the Company was increased from £525,000,000 to £1,525,000,000 by the creation of 2,000,000,000 new ordinary shares of £0.50 each ranking pari passu in all respects with the existing ordinary shares of £0.50 each in the capital of the Company. On the same date, 2,000,000,000 ordinary shares of £0.50 each were issued to Powergen Group Investments at par value.



## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 26 Share based payments

##### Stock Appreciation Rights (SAR's)

In 1999, the E.ON AG Group introduced a stock-based compensation plan, SARs, based on E.ON AG shares. In 2002, E.ON UK issued the fourth tranche of SARs to E.ON UK plc directors and certain qualified executives for the first time, following the acquisition by E.ON AG. This plan ended in 2005.

In 2007, the remainder of the seventh tranche of SARs was exercised in full. SARs from the fourth and fifth tranches may still be exercised in accordance with the terms and conditions of the SARs. In 2007, the following obligations from the fourth to seventh tranches were outstanding. The terms of the SARs are based in Euros (€) and information is presented in Euros below.

	<b>Tranche 7</b>	<b>Tranche 6</b>	<b>Tranche 5</b>	<b>Tranche 4</b>
Date of issuance	3 January 2005	2 January 2004	2 January 2003	2 January 2002
Term	7 years	7 years	7 years	7 years
Vesting period	2 years	2 years	2 years	2 years
Price at issuance (€) *	61.10	44.80	37.86	50.70
Base price of Dow Jones STOXX Utilities Index (€)	268.66	211.58	202.14	262.44
Number of participants in year of issuance	31	13	21	18
Number of SARs issued	77,044	62,325	90,927	58,859
Exercise hurdle (exercise price exceeds the price at issuance by at least %)	10	10	10	10
Exercise hurdle (minimum exercise, €) *	67.21	49.28	41.65	55.77
Maximum exercise gain (€)	65.35	49.05	-	-
Out performance of benchmark index?	yes	yes	yes	yes

\* Adjusted for special dividend distribution

SARs can only be issued if the qualified executive owns a certain minimum number of shares of E.ON AG stock, which must be held until the issued SARs' expiration date or until all SARs have been exercised.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **26 Share based payments (continued)**

Following the expiration of a two year vesting period after issuance, qualified executives can exercise all or a portion of the SARs issued to them within predetermined exercise windows. These windows commence four weeks after the publication of an E.ON AG Interim Report or Annual Report in the years after the vesting period of the respective tranche's term. The term of the SARs is limited to a total of 7 years.

Both of the following two conditions must be met before SARs may be exercised:

- Between the date of issuance and exercise, the E.ON AG stock price must outperform the "Dow Jones STOXX Utilities Index (Price EUR)" on at least ten consecutive trading days.
- The E.ON AG stock price at the time of exercise must be at least 10 percent higher than the price at issuance.

SARs that remain unexercised by the qualified executive on the corresponding tranche's last exercise date are considered to have been exercised automatically on that date, subject to fulfilment of the exercise conditions. If the conditions are not met, the rights embodied in the SARs expire.

When exercising SARs, qualified executives receive cash. Possible dilutive effects on E.ON AG stock of capital related measures and extraordinary dividend payments between the SARs' time of issuance and exercise are taken into consideration when calculating such compensation.

The amount paid to qualified executives when they exercise their SARs is the difference between the E.ON AG stock price at the time of exercise and the underlying stock price at issuance multiplied by the number of SARs exercised. Beginning with the sixth tranche, a cap on gains on SARs equal to 100 percent of the strike price was put in place in order to limit the effect of unforeseen extraordinary increases in the price of the underlying stock. This cap on gains took effect for the first time in the 2006 fiscal year.

The underlying stock price equals the average XETRA closing quotations for E.ON AG stock during the December prior to issuance.

Once issued, SARs are not transferable and when the qualified executive leaves the E.ON AG Group they may be exercised according to the SARs' conditions either on the next possible allowed date or, if certain conditions have been fulfilled, prior to that date. If employment is terminated by the qualified executive, SARs expire and become void without compensation if such termination occurs within the two year vesting period or if the SARs are not exercised on the next possible exercise date.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 26 Share based payments (continued)

A recognised option pricing model (Monte Carlo simulation) is applied in order to determine the value of the SARs under IFRS 2. This option pricing model simulates a large number of different scenarios for the E.ON AG stock and the benchmark, the Dow Jones STOXX Utilities Index (Price EUR). The intrinsic value of the stock options is determined for each scenario. The calculated value of the options is equivalent to the discounted average of these intrinsic values.

The table on page 88 and the following table show the parameters used for the purpose of the valuation on the balance sheet date.

	Tranche 7	Tranche 6	Tranche 5	Tranche 4
Price of E.ON AG stock on 31 December 2007 (€)	145.59	145.59	145.59	145.59
Fair value on 31 December 2007 (€)	64.09	48.64	104.39	93.81
Swap rate (%)	4.43	4.42	4.45	4.55
Volatility of the E.ON AG stock (%)	25.61	25.47	24.44	21.97
Volatility of the Dow Jones STOXX Utilities Index (Price €) (%)	14.74	14.78	14.54	13.78
Correlation	0.7015	0.7191	0.7492	0.7845
Dividend yield of the E.ON share (in %)	2.30	2.30	2.30	2.30
Dividend yield of Dow Jones STOXX Utilities Index (Price €) (in %)	3.18	3.18	3.18	3.18

In this option price model, the corresponding historical volatilities and correlations of the E.ON AG stock and the Dow Jones STOXX Utilities Index (Price EUR) are applied to the term or remaining term of the respective tranches. The volatilities and correlations between the E.ON AG stock and the benchmark index are weighted at an exponentially decreasing rate. The swap rate is applied as the interest rate for the corresponding remaining maturity.

In 2007, 8,433 SARs (2006: 1,869) of tranche four, 12,665 SARs (2006: 6,268) of tranche five, nil (2006: 62,325) of tranche six and 65,520 SARs (2006: nil) of tranche seven were exercised on an ordinary basis. Of tranche seven, 7,013 SARs (2006: 4,511) were exercised on an extraordinary basis. No options were exercised prior to their normal exercise window and no SARs expired. The gain to the holders on exercise was £4.6 million (2006: £2 million).

The fair values of the fourth to seventh tranches are shown in the above table. Accordingly, the liability recognised on the balance sheet at 31 December 2007 amounted to £2 million (2006: £4 million). The total cost of the stock option program in 2007 amounted to £2 million (2006: £2 million).

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 26 Share based payments (continued)

The number of SARs, the liability recognised and the expenses arising from the E.ON AG SARs program were as follows:

	Tranche 7	Tranche 6	Tranche 5	Tranche 4
SARs outstanding as of 1 January 2006	77,044	62,325	38,496	13,836
SARs exercised in 2006	(4,511)	(62,325)	(6,268)	(1,869)
SARs outstanding as of 31 December 2006	72,533	-	32,228	11,967
SARs exercised in 2007	(72,533)	-	(12,665)	(8,433)
SARs outstanding as of 31 December 2007	-	-	19,563	3,534
SARs exercisable at year end	-	-	19,563	3,534
Provision as of 1 January 2006 (£m)	1	2	1	-
Gain to holders in 2006 (£m)	-	(2)	-	-
Expense in 2006 (£m)	1	-	1	-
Provision as of 31 December 2006 (£m)	2	-	2	-
Gain to holders in 2007 (£m)	(3)	-	(1)	-
Expense in 2007 (£m)	1	-	1	-
<b>Provision as of 31 December 2007 (£m)</b>	<b>-</b>	<b>-</b>	<b>2</b>	<b>-</b>
Average gain to holders per option in 2007 (£)	45.10	-	66.23	63.66

The average gain per stock option exercised during the year ended 31 December 2007 amounted to £45 in tranche 7 (2006: £19), £nil in tranche 6 (2006: £32), £66 in tranche 5 (2006: £234) and £64 in tranche 4 (2006: £26).

At 31 December 2007, the SARs of tranches four and five were exercisable.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 26 Share based payments (continued)

##### E.ON Share Performance Plan

In 2006, the E.ON AG Group introduced a new stock-based compensation plan, the E.ON Share Performance Plan, based on E.ON AG shares. During 2007, virtual shares ('Performance Rights') from the second tranche were granted to qualified executives for the first time.

The terms of the Performance Rights are based in Euros (€) and information is presented in Euros below:

	<b>Tranche 2</b>	<b>Tranche 1</b>
	1 January	1 January
Date of issuance	2007	2006
Term	3 years	3 years
Target value of compensation at issuance (€)	96.52	79.22
Number of participants in year of issuance	28	33
Number of Performance Rights issued	28,434	15,832
Maximum cash amount (€)	289.56	237.66

At the end of the three year term, each Performance Right is entitled to a cash payment linked to the final E.ON AG share price established at the time. The amount paid out will equal the target value of compensation if the following conditions are met:

- The E.ON AG stock price at the end of the term must equal the initial price at the beginning of the term.
- The performance of the E.ON AG stock price must match that of the "Dow Jones STOXX Utilities Index (Total Return EUR)" between the date of issuance and the exercise date.

The maximum amount paid out per Performance Right is limited to three times the original target value at grant date.

The calculation of the payment amount to participants takes place on the last day of the term of the tranche. The final share price is paid out if the performance of the E.ON AG stock matches that of the index. If the E.ON AG stock outperforms the index, the amount paid out is increased proportionally by one percent for each one percent of out performance. If the E.ON AG stock underperforms the index, disproportionate deductions of five percent are made for each one percent of underperformance. If the E.ON AG stock underperforms by 20 percent or more then no payment is made.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### **26 Share based payments (continued)**

The fair value of the Performance Rights in accordance with IFRS 2 is calculated using a recognised option pricing model (Monte Carlo simulation). This model simulates a large number of different scenarios for the E.ON AG stock and the benchmark, the Dow Jones STOXX Utilities Index (Total Return EUR). As all payments to plan participants take place on a specified date, no assumptions concerning exercise behaviour are made in this model.

The table below shows the parameters used for the purpose of the valuation on the balance sheet date.

	<b>Tranche 2</b>	<b>Tranche 1</b>
Price of E.ON AG stock on 31 December 2007 (€)	145.59	145.59
Fair value on 31 December 2007 (€)	163.59	158.72
Swap rate (%)	4.45	4.55
Volatility of the E.ON AG stock (%)	21.73	21.56
Volatility of the Dow Jones STOXX Utilities Index (Total Return €) (%)	13.46	13.81
Correlation	0.7977	0.8056
Dividend yield of the E.ON share (€)	2.30	2.30

At 31 December 2007, the cash amount from 3,340 of the first tranche of Performance Rights was paid out on an extraordinary basis in accordance with the terms and conditions of the plan. No other Performance Rights were exercised. In 2007, 166 Performance Rights from tranche 1 expired. The issue of a third tranche of the E.ON AG Share Performance Plan is planned for 2008.

The liability recognised on the balance sheet at 31 December 2007 amounted to £2 million (2006: £2 million). The total cost of the stock option program in 2007 amounted to £2 million (2006: £nil).

**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**26 Share based payments (continued)**

The number of Performance Rights, the liability recognised and the expenses arising from the E.ON Share Performance Plan were as follows:

	<b>Tranche 2</b>	<b>Tranche 1</b>
Performance Rights outstanding as of 1 January 2006	-	-
Performance Rights granted in 2006	-	15,832
Performance Rights outstanding as of 31 December 2006	-	15,832
Performance Rights granted in 2007	28,434	-
Performance Rights settled in 2007	-	(3,340)
Performance Rights expired in 2007	-	(166)
<b>Performance Rights outstanding at year end</b>	<b>28,434</b>	<b>12,326</b>
Provision as of 31 December 2006 (£m)	-	-
Expense in 2007 (£m)	1	1
<b>Provision as of 31 December 2007 (£m)</b>	<b>1</b>	<b>1</b>

**27 Share premium account**

	<b>2007</b>	<b>2006</b>
	<b>£m</b>	<b>£m</b>
At 1 January and 31 December	<b>97</b>	97

The share premium account is not available for distribution.

**28 Retained earnings**

	<b>£m</b>
At 1 January 2006	1,814
Retained loss for the year	(332)
Actuarial gains and losses (net of tax)	109
At 31 December 2006	1,591
Retained profit for the year	738
Actuarial gains and losses (net of tax)	(70)
Dividends (£0.09 per share paid on 21 December 2007)	(240)
<b>At 31 December 2007</b>	<b>2,019</b>

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 29 Other reserves

The Group	Capital redemption reserve £m	Special capital reserve £m	Available for sale investment reserves £m	Hedging reserve £m	Translation reserve £m	Revaluation reserve £m	Total £m
At 31 December 2005	85	474	1	118	(1)	24	701
Disposals	-	-	-	-	1	-	1
Cash flow hedges (net of tax)	-	-	-	(226)	-	-	(226)
At 31 December 2006	85	474	1	(108)	-	24	476
Cash flow hedges (net of tax)	-	-	-	100	-	-	100
<b>At 31 December 2007</b>	<b>85</b>	<b>474</b>	<b>1</b>	<b>(8)</b>	<b>-</b>	<b>24</b>	<b>576</b>

The special capital reserve and capital redemption reserve are not available for distribution. The special capital reserve was determined in accordance with the Transfer Scheme made pursuant to the Electricity Act 1989, under which the Central Electricity Generating Board's (CEGB) net assets were vested in its successor companies.

The revaluation reserve arose as a result of the step acquisitions of the renewables business and Cottam Development Centre Limited.

#### 30 Equity minority interests

The Group	2007 £m	2006 £m
At 1 January	(6)	-
Income statement	6	(2)
Dividends paid to minority interests	(2)	(4)
<b>At 31 December</b>	<b>(2)</b>	<b>(6)</b>



**E.ON UK PLC**

**Notes to the financial statements**  
**for the year ended 31 December 2007 (continued)**

**31 Cash flows from operating activities**

Reconciliation of net profit/(loss) to cash generated from operations:

	<b>Year ended 31 December 2007</b>	Year ended 31 December 2006
	<b>£m</b>	£m
Net profit /(loss)	<b>744</b>	(334)
Adjustments for:		
Tax charge/(credit)	<b>263</b>	(127)
Amortisation and impairment of intangible fixed assets	<b>62</b>	198
Depreciation and impairments of property, plant and equipment	<b>237</b>	248
Other impairments and onerous contract recognition	-	68
Loss on disposal of property, plant and equipment	<b>2</b>	1
Gains on disposal of property, plant and equipment	<b>(6)</b>	(1)
Profit on sale of investments	-	(18)
Net interest	<b>227</b>	239
Share of associate results after taxation	<b>(11)</b>	(4)
Non cash (gains)/losses on commodity and other derivative financial instruments	<b>(419)</b>	980
Other non-cash differences	<b>4</b>	-
Changes in working capital (excluding effects of acquisitions and disposal of subsidiaries)		
Decrease/(increase) in inventories	<b>74</b>	(142)
Decrease/(increase) in trade and other receivables	<b>1,065</b>	(282)
Decrease in payables	<b>(917)</b>	(72)
Decrease in pensions liability	<b>(28)</b>	(18)
Increase in provisions	<b>35</b>	36
<b>Cash generated from continuing operations</b>	<b>1,332</b>	772

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 32 Commitments and contingent liabilities

- a) At 31 December 2007, the Group had commitments contracted but not provided for of £627 million (2006: £327 million) for capital expenditure.
- b) The Group is aware of claims in respect of current and former employees, including former employees of the CEGB, and contractors in respect of industrial illness and injury and other potential claims which involve or may involve legal proceedings against the Group.

The directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions held, as appropriate, that it is unlikely that the matters referred to above will have a material effect on the Group's financial position, results of operations or liquidity.

- c) A complaint was made to the European Commission by the South Wales Small Mines Association (SWSMA) against, amongst others, the Company and National Power plc in 1990. The complaint alleged breaches of EU law by the CEGB in its coal purchasing practices prior to 1990. Under the arrangements for electricity privatisation, it is possible that either or both of the Company and National Power plc (through its successor companies) could be liable to pay any compensation that may ultimately arise.

The Commission rejected the complaint in 1998 on legal grounds and that decision was subsequently appealed by some former members of SWSMA. The appeal did not proceed to judgement because the Court of Justice of the European Communities held this to be without purpose in light of its decision in a parallel case, in which it overturned the Commission's rejection of a similar complaint. The Commission proceeded to carry out an investigation into the substantive merits of the complaint. By a decision dated 18 June 2007 the Commission rejected the SWSMA complaint, indicating that there were insufficient grounds for acting upon it. This decision has been appealed by members of SWSMA to the European Court of First Instance and the Company have been granted leave to intervene in that action.

- d) The Group has in place a portfolio of fuel contracts of varying volume, duration and price, reflecting market conditions at the time of commitment. These contracts are with UK and international suppliers of coal and are backed by transport contracts for rail, road, canal and sea movements. At 31 December 2007, the Group's future commitments for the supply of coal under all its contractual arrangements totalled £1,150 million (2006: £745 million).

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 32 Commitments and contingent liabilities (continued)

The Group is also committed to purchase gas under various long-term gas supply contracts including the supply of gas to the Group's three UK power stations. At 31 December 2007, the estimated minimum commitment for the supply of gas under all these contracts totalled £3,379 million (2006: £3,793 million).

The Group is also committed to power purchase contracts for the supply of electricity. At 31 December 2007 the total contractual commitment for the Group was £1,008 million (2006: £1,444 million).

- e) In the normal course of business the Group gives certain other indemnities and guarantees which are not considered to be material in the context of these financial statements and on which no losses are anticipated to arise.
- f) At 31 December 2007, the Group had the following operating lease commitments:

	31 December 2007		31 December 2006	
	Property £m	Other assets £m	Property £m	Other assets £m
Annual commitments under non-cancellable operating leases expiring:				
Within one year	26	4	32	7
Within two to five years	27	11	17	15
After five years	35	-	30	-
	<b>88</b>	<b>15</b>	79	22

The Group leases various offices and other buildings under non-cancellable operating lease arrangements. The leases have various terms, escalation clauses and renewal rights. The Group also leases certain other equipment under non-cancellable operating lease arrangements.

#### 33 Ultimate holding company

The immediate parent undertaking is Powergen Group Investments. The ultimate parent undertaking and controlling party is E.ON AG, a company incorporated in Germany, which is the parent company of the largest and smallest group to consolidate these financial statements. Copies of E.ON AG's accounts are available from the offices of E.ON AG at the following address:

E.ON AG  
E.ON-Platz 1  
D-40479  
Düsseldorf  
Germany

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 34 Related party transactions

Information about material related party transactions is set out below:

##### Subsidiary companies

Details of investments in principal subsidiary companies are disclosed in Note 12.

##### Parent company and fellow subsidiaries

Transactions and balances with the parent company and fellow subsidiaries are summarised below. Purchases and sales relate predominantly to purchases and sales of gas.

Income statement items	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Expenses incurred from parent undertaking and fellow subsidiaries	789	1,010
Income received from parent undertaking and fellow subsidiaries	84	111

Balance sheet items with parent undertakings and fellow subsidiaries are disclosed in Notes 16, 17, 18 and 19. Income statement interest payable and receivable are disclosed in Note 7.

##### Associates

Transactions and balances with associates are summarised below. Sales relate largely to management fees. Purchases relate largely to electricity generated by associates.

Income statement items	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Purchases from associates	102	84
Sales to associates	6	3

  

Balance sheet items	At 31 December 2007 £m	At 31 December 2006 £m
Receivables from associates	3	1
Payables to associates	15	26

##### Pension funds

Information relating to the pension fund arrangements is disclosed in Note 22.

##### Directors and key management

Details of directors' and key management remuneration are disclosed in Note 6.

## E.ON UK PLC

### Notes to the financial statements for the year ended 31 December 2007 (continued)

#### 35 Events after the balance sheet date

##### E.ON IS

On 30 April 2008, E.ON UK sold its 49% investment in E.ON IS to the major shareholder, E.ON IS GmbH for its market value of 3,718,000 Euros.

##### Acquisitions

On 15 January 2008, the Group purchased the entire issued share capital of CHN Group Ltd. The CHN Group wholly owns five trading subsidiaries, CHN Contractors Limited, CHN Electrical Services Limited, CHN Gas Service and Maintenance Limited, CHN Special Projects Limited and Industry Developments Limited. These companies are all located within the West Midlands. Their primary activities are to provide installation, service, maintenance and repair of plumbing, heating and electrical systems, primarily through business to business contracts with local authorities and housing associations.

On 31 March 2008, the Group purchased the entire issued share capital of Empower Training Services Limited. The primary activity of Empower Training Services Limited is to provide training for the utilities industries.

The two acquisitions are immaterial to the Group and therefore the information below is shown in aggregate. Due to the recent closure of both acquisitions, the fair values of the significant assets and liabilities assumed are preliminary and pending finalisation of valuation. At this stage the fair values are as follows:

	<b>£m</b>
Property, plant and equipment	<b>2</b>
Cash and cash equivalents	<b>2</b>
Other current assets	<b>8</b>
Other current liabilities	<b>(6)</b>
Creditors > 1 year	<b>(1)</b>
Fair value of net tangible assets acquired	<b>5</b>
Goodwill arising on acquisition	<b>20</b>
Fair value of net assets acquired	<b>25</b>
Cash paid to former shareholders	<b>25</b>