E.ON UK PLC

GROUP REPORT AND ACCOUNTS

for the year ended 31 December 2005

Registered No: 2366970

Directors' report for the year ended 31 December 2005

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 2005.

Principal activities, review of business and future developments

The Group's principal activities are electricity generation and distribution, and 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, to sustain and develop its distribution and generation asset businesses and to build competitive trading and retail businesses. Both the level of business and financial position of the Group at 31 December 2005 were satisfactory and the directors believe the present levels of activity in the UK will be sustained in the current year.

A description of the development of the business during the financial year under report and the outlook for the future is given below. The following section includes information about the Group's research and development ('R&D') activities.

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

- 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. At 31 December 2005, E.ON UK supplied 8.6 million customer accounts, of which 7.9 million were residential and 0.7 million were small and medium sized business and industrial customer accounts. There was a net decrease of approximately 0.2 million customers during the year as some customers switched suppliers partly as a result of retail price increases described below. E.ON UK continues to focus on reducing the costs of its retail business, through efficiency improvements, more economical procurement of services and the utilisation of lower cost sales channels.

Residential and small and medium sized business customers

The residential business had approximately 7.9 million customer accounts as of 31 December 2005. Approximately 66 percent of E.ON UK's residential customer accounts are electricity customers and 34 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 28.4 TWh of electricity and 54.1 TWh of gas in 2005, as compared with 29.2 TWh of electricity and 51.5 TWh of gas in 2004.

E.ON UK targets residential customers through national marketing activities such as media advertising (including print, television and radio), targeted direct mail, public relations and online campaigns under its Powergen brand. E.ON UK also seeks to continue to exploit the high level of national awareness of its Powergen brand and has taken steps to enhance the strength of its brand, including the sponsorship of high profile, national sports competitions such as the Powergen Cups in Rugby Union and Rugby League. E.ON UK is also the main sponsor for Ipswich Town, a football team playing in the English Championship league. From the start of the 2006/2007 football season, the sponsorship of Ipswich Town will be under the E.ON brand. In addition, E.ON UK will sponsor the FA Cup under the E.ON brand. In an environment of rising wholesale energy prices and increasing environmental costs, E.ON UK, like other suppliers implemented a number of electricity and gas price increases affecting residential customers in 2005 and 2006, though the precise level of increases varied by supplier. E.ON UK's increases in 2005 amounted to 7.2 percent for electricity and 11.9 percent for gas and in 2006 to date have amounted to 18.4 percent for electricity and 24.4 percent for gas. At the same time, E.ON UK has also implemented a package of measures to limit the effects of rising wholesale costs on its most vulnerable customers, including free cavity wall insulation for customers aged 60 or over and offering free energy saving light bulbs to all its residential customers in 2005.

Industrial & Commercial

The number of accounts in this sector totalled approximately 0.7 million at year-end 2005. In this sector, E.ON UK sold 31.3 TWh of electricity and 46.1 TWh of gas in 2005, as compared with 33.5 TWh of electricity and 50.6 TWh of gas in 2004. E.ON UK's focus in this area remains on acquiring and retaining the most profitable contracts available.

In June 2005, E.ON UK acquired Economy Power Limited, which supplies 45,000 small and medium-sized business customers with electricity.

Energy Wholesale

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

However, for the purposes 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. At 31 December 2005, E.ON UK owned power stations in the UK with an attributable registered generating capacity of 10,547 MW, including 577 MW of Combined Heat and Power ('CHP') plants and 50 MW of hydroelectric plant, while its attributable portfolio of operational wind capacity stood at 183 MW. The increase in E.ON UK's generation capacity during the year reflected the return to service of the Killingholme plant and the purchase of the Enfield plant, offset in part by the return of the Speke CHP plant to the former client at the end of the contract as described below. Despite the increase, E.ON UK's share of the generation market in England and Wales remained relatively stable in 2005 at approximately 10 percent.

E.ON UK generates electricity from a diverse portfolio of fuel sources. In 2005, approximately 56 percent of E.ON UK's electricity output was fuelled by coal and approximately 42 percent by gas of which approximately 8 percent was from CHP schemes, with the remaining 2 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 regularly monitors the economic status of its operational and mothballed plant in order to respond to changes in market conditions. This flexibility was demonstrated during 2005, when E.ON UK shut down two oil fired units at Grain for the summer, and then returned these two units for winter use later in the year. Both Combined Cycle Gas Turbine ('CCGT') modules at Killingholme were also returned to service at full capacity during 2005, the first time a CCGT plant had been returned to service after being mothballed in the UK. Both actions were in response to increasing market prices which made the resumed operation of both plants economically attractive.

- *Renewable Energy*

E.ON UK plans to grow its renewable generation business in response to recent UK government and regulatory initiatives. E.ON UK is already one of the UK's leading developers and owner/operators of wind farms, with interests in 20 operational onshore and offshore wind farms in the UK and Ireland with total capacity of 197 MW, of which 183 MW is attributable to E.ON UK.

During 2004, E.ON UK completed the construction of a large offshore windfarm site with a capacity of 60 MW at Scroby Sands off the coast of East Anglia. Potential onshore and offshore projects with an aggregated capacity of approximately 1100 MW are now in the development stage (compared with 770 MW in the development phase in 2004).

In addition to the planned expansion of its wind farm portfolio, E.ON UK increased its generation from biomass in 2005 by co-firing with coal at the Kingsnorth, Ironbridge and Ratcliffe power stations, generating a total of 230 GWh of renewable energy by this method during the year. Work has also commenced on the construction of a 44 MW wood-burning plant in Lockerbie, in southwest Scotland, which when built will be the United Kingdom's largest dedicated biomass plant. The start of commercial operation of the plant is planned for December 2007.

During 2006, E.ON UK expects to develop its capability in marine generation (using tidal power) to position itself to capture future opportunities in this area.

As a part of its balanced approach, E.ON UK seeks to fulfil its renewables obligation through a combination of its own generation, renewable energy purchased from other generators under tradable Renewable Obligation Certificate ('ROC') contracts and direct payment of any residual obligation into the buy-out fund. For the period from 1 April 2004 to 31 March 2005, E.ON UK achieved the 4.9 percent target under the renewables obligation scheme.

- CHP

E.ON UK also operates large-scale CHP schemes. CHP is an energy efficient technology which recovers heat from the power generation process and uses it for industrial processes such as steam generation, product drying, fermentation, sterilizing and heating. E.ON UK's total operational CHP electricity capacity is 577 MW with clients ranging across a number of sectors, including pharmaceuticals, chemicals, paper and oil-refining. CHP capacity declined by 10 MW in 2005 due to the scheduled termination of the 10 year contract for the Speke CHP plant with Eli Lilly and Company Limited in November 2005. Under the terms of the contract, the asset was transferred back to the owner upon termination.

Energy Trading

E.ON UK's energy trading unit engages in asset-based energy marketing in gas and electricity markets to assist E.ON UK in commercial risk management and the optimisation of its UK gross margin. The energy trading unit plays a key role in E.ON UK's integrated electricity and gas business in the UK by acting as the 'commercial hub' for all energy transactions. It manages price and volume risks and seeks to maximise the integrated value from E.ON UK's generation and customer assets.

E.ON UK also engages in a controlled amount of proprietary trading in gas, power, coal, oil and CO_2 emission certificates markets in order to take advantage of market opportunities and maintain the highest levels of market understanding required to support optimisation and risk management activities. In 2005, proprietary trading gross volumes totalled 20.8TWh in power (2004 41.8TWh) and 72.4TWh of gas (2004 173.1TWh). Proprietary gas trading volumes decreased significantly in 2005 as risk restraints limited trading, reflecting both higher prices and higher volatility in the gas market in 2005.

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 and weather derivatives. All of E.ON UK's energy trading operations, including its limited proprietary trading, are subject to E.ON UK's risk management policies for energy trading.

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

The supply of gas for E.ON UK's CCGT and CHP plants is sourced through non-interruptible long-term gas supply contracts with gas producers (certain ones of which contain 'take or pay' provisions), and through purchases on the forward and spot markets. From 1 October 2004, E.ON Ruhrgas became 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.

Distribution

Central Networks East plc ('CNE') and Central Networks West plc ('CNW'), both wholly owned subsidiaries of E.ON UK plc, own, manage and operate two electricity distribution networks servicing the East and West Midlands areas of England respectively. The combined service areas cover approximately 11,312 square miles, extending from the Welsh border in the West to the Lincolnshire coast in the East and from Chesterfield in the North to the northern outskirts of Bristol in the South and containing a resident population of approximately 10 million people. The networks distribute electricity to approximately 4.9 million homes and businesses in the combined service areas, and virtually all electricity supplied to consumers in the service areas (whether E.ON UK's retail business or by other suppliers) is transported through the CNE or CNW distribution network. 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.

The results of the Electricity Price Control Review (DR4) were announced in November 2004, setting out the allowed income for investing in and operating the network, as well as five-year performance targets. The price controls run from 1 April 2005 until 31 March 2010.

Other activities

The UK Services business provides a single shared service function delivering IT, 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.

Midlands Electricity Non–Distribution Assets

E.ON UK also acquired a number of non-distribution businesses in the Midlands Electricity acquisition. These included an electrical contracting operation and an electricity and gas metering business in the UK, as well as minority equity stakes in companies operating three electricity generation plants. Following disposals in 2004 and 2005, the only remaining stake is a 31.0 percent interest in Trakya Electric Uretin ve Ticaret A.S., which owns and operates a 478 MW CCGT plant in Turkey. E.ON UK has decided to retain the electricity and gas metering services business and core parts of the contracting business (including street lighting) within a business unit, formed 1 January 2006, called E.ON Energy Services. The remaining non-core contracting businesses have been sold or closed in the year.

Results and dividends

The profit attributable to shareholders for the financial year to 31 December 2005 was £640 million (year ended 31 December 2004 £415 million).

The directors do not recommend payment of a final dividend (year ended 31 December 2004 £nil). During the year, an interim dividend of £240 million was paid (year ended 31 December 2004 £nil).

Directors and their interests

The following directors served on the Board during the year:

Dr Paul Golby
Graham Bartlett
Dr Burckhard Bergmann
Dr Wulf Bernotat
Dr Anthony Cocker
Nicholas Horler
Jarri Sandstrom
Dr Erhard Schipporeit
Robert Taylor

Information on directors' emoluments is given in Note 5 to the Accounts, on pages 43 and 44.

No director had, at any time during the period under report, any interest in the shares of the Company or any subsidiary undertaking. At 31 December 2005 and 31 December 2004 no director had any interest requiring disclosure in these accounts.

Employees

The Company 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 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.

Contributions for political and charitable purposes

Donations to charitable organisations during the financial year by the Group amounted to £74,673. The decrease from the prior year value of £409,793 is primarily due to a significant donation made to the DEC Tsunami Appeal Fund made during 2004. Political donations during the financial year by the Company amounted to £6,500. These consisted of sponsorship of a Political Party Conference and the cost of passes to a Political Party Conference.

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 47 days (31 December 2004 33 days).

Going Concern

Not withstanding the fact that the Group and Company have net current liabilities, the directors have prepared the financial statements on the going concern basis. The directors have received confirmation from Powergen Limited, the intermediate parent undertaking, of its intention to financially support the Group and the Company such that they 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.

The Board has reviewed the Group's budget and cash flow forecasts for the year ended 31 December 2006 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' responsibilities

The directors are responsible 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, and for preparing the parent company financial statements and the Directors' Remuneration Report in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

The directors are responsible for preparing financial statements for each financial year which give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of affairs of the group and of the profit or loss of the group and a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of affairs of the company for that period. In preparing those 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 whether the group financial statements comply with IFRSs as adopted by the European Union, and with regard to the parent company financial statements whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

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

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and the group and to enable them to ensure that the group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation and the parent company financial statements and the Directors' Remuneration Report comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

Fiona S Stark

Fiona Stark
Company Secretary
E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG

26 June 2006

Financial review for the year ended 31 December 2005

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

Overview

E.ON UK and its associated companies are actively involved in electricity generation, distribution, retail and trading. As of 31 December 2005, E.ON UK owned or through joint ventures had an attributable interest in 10,547 MW of generation capacity, including 577 MW of CHP plants and 233 MW of operational wind and hydroelectric generation capacity. E.ON UK served approximately 8.6 million electricity and gas customer accounts at 31 December 2005 and its Central Networks business served 4.9 million customer connections.

2005 was a year of further consolidation for the Group, following the acquisitions of Midlands Electricity in 2004 and TXU in 2003. During 2005, E.ON UK brought together three separate businesses (metering, new connections and home installation), previously forming part of the retail and distribution businesses, to form E.ON Energy Services, with the vision of providing E.ON UK customers with all the services they need to get connected to energy supplies, heat their homes and understand their energy use. E.ON Energy Services employs more than 2,300 people and manages over 2,000 contractors. Each year E.ON Energy Services staff are expected to visit more than 12 million households and carry out work in 600,000 homes. The new energy services business was part of Central Networks and Retail during 2005.

Accounting Policies

During the year the Group has adopted International Financial Reporting Standards in the preparation of its financial statements. The Group's accounting policies are described on pages 26 to 37. Details of the changes to UK GAAP information previously published are disclosed in Note 34 to the financial statements.

Group financial results

Profit before tax and impairment and integration costs and profits less losses on disposal of investments/businesses for the year ended 31 December 2005 was £967 million, compared to £579 million for the same period last year. The profit before tax was £869 million compared with £450 million for the previous twelve months.

Revenue

Group revenue grew by £1,203 million during the year to £6,928 million, an increase of 21 percent. Revenue in the UK increased primarily as a result of significantly increased sales in the non-regulated business. Higher retail prices and higher market commodity gas and power sales were the main reasons for the increase, offset by a reduction in retail sales volumes in the industrial and commercial business. The volume of electricity sold in the Retail business decreased by 7.1 billion kWh. Revenue in the Regulated Distribution business decreased on last year due to the impact of the DR4 price review that was effective from 1 April 2005.

Financial review for the year ended 31 December 2005 (continued)

Revenue is further analysed below:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
UK Operations		
Energy Wholesale	**1,487**	968
Distribution	**557**	639
Retail	**5,014**	4,280
Internal charges from distribution to retail	**(130)**	(162)
	6,928	5,725

Operating Costs

Details of the Group's operating costs are set out in Note 2 to the financial statements. The figures are summarised below.

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Fuel costs	**607**	460
Power purchases and other costs of sales	**4,560**	3,489
Staff costs	**369**	325
Depreciation	**240**	251
Intangible asset amortisation	**61**	59
Other operating charges, including restructuring costs	**210**	624
	6,047	5,208

Fuel costs rose substantially in 2005 due to significant increases in coal and gas purchase costs and the increased amount of owned generation from 34.9 billion kWh in 2004 to 37.3 billion kWh in 2005. This increase was largely driven by the acquisition of Enfield power station and the return to service of both CCGT modules at Killingholme. Average day ahead gas prices in the UK for 2005 were 41 pence per therm, 71percent higher than during 2004.

Power purchase and other costs of sales increased significantly due to higher wholesale power prices and costs of complying with the EU emissions trading scheme.

Staff costs at £369 million were 13.5 percent higher than in the previous year due to the acquisitions of a number of new subsidiaries, together with the transfer in house of a number of staff from an external service provider. Staff numbers at 31 December 2005 totalled 12,106 and all except 6 were based in the UK.

Financial review for the year ended 31 December 2005 (continued)

The depreciation charge decreased from £251 million in 2004 to £240 million in 2005. Intangible asset amortisation remained static compared to prior years.

Other operating charges included the costs of running the UK businesses, supporting corporate infrastructure and movement in the fair value of commodity and other derivative instruments. Other operating charges have decreased during 2005 primarily due to gains of £327 million on commodity derivative instruments in the Energy Wholesale business.

Operating income

Other operating income was £187 million this year compared with £94 million in the year to 31 December 2004. The increase primarily relates to increased income from the new connections business.

Impairment and integration costs

Impairment and integration costs before tax amounted to £103 million in 2005 compared with £103 million in 2004. During 2005 certain CHP plants were impaired by £90 million. The impairments have arisen 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, a further £13 million of integration costs were incurred in relation to the Midlands Electricity integration. In 2004 integration costs of £62 million (primarily Midlands Electricity) were incurred, International and UK business disposals and write downs were £26 million and CHP impairment charges were £41 million.

Operating profits

A more detailed analysis of operating profits and reconciliation to profit before tax is set out below:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
UK Operations		
Energy Wholesale	**479**	108
Distribution	**350**	241
Retail	**387**	352
Central / Unallocated	**(148)**	(90)
Group operating profit after impairment and integration costs	**1,068**	611
Interest costs	**(211)**	(192)
Share of results of associates after tax	**12**	31
Profit before tax	**869**	450

Financial review for the year ended 31 December 2005 (continued)

Group operating profits totalled £1,068 million for the year compared with £611 million in the same period to 31 December 2004. Within this total, wholesale and trading profits increased by £371 million to £479 million, largely due to gains on commodity derivative instruments of £327 million.

Distribution profits increased from £241 million to £350 million, primarily reflecting additional income from the new connections business.

Within the retail business, profits increased by £35 million to £387 million, reflecting cost reductions in 2005.

Interest costs

E.ON UK's interest costs increased from £192 million to £211 million due to higher debt and higher interest rates being incurred on debt.

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 teams liaise closely with the local business to ensure that liquidity and risk management needs are met within the requirements of the E.ON AG policies and procedures. The treasury team works closely with the treasury and corporate finance teams at E.ON AG.

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 financial 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 on behalf of their activities. A group-wide cash forecasting and currency exposure reporting process exists which ensures regular reporting into 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 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.

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's 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 trading cash flows 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. E.ON AG requires subsidiaries to maintain a fixed and floating ratio between 0 per cent and 50 per cent. The Group has a significant portfolio of debt, and is exposed to movements in interest rates. E.ON UK manages these interest rate exposures primarily through the use of fixed and floating rate borrowings and interest rate swaps.

Financial review for the year ended 31 December 2005 (continued)

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 E.ON 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.

Liquidity planning, trends and risks

E.ON UK has sufficient committed borrowing facilities to meet planned liquidity needs, through facilities provided by its parent company E.ON AG at a lower cost than E.ON UK could achieve externally. 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 19 to the accounts.

At 31 December 2005, the Group had total borrowings of £4,482 million (31 December 2004 £3,549 million) including £2,019 million of long-term loans and £2,463 million of short-term loans and overdrafts.

At 31 December 2005, the Group had £68 million of cash and short-term investments (31 December 2004 £52 million). E.ON UK's policy is 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 2005 was therefore £4,414 million, compared to £3,497 million at 31 December 2004. The average interest rate for the year, when compared to average net borrowings, was 5.92 per cent compared with 5.7 per cent in the previous year.

Gearing (net debt as a percentage of net assets plus net debt) was 58 per cent at 31 December 2005 compared with 57 per cent at the end of 2004.

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 £227 million for the year compared with £26 million charge for the same period to 31 December 2004. The effective rate was 26 per cent compared with 6 per cent in the year to 31 December 2004. The main reasons for the effective rate being less than 30% in both periods are adjustments to current and deferred tax provisions in respect of prior year items. The impact of such adjustments was less in the year to 31 December 2005 leading to an increase in the effective rate.

Dividends

During the year, an interim dividend of £240 million (year ended 31 December 2004 £nil) was paid.

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 2005 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 2005.

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 if, in our opinion, the Directors' Report is not consistent with the group financial statements, if 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.

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 2005 and of its profit and cash flows for the year then ended; and

- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
26 June 2006

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 2005

	Note	**Year ended 31 December 2005 £m**	Year ended 31 December 2004 £m
Group revenue	1	**6,928**	5,725
Operating costs excluding impairment and integration costs	2	**(5,944)**	(5,105)
Impairment and integration costs	3	**(103)**	(103)
Total operating costs		**(6,047)**	(5,208)
Other operating income	2	**187**	94
Group operating profit		**1,068**	611
Finance income	6	**34**	20
Finance costs	6	**(245)**	(212)
Group's share of associates' profit after tax		**12**	31
Profit before tax		**869**	450
Taxation	7	**(227)**	(26)
Profit for the year		**642**	424
Profit attributable to:			
Minority interest	28	**2**	9
Shareholders		**640**	415
		642	424

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

The accounting policies and the notes on pages 26 to 90 form part of these financial statements.

E.ON UK PLC

GROUP STATEMENT OF TOTAL RECOGNISED INCOME AND EXPENSE for the year ended 31 December 2005

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Profit for the year from continuing operations	**642**	424
Profit attributable to minority interests	**(2)**	(9)
Profit attributable to shareholders	**640**	415
Cash flow hedge fair value gains	**147**	-
Cash flow hedge gains transferred to the profit and loss account	**(1)**	-
Currency translation differences on foreign currency net investments	**-**	(1)
Gains on AFS securities	**1**	-
Tax on items taken directly to equity	**(44)**	-
Total recognised income for the year	**743**	414

Adjustment for adoption of IAS39 (net of tax) to:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Retained earnings	89	-
Other reserves	16	-
	105	-

The accounting policies and the notes on pages 26 to 90 form part of these financial statements.

E.ON UK PLC

CONSOLIDATED BALANCE SHEET
as at 31 December 2005

	Note	31 December 2005 £m	31 December 2004 £m
Non-current assets			
Intangible assets			
Goodwill	9	**2,597**	2,582
Other	9	**541**	430
Total intangible assets		**3,138**	3,012
Property, plant and equipment	10	**4,260**	4,016
Interests in associates	11	**7**	9
Available for sale investments	13	**18**	26
Financial receivables	14	**28**	105
Commodity and other derivative financial instruments	20	**57**	-
		7,508	7,168
Current assets			
Inventories	15	**224**	157
Trade and other receivables	16	**1,922**	1,407
Commodity and other derivative financial instruments	20	**1,407**	-
Cash and cash equivalents		**68**	52
		3,621	1,616
Total Assets		**11,129**	8,784

E.ON UK PLC

CONSOLIDATED BALANCE SHEET
as at 31 December 2005 (continued)

	Note	31 December 2005 £m	31 December 2004 £m
Current Liabilities			
Borrowings	18	**2,463**	1,670
Commodity and other derivative financial instruments	20	**699**	-
Trade and other payables	17	**1,587**	1,225
Current tax liabilities		**130**	153
Provisions	22	**73**	146
		4,952	3,194
Non-current Liabilities			
Borrowings	19	**2,019**	1,879
Commodity and other derivative financial instruments	20	**1**	-
Provisions	22	**93**	78
Deferred tax	23	**625**	349
Pension liability	21	**213**	660
		2,951	2,966
Total Liabilities		**7,903**	6,160
Shareholders' equity			
Ordinary shares	24	**325**	325
Share premium	26	**97**	97
Retained earnings	27	**2,088**	1,599
Other reserves	28	**701**	582
Total shareholders' equity		**3,211**	2,603
Minority interest in equity	29	**15**	21
Total equity		**3,226**	2,624
Total liabilities and equity		**11,129**	8,784

Approved by the Board on 26 June 2006

Graham John Bartlett
Director

The accounting policies and the notes on pages 26 to 90 form part of these financial statements.

E.ON UK PLC

CONSOLIDATED CASH FLOW STATEMENT
for the year ended 31 December 2005

	Note	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Cash flows from operating activities			
Cash generated from operations	30	**304**	500
Interest received		**8**	10
Interest paid		**(204)**	(116)
Tax paid		**(69)**	(35)
Dividends received from associates		**9**	41
Net cash from operating activities		**48**	400
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets		**(384)**	(336)
Acquisitions (net of cash acquired)		**(246)**	8
Purchase of available for sale investments		**-**	(12)
Finance lease principal receipts		**18**	20
Proceeds from sale of property, plant & equipment		**3**	4
Proceeds from sale of investments		**20**	66
Proceeds from sale of other financial assets		**-**	7
Net cash used in investing activities		**(589)**	(243)
Cash flows from financing activities			
Proceeds from issue of new borrowings		**2,017**	1,778
Repayment of borrowings		**(1,198)**	(1,921)
Finance lease principal payments		**(16)**	(13)
Dividends paid to minority interests		**(6)**	(4)
Dividends paid to equity shareholder		**(240)**	-
Net proceeds from financing activities		**557**	(160)
Net increase / (decrease) in cash and cash equivalents		**16**	(3)
Cash and cash equivalents at 1 January		**52**	55
Cash and cash equivalents at 31 December		**68**	52

Notes to the financial statements for the year ended 31 December 2005

Nature of operations

The Group's principal business in the UK is the generation, distribution and sale of electricity and the sale of gas. The principal business overseas is the generation of electricity and associated energy-related businesses.

Accounting Policies:

Basis of preparation of accounts

The financial statements are prepared under the historical cost convention and in accordance with applicable International Financial Reporting Standards ("IFRS"), International Financial Reporting Interpretations Committee ("IFRIC") interpretations and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The group's date of transition to IFRS was 1 January 2004. On transition to IFRS, the group has taken advantage of the following exemptions to assist groups with the transition process contained within IFRS 1 'First-time Adoption of International Financial Reporting Standards'.

- Business Combinations: The Group has elected not to restate business combinations accounted for prior to 1 January 2004, the Group's transition date to IFRS.
- Employee Benefits: The cumulative actuarial losses relating to pensions at the date of transition to IFRS have been recognised in retained earnings.
- Translation reserve: Cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRS.
- Financial Instruments: The Group has elected not to prepare comparative information in accordance with IAS 32 'Financial Instruments: Disclosure and Presentation' ("IAS 32") and IAS 39 'Financial Instruments: Recognition and Measurement' ("IAS 39"). These standards will be applied with effect from 1 January 2005. For the year ended 31 December 2004, financial instruments continue to be accounted for in accordance with the Group's previous policies for financial instruments under UK GAAP, as set out below.
- The Group has chosen to apply IFRIC 4 'Determining Whether an Arrangement Contains a Lease' from the date of transition to IFRS.

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

IFRS 6	*Exploration for and Evaluation of Mineral Resources*
IFRS 7	*Financial instruments: Disclosures*
IFRIC 5	*Right to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
IFRIC 6	*Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*
IFRIC 7	*Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*
IFRIC 8	*Scope of IFRS 2*

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 and relevant facts 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.

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

<u>The exemptions adopted under IFRS</u>

The Group has taken advantage of the following exemptions, as explained above, to assist with the transition process.

- Business Combinations
- Employee Benefits
- Translation Reserve
- Financial Instruments
- IFRIC 4 'Determining Whether an Arrangement Contains a Lease'

Notes to the financial statements for the year ended 31 December 2005 (continued)

Emissions trading scheme

The Group has been subject to the European Emissions Trading Scheme (EU ETS) 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.

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:

Impairment of goodwill and indefinite lived intangible assets

The Group determines whether goodwill and indefinite lived intangible assets are impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which goodwill and indefinite lived intangibles are allocated. Estimating the value-in-use requires the Group to make an estimation of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Further detail on the assumptions used in determining value-in-use calculations is provided in Note 9.

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). 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.

The reconciliation process can result in either a higher or lower value of industry deemed supply than has been billed to customers, but in practice tends to result in a higher level of deemed supply. Management estimate the level of recovery which will be achieved either through subsequent customer billing or through the developing industry settlement process.

Determination of fair values – energy derivatives

Derivative contracts are carried in the Balance Sheet at fair value, with changes in fair value recorded in the Income Statement. Fair values of energy derivatives are estimated by reference in part to published price quotations in active markets and in part by using valuation techniques.

Pensions and other post-retirement benefits

The Group operates a number of defined benefit pension schemes. The cost of providing benefits under the defined benefit schemes is determined separately for each scheme under the projected unit credit actuarial valuation method. Actuarial gains and losses exceeding 10% of the present value of the obligation are spread over employees' remaining working lives. 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 21.

Impairment of the Group's CHP plants

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.

Going concern

Not withstanding the fact that the Group and the Company have net current liabilities, the directors have prepared the financial statements on the going concern basis. The directors have received confirmation from Powergen Limited, the intermediate parent undertaking, of its intention to financially support the Group and the Company such that they 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.

Basis of consolidation

The consolidated accounts include the financial statements of the Company and all of its subsidiary undertakings, together with the Group's share of the results and net assets of associated undertakings. The results of subsidiaries sold or acquired are included in the consolidated income statement up to, or from, the date on which control passes. Intra-group sales, profits, and balances are eliminated on consolidation.

Business combinations

The Group's share of profits less losses of associated undertakings is 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 passes. 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 within the United Kingdom comprises revenue from the trading and wholesale of electricity; revenue from the distribution of electricity; revenue from the sale of electricity and gas to industrial and commercial customers and sales of electricity and gas to domestic customers. Revenue excludes Value Added Tax.

Revenue from the sale of electricity and gas to industrial, commercial and domestic customers is recognised when delivered and reflects the value of units supplied, including an estimated value of units 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.

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 three operating divisions – Energy Wholesale, Distribution and Retail. These divisions are the basis on which the Group reports its primary segment information.

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 a Group company 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.

A provision and related fixed asset are recognised in respect of the estimated total discounted cost of decommissioning generating assets. The resulting fixed asset is depreciated on a straight-line basis over its useful economic life, and the discount on the associated provision is amortised over the useful life of the associated power stations.

Future operating costs are not provided for.

Foreign exchange

Items included in the IFRS 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 IFRS 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. As set out below and as permitted by IFRS 1, prior to January 1 2005 the Group followed UK GAAP for hedge accounting and, consequently, monetary assets and liabilities denominated in foreign currencies were translated at hedged rates where matching forward exchange contracts had been entered into.

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.

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 (IFRS policies applied in the preparation of consolidated IFRS financial statements for the year ended 31 December 2005)

The accounting policies below have been applied in preparing the IFRS financial information for the year ended 31 December 2005, following the application of IAS 32 and IAS 39 on 1 January 2005.

Investments

The Group's share of the net assets of associated undertakings is included in the consolidated balance sheet. Other investments that are not subject to equity accounting are classified as available for sale and are carried at fair value. Unrealised gains and losses on available for sale investments are recognised in equity until the investment is disposed of.

Debt Instruments

In accordance with IAS 32, all borrowings are initially stated at the fair value of consideration received after deduction of directly attributable transaction costs. The issue costs and interest payable on bonds are charged to the income statement at a constant rate over the life of the bond. Any premium or discount arising on the early repayment of borrowings is written off to the income statement as incurred or received.

Derivative Instruments

The Group uses a range of derivative instruments, including interest rate swaps, cross-currency swaps and energy-based options and futures contracts and foreign exchange contracts. Derivative instruments are used for hedging purposes, apart from certain energy-based options and futures contracts, which are used for trading purposes. Wherever possible, the Group takes the own use exemption permitted by IAS 39 for commodity contracts entered into and held for the purpose of the Group's own purchase, sale or usage requirements. Commodity contracts that do not qualify for own use exemption, including those entered into for trading purposes are accounted for in accordance with the policy below. Certain commodity derivatives qualify as designated hedges of future cash flows.

Derivative instruments are recorded as either assets or liabilities in the balance sheet and measured at fair value. Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised within operating costs in the income statement as they arise.

Changes in the value of instruments that are designated and effective as hedges of future cash flows ("cash flow hedges") are recognised directly in the hedging reserve, with any ineffective portion recognised immediately within operating costs in the income statement.

Changes in the value of derivative instruments that are designated as hedges of the changes in fair value of assets or liabilities are recognised in the income statement within finance costs if the instrument is a pure interest rate swap, else within operating costs. A movement in fair value in the hedged item that is attributable to the risk being hedged is also recognised in the income statement, resulting in any ineffectiveness being recognised immediately.

Exchange gains or losses arising on financial instruments that are designated and effective as hedges of the Group's net investment in overseas subsidiaries are recorded directly in the translation reserve, with any ineffective portion recognised immediately within operating costs in the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or no longer qualifies for hedge accounting. At that time, any cumulative gains or losses relating to cash flow hedges recognised in equity are recognised in the income statement in the same periods in which the hedged item affects net profit or loss. If a hedged transaction is no longer expected to occur, any net cumulative gain or loss recognised in equity is immediately transferred to the income statement.

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.

Financial instruments (UK GAAP policies applied in the preparation of comparative information for the year ended 31 December 2004)

The accounting policies below have been applied in preparing the IFRS financial information for the year ended 31 December 2004 and are those policies applied by the group under UK GAAP for the year then ended.

Investments

The Group's share of the net assets of associated undertakings is included in the consolidated balance sheet. Other fixed asset investments are stated at cost less any provision for impairment in value. Investments in subsidiary undertakings are stated in the balance sheet of the parent company at cost, less any provision for impairment in value.

Debt Instruments

All borrowings are initially stated at the fair value of consideration received after deduction of issue costs. The issue costs and interest payable on bonds are charged to the profit and loss account at a constant rate over the life of the bond. Any premium or discount arising on the early repayment of borrowings is written off to the profit and loss account as incurred or received.

Derivative Instruments

The Group uses a range of derivative instruments, including interest rate swaps, cross-currency swaps and energy-based options and futures contracts and foreign exchange contracts. Derivative instruments are used for hedging purposes, apart from energy-based options and futures contracts, which are used for trading purposes. The accounting policy for each instrument is set out below. Interest differentials on derivative instruments are charged to the profit and loss account as interest costs in the period to which they relate. Changes in the market value of options and futures trading contracts are reflected in the profit and loss account in the period in which the change occurs.

a) Interest rate swaps

Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these agreements are recognised as adjustments to interest expense over the period of the contracts.

b) Forward currency contracts

The Group enters into forward currency contracts for the purchase and/or sale of foreign currencies in order to manage its exposure to fluctuations in currency rates. With the exception of contracts used for translation hedging purposes, unrealised gains and losses on currency contracts are not accounted for until the maturity of the contract. The cash flows from forward purchase currency contracts are classified in a manner consistent with the underlying nature of the hedged transaction.

c) Currency swaps

Currency swap agreements are used to manage foreign currency exposures and are accounted for using hedge accounting. In order to qualify for hedge accounting the instrument must be identified to a specific foreign currency asset or liability and must be an effective hedge. Foreign currency loans, where the repayment of principal is hedged by currency swaps, are included in the balance sheet at the closing exchange rate. The fair value of the swap is also recognised. Interest on the loan is charged to the profit and loss account at the hedged rate.

d) Commodity instruments

The Group makes use of energy trading derivative financial instruments, a certain proportion of which relate to proprietary trading activities. The instruments relating to these activities are traded in an established and liquid market place. Open derivative positions are marked to market through operating costs.

Intangible fixed assets

Goodwill

Goodwill arising on consolidation represents the excess of the fair value of the consideration given over 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.

Goodwill arising on acquisition before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Software costs

Acquired computer software is capitalised on the basis of costs incurred to bring the software to use. Costs associated with developing computer software programmes that will probably generate economic benefits are also capitalised. All capitalised software costs are amortised over their useful economic life on a straight-line basis.

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 cost of goods sold.

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

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:

Asset	*Life in years*
Customer Base	7-10

Emission rights and renewable obligation certificates generally have maturities of less than one year and are therefore not amortised. Contractual development rights are amortised from the date that the development is completed.

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

Major assets in the course of construction are included in tangible fixed assets 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.

Customers' contributions towards distribution network assets are credited to the income statement over the life of the distribution network assets to which they relate. The contributions are deducted from the cost of the fixed assets.

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 tangible fixed assets. 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 other principal categories of fixed assets are:

Asset	*Life in years*
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.

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.

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.

Fuel stocks and stores

Fuel stocks and general and engineering stores 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 stocks to be categorised between raw materials, work in progress and finished goods. Fuel stocks and general 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 assets and liabilities are recognised for the estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated using the 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 also dealt with in equity.

Pensions

The Group provides pension benefits through both defined benefit and defined contribution schemes. Defined benefit pension scheme costs are charged to the income statement according to the "corridor approach" allowed by IAS19 – Employee Benefits. Expected return on assets and interest costs are recorded throughout the year. Actuarial gains and losses exceeding 10 percent of the present value of the obligation are spread over employees' remaining working lives. Details of actuarial valuations, including the frequency and methodology, are set out in Note 21.

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

Share based payments

Certain directors and senior management personnel participate in a cash settled share appreciation right scheme administered by the ultimate parent company, E.ON AG. The Group accounts for its share appreciation rights ('SARs') in accordance with IFRS 2 "Share-based payment". The liability relating to SARs is measured initially, and at each reporting date, based on the fair value of the SARs, by applying the Monte Carlo option pricing model, taking into account the SARs granted and service rendered to date. The cost of the SARs is recognised in the income statement over the expected vesting period.

Impairment

Impairments of assets are calculated as the difference between the carrying value of the asset and its recoverable amount, if lower. Where such 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.

Notes to the financial statements
for the year ended 31 December 2005 (continued)

1 Segmental Reporting

Year ended 31 December 2005	Energy Wholesale £m	Distribution £m	Retail £m	Central / Unallocated £m	Eliminations £m	Group £m
External sales	1,487	427	5,014	-	-	6,928
Inter-segment sales	3,325	130	24	-	(3,479)	-
Total revenue	4,812	557	5,038	-	(3,479)	6,928
Segment result	479	350	387	(148)		1,068
Finance income						34
Finance costs						(245)
Share of results of associates after tax	1	-	-	11		12
Profit before tax						869
Tax						(227)
Profit for the year from continuing activities						642
Total assets	5,133	3,319	2,686	(9)		11,129
Total liabilities*	3,645	512	(2,230)	5,976		7,903
Other segment items						
Capital expenditure (including acquisitions)	271	234	3	11		519
Depreciation	130	99	3	8		240
Amortisation of intangible assets	2	-	57	2		61
Goodwill	63	308	1,253	973		2,597

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

Notes to the financial statements
for the year ended 31 December 2005 (continued)

1 Segmental Reporting (continued)

Year ended 31 December 2004	Energy Wholesale £m	Distribution £m	Retail £m	Central / Unallocated £m	Eliminations £m	Group £m
External sales	968	477	4,280	-	-	5,725
Inter-segment sales	2,499	162	14	-	(2,675)	-
Total revenue	3,467	639	4,294	-	(2,675)	5,725
Segment result	108	241	352	(90)		611
Finance income						20
Finance costs						(212)
Share of results of associates after tax	1	8	-	22		31
Profit before tax						450
Tax						(26)
Profit for the year from continuing activities						424
Total assets	3,263	3,188	2,458	(125)		8,784
Total liabilities*	2,495	1,432	(717)	2,950		6,160
Other segment items						
Capital expenditure (including acquisitions)	123	2,232	3	7		2,365
Depreciation	145	93	3	10		251
Amortisation of intangible assets	2	5	50	2		59
Goodwill	67	301	1,234	980		2,582

* Interest and current 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.

2 Operating costs and other operating income

Operating costs were as follows:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Fuel costs	**607**	460
Power and gas purchases and other costs of sales	**4,560**	3,489
Staff costs (Note 5)	**369**	325
Depreciation, including relevant impairments	**240**	251
Intangible asset amortisation	**61**	59
Other operating charges, including restructuring costs	**210**	624
Operating costs, after impairment and integration costs	**6,052**	5,208
Operating costs, before integration and restructuring costs	**5,944**	5,105
Integration and restructuring costs (Note 3)	**103**	103

£1 million of foreign exchange losses were recognised in the profit and loss account (year ended 31 December 2004 £1 million losses).

Operating costs also include:	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Repairs and maintenance costs	**106**	104
Research and development costs	**5**	3
Operating leases	**27**	19
Loss / (gain) on disposal of fixed assets	**4**	(1)
Profit / (loss) on disposal of businesses / investments (Note 4)	**5**	(26)
Auditors' remuneration for:		
Statutory audit	**1.4**	1.2
Audit related regulatory reporting	**0.1**	0.2
Further assurance services	**0.2**	0.2
Tax – Advisory services	**0.1**	0.1

Other operating income in 2005 includes £99 million of income from the new connections business within distribution. Other operating income in 2005 also included PowerTechnology consulting income of £13 million and sales of spares of £10 million.

Notes to the financial statements
for the year ended 31 December 2005 (continued)

2 Operating costs and other operating income (continued)

Other operating income in 2004 includes £40 million of deferred income in respect of the provision of services under warranty arrangements associated with the disposal of Fiddlers Ferry and Ferrybridge C power stations to Edison Mission Energy during 1999 which expired during 2004. Other operating income in 2004 also included PowerTech consulting income of £17 million.

3 Impairment and integration costs

Impairment and integration costs comprise:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Impairment costs before taxation	**(90)**	(41)
Integration costs before taxation	**(13)**	(62)
Impairment and integration costs before taxation	**(103)**	(103)
Tax on impairment costs	**27**	12
Tax on integration costs	**4**	18
Impairment and Integration costs after taxation	**(72)**	(73)

Year ended 31 December 2005

During the year finance lease receivables relating to CHP plants were impaired by £76 million. CHP property, plant and equipment was impaired by £14 million. The impairments have arisen 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. A tax credit of £27 million arose as a result of these charges. CHP plants are within the Energy Wholesale segment.

In addition, a further £13 million charge was recognised as a result of the integration of Midlands Electricity into Central Networks. A tax credit of £4 million arose as a result of this charge.

Year ended 31 December 2004

Following the acquisition of Midlands Electricity in January 2004, an integration programme was implemented to merge the Midlands Electricity distribution business into the existing East Midlands Electricity distribution business, the combined business being renamed Central Networks. Additionally certain group functions and services were integrated into E.ON UK's UK Services business unit. £60 million was charged during the year in respect of that programme in both the Midlands Electricity and existing Distribution businesses, which primarily comprised committed severance and related payments to approximately 600 employees and costs relating to the rationalisation of IT systems and business locations. A tax credit of £17 million arose as a result of this charge.

3 Impairment and integration costs (continued)

In addition to the integration of the Midlands Electricity business, E.ON UK charged a further £2 million in respect of the reorganisation and restructuring of the business acquired from TXU in 2003. A tax credit of £1 million arose as a result of this charge.

During the year finance lease receivables relating to CHP plants were impaired by £25 million. CHP property, plant and equipment were impaired by £16 million. A tax credit of £12 million arose as a result of this charge.

4 Profit less losses on disposal of investments / businesses (including provisions)

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

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Profits less losses on disposal of investments / businesses (including provisions) before taxation	**5**	(26)
Tax on profits less losses on disposal of investments / businesses (including provisions)	**-**	-
Profits less losses on disposal of investments / businesses (including provisions) after taxation	**5**	(26)

Year ended 31 December 2005

During the year E.ON UK disposed of its 40 percent of its investment in Uch Power Limited for proceeds of £5 million. Net assets disposed of totalled £3 million, resulting in a profit of £2 million. In addition, the Company sold its 19.2 percent share in Teeside Power Limited for £4 million. Net assets disposed of were £1 million, resulting in a profit of £3 million.

Year ended 31 December 2004

As part of E.ON UK's ongoing strategy to withdraw from the international markets, E.ON UK disposed of its 35 percent investment in PT Jawa Power for proceeds of £66 million. Net assets disposed of totalled £88 million (comprising £76 million investment and £12 million loan) and costs of disposal were £2 million, giving rise to an exceptional loss of £24 million. No tax credit arose as a result of this disposal.

During the period the investments in associates acquired as part of the acquisition of Midlands Electricity were impaired by £2 million in anticipation of their disposal. No tax credit arose as a result of this disposal.

5 Employee information, including directors' remuneration

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

	Year ended 31 December 2005	Year ended 31 December 2004
Total operations (including Corporate Centre)	**12,121**	10,469

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

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Wages and salaries	**346**	299
Social security costs	**31**	27
Other pension costs (Note 21)	**32**	31
	409	357
Capitalised in fixed assets	**(40)**	(32)
Charged in profit and loss account as staff costs	**369**	325

The key management compensation costs, representing directors, were:

	Year ended 31 December 2005 £	Year ended 31 December 2004 £
Salaries and short-term employee benefits	**3,729,484**	4,492,058
Post-employment benefits	**515,790**	265,150
Share based payments	**1,113,914**	594,881
	5,359,188	5,352,089

Notes to the financial statements for the year ended 31 December 2005 (continued)

6 Finance Income and Costs

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Interest receivable		
From fellow E.ON group undertakings	**1**	2
Other	**33**	18
Finance Income	**34**	20
Interest payable		
Loans from fellow E.ON group undertakings	**(218)**	(170)
Other loans	**(24)**	(39)
Unwinding of discount in provisions	**(3)**	(3)
Finance Costs	**(245)**	(212)
Net Finance Costs	**(211)**	(192)

Notes to the financial statements for the year ended 31 December 2005 (continued)

7 Taxation

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Current tax:		
United Kingdom Corporation tax at 30%	**100**	98
Over provision in prior year	**(58)**	(6)
Overseas taxation	**1**	1
Total current tax charge	**43**	93
Deferred tax:		
Origination and reversal of timing differences	**181**	66
Under / (over) provision in prior period	**3**	(133)
Total deferred tax (credit)/charge (Note 23)	**184**	(67)
Tax charge on profit on ordinary activities	**227**	26

The effective tax rate increased in 2005 as a result of the conclusion of the period covered by the major parts warranty given to the purchaser on the disposal of Fiddler's Ferry and Ferrybridge C power stations in 1999. Part of the proceeds on the disposal was deferred and were recognised in the profit and loss account over the period covered by the warranty. This deferred income was subject to tax when actually received and was therefore not subject to tax when recognised in the income statement. The effective rate of tax increased in 2005 as a result of the warranty period coming to an end.

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 2005 £m	Year ended 31 December 2004 £m
Profit on ordinary activities before tax	**869**	450
Less Group's share of associates' profit after tax	**(12)**	(31)
Profit on ordinary activities excluding associates' profit	**857**	419
Tax charge on profit on ordinary activities at 30%	**257**	126
Effects of:		
Prior year adjustment	**(55)**	(139)
Expenses not deductible for tax purposes	**26**	46
Non-taxable income	**(1)**	(6)
Net effect of different rates of tax in overseas businesses	**-**	(1)
Total current tax charge	**227**	26

The tax impact of individually material items is given in Note 3.

8 Acquisitions

The Group made several small acquisitions during 2005. The impact of these acquisitions has been aggregated below. The total consideration was £158 million. From the date of acquisition to 31 December 2005 the acquisitions contributed £64 million to revenue and a loss of £2 million to operating profit. If the acquisitions had been made at the beginning of the year, it is estimated that the Group's revenue and consolidated profit would not have been materially different.

Details of the acquisition balance sheets and fair value of consideration are as follows:

	Book value £m	Fair value adjustments £m	Fair value to the E.ON UK Group £m
Net assets acquired:			
Intangible fixed assets	-	109	109
Property, plant and equipment	122	6	128
Inventory	1	-	1
Receivables	61	-	61
Cash	23	-	23
Payables	(44)	(22)	(66)
Commodity and other derivative financial instruments	(4)	105	101
Current tax	(1)	(3)	(4)
Borrowings	(88)	(3)	(91)
Provisions	(1)	-	(1)
Deferred tax	(14)	10	(4)
	55	202	257
Minority interests			(114)
Net assets acquired			143
Goodwill arising			15
Consideration, including costs of acquisition			158

Consideration satisfied by:	
- cash	154
- loan notes	4
	158

On 5 May 2005, the Group acquired the shares held by minority interests identified above for cash consideration of £111 million. In addition, other minority interests were acquired during the year for cash consideration of £4 million.

Intangible fixed assets acquired primarily represent contractual development rights for a gas storage facility.

9 Intangible assets

	Goodwill	Software	Customer Lists	Other	Total
	£m	£m	£m	£m	£m
Cost					
At 1 January 2005	2,582	120	451	35	3,188
Acquisitions	15	-	13	96	124
Additions	-	13	-	105	118
Disposals	-	-	-	(55)	(55)
At 31 December 2005	**2,597**	**133**	**464**	**181**	**3,375**
Aggregate impairment & amortisation					
At 1 January 2005	-	77	99	-	176
Amortisation for the year	-	15	46	-	61
At 31 December 2005	**-**	**92**	**145**	**-**	**237**
Net book value at 31 December 2005	**2,597**	**41**	**319**	**181**	**3,138**

	Goodwill	Software	Customer Lists	Other	Total
	£m	£m	£m	£m	£m
Cost					
At 1 January 2004	2,271	97	450	40	2,858
Acquisitions	311	-	1	-	312
Additions	-	23	-	50	73
Disposals	-	-	-	(55)	(55)
At 31 December 2004	2,582	120	451	35	3,188
Aggregate impairment & amortisation					
At 1 January 2004	-	63	54	-	117
Amortisation for the year	-	14	45	-	59
At 31 December 2004	-	77	99	-	176
Net book value at 31 December 2004	2,582	43	352	35	3,012

Other intangible assets comprise emission rights, renewable obligation certificates 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. The carrying amount of goodwill by segment can be seen in Note 1.

Notes to the financial statements for the year ended 31 December 2005 (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 that cover periods well in excess of five years. 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 was 2 percent. Projected cash flows were discounted at rates of between 6 percent and 7.75 percent based on risks relevant to the segment. The discount rate used is post tax.

10 Property, plant and equipment

	Generating assets £m	Distribution and transmission networks £m	Other operating and short-term assets £m	Total £m
Cost				
At 1 January 2005	3,646	3,828	567	8,041
Additions	120	212	33	365
Acquisitions	148	-	6	154
Exchange differences	6	-	-	6
Disposals	(311)	-	(20)	(331)
At 31 December 2005	**3,609**	**4,040**	**586**	**8,235**
Depreciation				
At 1 January 2005	2,246	1,433	346	4,025
Acquisitions	26	-	-	26
Charge for the year	130	74	36	240
Exchange differences	7	-	-	7
Disposals	(311)	-	(12)	(323)
At 31 December 2005	**2,098**	**1,507**	**370**	**3,975**
Net book value at 31 December 2005	**1,511**	**2,533**	**216**	**4,260**

Additions in 2005 include capitalised borrowing costs amounting to nil (2004 £2 million).

The net book value of property, plant and equipment held under finance leases is £84 million (2004 £85 million).

Notes to the financial statements
for the year ended 31 December 2005 (continued)

10 Property, plant and equipment (continued)

	Generating assets £m	Distribution and transmission networks £m	Other operating and short-term assets £m	Total £m
Cost				
At 1 January 2004	3,476	1,793	452	5,721
Additions	108	188	27	323
Acquisitions	79	1,857	106	2,042
Disposals	(17)	(10)	(18)	(45)
At 31 December 2004	3,646	3,828	567	8,041
Depreciation				
At 1 January 2004	2,086	652	274	3,012
Charge for the year	141	82	28	251
Acquisitions	36	706	62	804
Disposals	(17)	(7)	(18)	(42)
At 31 December 2004	2,246	1,433	346	4,025
Net book value at 31 December 2004	1,400	2,395	221	4,016

Group assets include assets in the course of construction at a cost of £nil (31 December 2004 £nil).

11 Interests in associates

	Associates - Net Assets £m	Associates - Loans £m	**Total** **£m**
Net assets			
At 31 December 2004	8	1	9
Retained profits	12	-	12
Dividends received	(9)	-	(9)
Disposals	(5)	-	(5)
At 31 December 2005	**6**	**1**	**7**

No goodwill is recorded within interests in associates.

11 Interests in associates (continued)

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 Company
Trakya Electric Uretin ve Ticaret A.S.	31 December	Turkey	Ordinary shares	31%

The principal activities of this associate are as owner and operator of gas fired power station in Turkey

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

	At 31 December 2005 £m	At 31 December 2004 £m
Share of assets:		
Share of fixed assets	**105**	271
Share of current assets	**35**	134
	140	405
Share of liabilities:		
Amounts falling due within one year	**(32)**	(93)
Amounts falling due after more than one year	**(102)**	(304)
	(134)	(397)
Share of net assets	**6**	8
Revenue	**51**	209
Operating profit	**23**	61

Notes to the financial statements for the year ended 31 December 2005 (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 or the Company %	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
E.ON UK CHP Limited *	Ordinary and preference shares	100	England and Wales	Sale of energy services involving the construction of CHP plant
E.ON UK Cogeneration Limited *	Ordinary shares	100	England and Wales	Sale of energy services involving the construction of CHP plant
Powergen Retail 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

13 Available for sale investments

	£m
At 1 January 2005	**26**
Adoption of IAS 39	**1**
Revaluation	**1**
Disposals	**(10)**
At 31 December 2005	**18**

Available for sale financial assets include the following:

	At 31 December 2005 £m	At 31 December 2004 £m
Listed equity securities – UK	**2**	1
Listed gilts – UK	**16**	15
Unlisted debt	**-**	10
	18	26

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

	At 31 December 2005 £m	At 31 December 2004 £m
Finance lease receivables	**28**	99
Other	**-**	6
	28	105

15 Inventories

	At 31 December 2005 £m	At 31 December 2004 £m
Fuel stocks	**156**	110
Stores	**68**	47
	224	157

The majority of consumed inventories represent fuel costs incurred during the period. Fuel costs are disclosed in Note 2.

16 Trade and other receivables

	At 31 December 2005 £m	At 31 December 2004 £m
Trade debtors	**1,847**	1,255
Less: Provision for impairment of receivables	**(118)**	(94)
Trade debtors - net	**1,729**	1,161
Other debtors	**27**	61
Prepayments and accrued income	**77**	62
Finance lease receivables	**5**	18
Amounts due from parent undertaking and fellow subsidiaries	**84**	105
	1,922	1,407

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 has the option to acquire the site at the end of the lease. The maturities of the finance leases are set out below:

	31 December 2005		31 December 2004	
	Gross Investment £m	**Net Investment £m**	Gross Investment £m	Net Investment £m
Within 1 year	**5**	**5**	18	18
Within 1-5 years	**22**	**15**	75	53
After 5 years	**23**	**13**	93	46
	50	**33**	186	117

Unearned finance income at 31 December 2005 amounted to £17 million (2004 £69 million)

17 Trade and other payables

	At 31 December 2005 £m	At 31 December 2004 £m
Trade payables	**1,141**	803
Amounts owed to parent undertaking and fellow subsidiaries	**190**	187
Other taxation and social security	**11**	1
Accruals and other creditors	**243**	234
Deferred income	**2**	-
	1,587	1,225

18 Borrowings: amounts falling due within one year

	At 31 December 2005 £m	At 31 December 2004 £m
Bank overdrafts	**17**	17
Short term loans from parent undertaking and fellow subsidiaries	**2,385**	1,593
Loan notes 2007	**-**	2
Other short-term loans	**43**	41
Finance lease payable	**18**	17
	2,463	1,670

Short-term funding is provided through inter-company facilities. The weighted average interest rate on all short-term loans during the year was 5.1 percent (year ended 31 December 2004 3.9 percent).

19 Borrowings: Amounts falling due after more than one year

	At 31 December 2005 £m	At 31 December 2004 £m
Amounts owed to external debt holders		
8.5% Sterling Bond 2006	-	44
7.45% US Dollar Yankee Bond 2007	100	90
Intra-Group swaps *	-	15
	100	105
7.375% Sterling Bond 2007		1
5% Euro Eurobond 2009	181	187
Intra-Group swaps*	-	(15)
	181	172
6.25% Sterling Eurobond 2024	3	3
2012 Loan	12	15
Loan notes 2007	4	-
Finance lease payable	34	50
	334	390
Amounts owed to fellow group undertakings		
8.5% Sterling Bond 2006	-	206
7.125% Sterling Bond 2006	-	350
7.45% US Dollar Yankee Bond 2007	140	124
Intra-Group swaps*	-	6
	140	130
7.375% Sterling Bond 2007	154	158
7.05% US Dollar Yankee Bond 2007	142	117
Intra-Group swaps*	-	8
	142	125
6.46% US Dollar Yankee Bond 2008	142	117
Intra-Group swaps*	-	8
	142	125
5% Euro Eurobond 2009	162	167
Intra-Group swaps*	-	(13)
	162	154
6.25% Sterling Eurobond 2024	243	241
Long term loan	702	-
	1,685	1,489
	2,019	1,879

* In 2004 borrowings were presented after the impact of currency derivatives, in accordance with UK GAAP. In 2005 borrowings are presented at the year-end exchange rate, with the currency derivatives disclosed as derivative financial instruments.

19 Non current financial liabilities – Borrowings (continued)

The carrying amount of borrowings in 2005 includes a £2 million adjustment (increase) for highly effective fair value hedges as required by IAS 39.

None of the bonds outstanding at 31 December 2005 have any financial covenants.

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

	At 31 December 2005 £m	At 31 December 2004 £m
Within one year	**18**	17
Within two to five years	**38**	55
After five years	**-**	-
	56	72
Future finance charges on finance leases	**(4)**	(5)
Present value of finance lease liabilities	**52**	67

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.

20 Financial Instruments

Treasury Instruments

As part of the financing of its normal operating activities, the Group holds a variety of financial instruments including swaps, futures, 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.

20 Financial Instruments (continued)

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:

- 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 are valued by the use of valuation models that include average probabilities and take into account individual contract details and variables.

20 Financial Instruments (continued)

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 £122 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. £46 million was charged to the income statement during 2005 in respect of fair value movements related to embedded derivatives.

As discussed in Note 1, the group applied IAS 32 and IAS 39 from 1 January 2005. Disclosures for the year ended 31 December 2005 are made in accordance with IAS 32. Disclosures relating to the year ended 31 December 2004 are presented on the basis of UK GAAP.

Amounts recognised in respect of derivative financial instruments are as follows:

	Assets £m	Liabilities £m
At 31 December 2005		
Interest rate swaps	17	(1)
Cross currency swaps	29	(7)
Forward foreign currency contracts	7	(3)
Commodity swaps	112	(58)
Commodity forward contracts	1,299	(509)
Embedded derivatives within long term gas contracts	-	(122)
	1,464	(700)

Notes to the financial statements for the year ended 31 December 2005 (continued)

20 Financial Instruments (continued)

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.

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
Cross currency swaps		
1 to 5 years	13	-
Commodity forward contracts		
Less than 1 year	196	(5)
1 to 5 years	44	-
	253	**(5)**

Maturities of derivative financial instruments designated as fair value hedges at the balance sheet date were:

	Contracts with positive fair values £m	Contracts with negative fair values £m
Interest rate swaps		
Greater than 5 years	-	(1)

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
Interest rate swaps	17	-
Cross currency swaps	16	(7)
Foreign currency forward contracts	7	(3)
Commodity swaps	112	(58)
Commodity forward contracts	1,059	(504)
Embedded derivatives within long term gas contracts	-	(122)
	1,211	**(694)**

Notes to the financial statements
for the year ended 31 December 2005 (continued)

20 Financial Instruments (continued)

The notional principal amount of derivatives and maturities at 31 December 2005 are as follows:

	Within 1 year £m	1 – 5 years £m	After 5 years £m	Total £m
Interest rate swaps	543	-	242	785
Cross currency swaps	443	428	-	871
Foreign currency forward contracts	364	-	-	364
Commodity swaps	570	-	-	570
Commodity forward contracts	3,405	601	-	4,006
Embedded derivatives within long term gas contracts	1,204	-	-	1,204
	6,529	**1,029**	**242**	**7,800**

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 2018 and interest rate swaps, cross currency swaps, foreign currency forward contracts, commodity swaps and commodity forward contracts that expire over the next 5 years.

Fair value of non-derivative financial instruments

The estimated fair value of non-derivative financial instruments held or issued to finance the Group's operations is as follows.

		31 December 2005		31 December 2004	
	Note	**Book Value £m**	**Fair value £m**	Book Value £m	Fair Value £m
Borrowings: amounts falling due after more than one year	(ii)	**(2,019)**	**(2,031)**	(1,879)	(2,029)
Borrowings: amounts falling due within one year	(i)(vi)	**(2,463)**	**(2,463)**	(1,670)	(1,670)
Cash and cash equivalents	(iii)	**68**	**68**	33	33
Available for sale investments	(iv)	**18**	**18**	26	27
Financial receivables: amounts falling due after more than one year	(v)	**28**	**28**	6	6
Financial receivables: amounts falling due within one year		**5**	**5**	18	18

(i) The fair value of borrowings: amounts falling due within one year approximates to the carrying value due to the short maturity of these loans.
(ii) The fair value of the borrowings: amounts falling due after more than one year has been stated at quoted market value.
(iii) The fair value of cash and cash equivalents approximates to carrying value due to the short maturity of instruments held.

20 Financial Instruments (continued)

(iv) The fair value of available for sale investments listed on a recognised stock exchange is stated at quoted market value.
(v) The fair value of financial receivables: amounts falling due after more than one year approximates to book value as the effect of discounting would be immaterial.
(vi) The fair values shown for borrowings do not take account of the fair values of cross currency swaps shown above.

The estimated fair value of the Group's other financial assets and liabilities as at 2004, is as follows (information provided in accordance with UK GAAP):

	Note	31 December 2004 Book Value £m	31 December 2004 Fair Value £m
Instruments held to manage the interest rate and currency profile:			
Foreign currency contracts	(i)	-	(18)
Foreign currency swaps	(i)	-	(21)
Interest rate swaps	(i)	-	25
Investments held for financial energy trading purposes:			
Energy derivatives held for trading	(ii)	7	7
Derivatives held to manage the financial profile	(iii)	-	22

(i) The fair values shown for short and long term debt do not take account of the fair values of cross currency swaps shown above.
(ii) The fair value of energy derivatives is based on quoted market value.
(iii) Derivatives held to manage financial profile relate to oil swaps valued at quoted market value.

Maturity of financial liabilities

The maturity profile of the carrying amount of the Group's non-current liabilities, at 31 December was as follows:

	2005 £m	2004 £m
In more than one year but not more than two years	**557**	616
In more than two years but not more than five years	**1,214**	1,004
In more than five years	**248**	259
	2,019	1,879

20 Financial Instruments (continued)

At 31 December 2005 there were £339 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, with the exception of the Powergen Limited facility, expire within 12 months from the balance sheet date. These facilities comprise:

Facility	Total facility £m	Amount undrawn at 31 December 2005 £m	Expiry date	Fees
E.ON UK plc – committed facility from E.ON AG *	870	35	21 December 2010	10bp
E.ON UK plc – committed facility from Powergen Limited	950	220	25 July 2008	-
E.ON UK plc – committed facility from Raab Karcher Electronic Systems plc	300	84	21 December 2010	-
	2,120	**339**		

* Drawings include £83m from Fidelia Corporation, a fellow subsidiary undertaking of E.ON AG, as these drawings fall under the E.ON AG facility

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.

Information on contracts held at 31 December 2005 is included in the disclosures above. At 31 December 2004, the net Sterling notional amounts of each foreign currency the Group has contracted to purchase (or sell) were as follows:

	At 31 December 2004 £m
US Dollars	18
Euros	19
	37

The weighted average time to maturity of foreign exchange contracts at 31 December 2004 was nine months.

Notes to the financial statements for the year ended 31 December 2005 (continued)

20 Financial Instruments (continued)

The notional amounts of foreign currency swaps held at 31 December 2004 were as follows:

	At 31 December 2004 £m
Foreign currency swaps into Sterling	828

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, as described in the Financial Review. Information on contracts held at 31 December 2005 is included in the disclosures above. The notional amounts of instruments used at 31 December 2004 can be summarised as follows:

	At 31 December 2004 £m
Interest rate swap contracts	754

The weighted average time to maturity of interest rate swap contracts at 31 December 2004 was 3 years.

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
	£m	£m	£m	%	Years
At 31 December 2005					
Sterling	**3,587**	**2,581**	**1,006**	**8.1**	**4.5**
Euros	**371**	**371**	**-**	**-**	**-**
Dollars	**524**	**-**	**524**	**7.1**	**1.7**
	4,482	**2,952**	**1,530**	**7.8**	**4.1**

20 Financial Instruments (continued)

	Total	Floating rate financial liabilities	Fixed rate financial liabilities		
				Weighted average interest rate	Weighted average period for which rate is fixed
	£m	£m	£m	%	Years
At 31 December 2004					
Sterling	2,977	1,974	1,003	8.1	5.5
Euros	48	48	-	-	-
Dollars	524	39	485	7.1	2.7
	3,549	2,061	1,488	7.8	4.5

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.

In addition to the above, the Group's provisions include £1 million (2004 £63 million) for contract provisions (see Note 22) which meet the definition of financial liabilities under FRS 26 and, previously, Financial Reporting Standard 13 'Derivatives and other financial instruments'. 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.

At 31 December 2004, the Group held £68 million (2004 £51 million) of financial assets in the form of Sterling bank deposits, and nil (2004 £1 million) in other currency deposits. These deposits earn interest at floating rates, fixed in advance for periods up to three months, by reference to Sterling LIBID.

21 Pension scheme arrangements

At 31 December 2005, E.ON UK had both statutorily approved defined benefit pension schemes and several smaller statutorily approved defined contribution schemes.

E.ON UK participates in the UK industry-wide scheme, the Electricity Supply Pension Scheme (ESPS), for the majority of its UK based employees. This is a funded scheme of the defined benefit type, with assets invested in separate trustee administered funds. At 31 December 2005, the Group has four separate funds within the ESPS: the Powergen fund, the East Midlands Electricity fund, the TXU fund and the Midlands Electricity fund. An actuarial valuation of the ESPS is normally carried out every three years by the Scheme's independent, professionally qualified actuary, who recommends the rates of contribution payable by each group participating in the scheme. In intervening years the actuary reviews the continuing appropriateness of the rates. The last published actuarial valuation of the ESPS was at 31 March 2004. During the year a special contribution of £432 million was made by the company to reduce the deficit in the scheme.

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

	31 December 2005	31 December 2004
Average nominal rate of annual increase in salaries	4.00%	4.00%
Average nominal rate of annual increase in pensions	2.50%	2.80%
Discount rate	5.50%	5.30%
Inflation rate	2.50%	2.80%

In determining the defined benefit obligation as at 31 December 2005 for the EON UK schemes, mortality assumptions are based on the '92 Series' tables, issued by the Institute and Faculty of Actuaries, updated to calendar year 2002. We have made an allowance for future longevity improvements using an adjustment that is approximately in line with the projections in the CMI Bureau's short cohort tables.

21 Pension scheme arrangements (continued)

The amounts recognised in the balance sheet are as follows:

	31 December 2005 £m	31 December 2004 £m
Fair value of plan assets	**4,917**	3,907
Present value of funded obligations	**(5,135)**	(4,683)
	(218)	(776)
Present value of unfunded obligations	**(22)**	(21)
Unrecognised actuarial losses	**27**	137
Net liability recognised in the balance sheet	**(213)**	(660)

The amounts recognised in the income statement are as follows:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Current service cost	**32**	31
Interest cost	**243**	236
Expected return on plan assets	**(263)**	(241)
Past service cost	**28**	31
	40	57

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

	Year ended December 2005 £m	Year ended 31 December 2004 £m
Opening defined benefit obligation	**4,704**	3,435
Service cost	**32**	31
Interest cost	**243**	236
Transfers in	**26**	-
Actuarial losses	**374**	252
Liabilities assumed in business combination	**-**	959
Past service cost	**28**	31
Contributions by plan participants	**12**	11
Benefits paid	**(262)**	(251)
Closing defined benefit obligation	**5,157**	4,704

21 Pension scheme arrangements (continued)

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

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Opening fair value of plan assets	3,907	2,881
Expected return on scheme assets	263	241
Transfers in	26	-
Actuarial gains	484	115
Contributions by employer	487	55
Assets acquired in a business combination	-	855
Contributions by plan participants	12	11
Benefits paid	(262)	(251)
	4,917	3,907

The group expects to contribute £32 million to its defined benefit pension plans in the year to 31 December 2006.

The major categories of plan assets as a percentage of total plan assets are as follows:

	Expected return		Fair value of assets	
	31 December 2005	31 December 2004	31 December 2005	31 December 2004
	%	%	%	%
Equity instruments	7.6	7.8	46	49
Debt instruments	5.0	5.2	48	50
Property	6.1	7.8	5	-
Other assets	-	-	1	1
	5.5	6.7	100	100

The expected return on assets has been determined following advice from the plan's independent actuary and is based on the expected return on each asset class together with consideration of the long-term asset strategy.

21 Pension scheme arrangements (continued)

History of experience adjustments:

	31 December 2005 £m	31 December 2004 £m
Fair Value of scheme assets	**4,917**	3,907
Present value of defined benefit obligations	**(5,157)**	(4,704)
Deficit in the scheme	**(240)**	(797)
Experience adjustments on plan liabilities		
Amounts (£m)	**(400)**	(252)
Percentage of scheme liabilities (%)	**7.8%**	5.4%
Experience adjustments on plan assets		
Amounts (£m)	**510**	115
Percentage of scheme assets (%)	**9.9%**	2.4%

22 Provisions

Movements on provisions comprise:

	31 December 2004	Charged / (released) to the income statement	Amortisation of discount	Provisions utilised	Acquisitions	**31 December 2005**
	£m	£m	£m	£m	£m	**£m**
Liability and damage claims	13	(11)	-	-	-	**2**
Decommissioning	63	2	3	(10)	1	**59**
Contract provisions	63	(53)	-	(9)	-	**1**
Restructuring	23	(3)	-	(17)		**3**
Emissions obligations	-	47	-	-	-	**47**
Renewable obligation certificates	60	69	-	(79)	-	**50**
Share based payments	2	3	-	(1)	-	**4**
	224	54	3	(116)	1	**166**

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

	31 December 2005 £m	31 December 2004 £m
Current	**73**	146
Non-current	**93**	78
	166	224

The liability and damage claims provision includes reserves in respect of potential claims for pension rationalisation costs. Given the inherent uncertainty surrounding the timing of any potential claims, it is not possible to estimate when these amounts will crystallise.

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 2005 relate to out of the money electricity purchase contracts, acquired on the purchase of CNE, and will be utilised over the period to 2008, when the contracts terminate. At 31 December 2004, contract provisions included an amount established on the purchase of TXU relating to an out of the money outsourced retail service contract arrangement. This contract was terminated during the year.

22 Provisions (continued)

Restructuring provisions relate to the acquisition of Midlands Electricity and subsequently merging it with CNE.

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

Renewable obligation certificates represent the value of certificates payable to national authorities for the Group's activities during the period.

Share Based Payments are fully described in Note 25.

23 Deferred tax

An analysis of the provision for deferred tax recognised at 31 December 2005 is as follows:

	At 31 December 2005 £m	At 31 December 2004 £m
Accelerated capital allowances	**825**	842
Other timing differences	**(200)**	(493)
Provision for deferred tax	**625**	349
Provision at 1 January	**349**	185
Adjustment for adoption of IAS 39	**44**	-
Provision at 1 January (restated)	**393**	185
Acquisitions	**4**	231
Deferred tax charge / (credit) for year	**184**	(67)
Taken to equity	**44**	-
Provision at end of year	**625**	349

The deferred tax on items charged direct to equity is that arising on the current year movements in cashflow hedges.

**Notes to the financial statements
for the year ended 31 December 2005 (continued)**

24 Share capital

The share capital of the Company comprises:

	At 31 December 2005 £m	At 31 December 2004 £m
Authorised		
1,050,000,002 ordinary shares of 50p each	**525**	525
Allotted, called-up and fully paid		
649,241,799 ordinary shares of 50p each	**325**	325

25 Share based payments

In 1999, the E.ON 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 Board of Management members and certain qualified executives for the first time, following the acquisition by E.ON AG.

In 2005, 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.

	Tranche 7	Tranche 6	Tranche 5	Tranche 4
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 (€)	65.35	49.05	42.11	54.95
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, €)	71.89	53.96	46.32	60.45
Maximum exercise gain (€)	65.35	49.05	-	-
Out performance of benchmark index?	yes	yes	yes	yes

25 Share based payments (continued)

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.

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.

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

25 Share based payments (continued)

Once issued, SARs are not transferable, and when the qualified executive leaves the E.ON 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.

A recognised option pricing model (Monte Carlo Simulation) is applied in order to determine the value of the option 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 71 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 stock on 31 December 2005 (€)	87.39	87.39	87.39	87.39
Fair value on 31 December 2005 (€)	25.53	37.53	39.50	32.50
Swap rate (%)	3.22	3.17	3.12	3.07
Volatility of the E.ON stock (%)	25.69	26.35	26.96	27.31
Volatility of the Dow Jones STOXX Utilities Index (Price €) (%)	14.55	14.82	15.10	15.32
Correlation	0.6617	0.6655	0.6731	0.6877
Last dividend paid by E.ON AG (€)	2.35	2.35	2.35	2.35
Dividend yield of Dow Jones STOXX Utilities Index (Price €) (in %)	4.5	4.5	4.5	4.5

In this option price model, the corresponding historical volatilities and correlations of the E.ON 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 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 2005, 32,718 SARs (2004 12,305) of tranche four and 49,529 SARs (2005 nil) of tranche five were exercised. No options were exercised prior to their normal exercise window and no SARs expired. The gain to the holders on exercise was £1 million (2004 £nil).

Notes to the financial statements for the year ended 31 December 2005 (continued)

25 Share based payments (continued)

The fair values of the fourth to seventh tranches are shown in the following table. Accordingly, the liability recognised on the balance sheet at 31 December 2005 amounted to £4 million (2004: £2 million). The total cost of the stock option program in 2005 amounted to £3 million (2004: £2 million).

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

	Tranche 7	Tranche 6	Tranche 5	Tranche 4
SARs outstanding as of 31 December 2003	-	-	88,025	58,859
SARs granted in 2004	-	55,028	-	-
SARs exercised in 2004	-	-	-	(12,305)
SARs expired in 2004	-	-	-	-
SARs outstanding as of 31 December 2004	-	55,028	88,025	46,554
SARs granted in 2005	77,044	7,297	-	-
SARs exercised in 2005	-	-	(49,529)	(32,718)
SARs expired in 2005	-	-	-	-
SARs outstanding as of 31 December 2005	77,044	62,325	38,496	13,836
SARs exercisable at year end	-	-	38,496	13,836
Provision as of December 31, 2003 (£m)	-	-	1	-
Gain to holders in 2004 (£m)	-	-	-	-
Expense in 2004 (£m)	-	-	1	-
Provision as of December 31, 2004 (£m)	-	-	2	-
Gain to holders in 2005 (£m)	-	-	(1)	-
Expense in 2005 (£m)	1	2	-	-
Provision as of December 31, 2005 (£m)	**1**	**2**	**1**	**-**
Average gain to holders per option in 2005 (£)	-	-	21	12
Difference between cash and equity-settled transactions (£m)	-	(1)	(1)	-

The average gain per stock option exercised during the year ended 31 December 2005 amounted to £21 in tranche 5 (2004 £nil) and £12 in tranche 4 (2004 £7).

At 31 December 2005 none of the SARs in the sixth and seventh tranches were exercisable due to the vesting periods not having expired.

Notes to the financial statements for the year ended 31 December 2005 (continued)

26 Share premium account

	2005 £m	2004 £m
At 1 January and 31 December	**97**	97

27 Retained earnings

	2005 £m	2004 £m
At 1 January	**1,599**	1,184
Adoption of IAS 39 (net of tax)	**89**	-
Retained profit for the year	**640**	415
Dividends	**(240)**	-
At 31 December	**2,088**	1,599

28 Other reserves

The Group	Capital redemption reserve £m	Special capital reserve £m	Available for sale investment reserves £m	Translation reserve £m	Hedging reserve £m	Revaluation reserve £m	Total £m
At 1 January 2004	85	474	-	-	-	15	574
Currency translation difference on foreign currency net investment	-	-	-	(1)	-	-	(1)
Revaluation on acquisition of CDC	-	-	-	-	-	9	9
At 31 December 2004	85	474	-	(1)	-	24	582
Adoption of IAS 39 (net of tax)	-	-	-	-	16	-	16
Cash flow hedges (net of tax)	-	-	-	-	102	-	102
Change in value of available for sale investments	-	-	1	-	-	-	1
At 31 December 2005	**85**	**474**	**1**	**(1)**	**118**	**24**	**701**

The share premium account, 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 CEGB's net assets were vested in its successor companies.

The revaluation reserve has arisen as a result of the step acquisitions of the renewable business and Cottam Development Centre.

Notes to the financial statements
for the year ended 31 December 2005 (continued)

29 Equity minority interests

The Group	31 December 2005 £m	31 December 2004 £m
At 1 January	**21**	26
Profit and loss account	**2**	9
Dividends paid to minority interests	**(6)**	(4)
Minority interests arising on acquisition	**114**	-
Purchase of minority interest	**(116)**	(10)
At 31 December	**15**	21

30 Cash flow from operating activities

Reconciliation of operating profit to net cash inflow from operating activities:

	2005 £m	2004 £m
Net profit	**642**	424
Adjustments for:		
Tax charge	**227**	26
Depreciation and impairments	**316**	276
Loss / (profit) on disposal of property, plant and equipment	**4**	(1)
(Profit) / loss on sale of investments	**(5)**	26
Amortisation of intangibles	**61**	59
Net interest	**211**	192
Share of results of associate after taxation	**(12)**	(31)
Gains on commodity and other derivative financial instruments	**(352)**	-
Other non-cash differences	**39**	(21)
Changes in working capital (excluding effects of acquisitions and disposal of subsidiaries)		
Increase in Inventories	**(116)**	(44)
Increase in Trade and other receivables	**(485)**	(150)
Increase/(decrease) in Payables	**260**	(309)
(Increase)/decrease in Pensions liability	**(427)**	7
(Decrease)/increase in Provisions	**(59)**	46
Cash generated from continuing operations	**304**	500

31 Commitments and contingent liabilities

a) At 31 December 2005, the Group had commitments contracted but not provided of £109 million (31 December 2004 £12 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) Complaints were made to the European Commission by the National Association of Licensed Opencast Operators (NALOO) and the South Wales Small Mines Association (SWSMA) against, amongst others, the Company and National Power plc in 1990 (NALOO and SWSMA) and 1994 (NALOO only). The complaints alleged breaches of EU law by the Central Electricity Generating Board 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 both complaints, on legal grounds, in 1998, which decisions were appealed by NALOO and, separately, by some former members of SWSMA. In 2003, the Court of Justice of the European Communities found in favour of NALOO, overturning the Commission's rejection of the complaint and whilst judgement has not yet been given in the appeal by the former SWSMA members all of the parties have agreed that this has now become devoid of purpose, in the light of the NALOO decision. The Commission indicated its intention to reject the complaints on their merits, but offered the parties the opportunity to negotiate a settlement to avoid further litigation by appeal. Settlement discussions have taken place following a meeting called by the Commission in January 2006. These discussions were based upon The Commission's calculation that the remaining NALOO and SWSMA claimants had total maximum claims of £11.2m and £ 1.6m, respectively and that a payment of the order of 5-15% of the maximum claims was appropriate. However, no settlement has been reached.

31 Commitments and contingent liabilities (continued)

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 2005 the Group's future commitments for the supply of coal under all its contractual arrangements totalled £535 million (31 December 2004 £333 million).

The Group also has purchase contracts for peat to burn in Edenderry power station. At 31 December 2005 the Group's future purchase commitment totalled £18 million (31 December 2004 £17 million).

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 2005 the estimated minimum commitment for the supply of gas under all these contracts totalled £2,937 million (31 December 2004 £1,687 million).

The Group is also committed to power purchase contracts for the supply of electricity. At 31 December 2005 the total contractual commitment for the group was £753 million (31 December 2004 £435 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 2005 the Group had the following operating lease commitments:

	31 December 2005		31 December 2004	
	Property	**Other assets**	Property	Other assets
	£m	**£m**	£m	£m
Annual commitments expiring under non-cancellable operating leases expiring:				
Within one year	**5**	**2**	1	6
Within two to five years	**18**	**5**	5	14
After five years	**27**	**-**	24	-
	50	**7**	30	20

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.

32 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

33 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 11.

Parent company

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

Income statement items	**Year ended 31 December 2005 £m**	Year ended 31 December 2004 £m
Purchases from parent undertaking and fellow subsidiaries	**402**	137
Sales to parent undertaking and fellow subsidiaries	**51**	7

Balance sheet items with parent undertakings and fellow subsidiaries are disclosed in Notes 16 & 17.

**Notes to the financial statements
for the year ended 31 December 2005 (continued)**

33 Related party transactions (continued)

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	2005 £000	2004 £000
Purchases from associates	1,014	983
Sales to associates	87	137

Balance sheet items	2005 £000	2004 £000
Receivables from associates	48	94
Payables to associates	239	232

Pension funds

Information relating to the pension fund arrangements is disclosed in Note 21.

Directors and key management

Details of directors' and key management remuneration are disclosed in Note 5.

34 Reconciliation of net assets and profit under UK GAAP to IFRS

The Group reported under UK GAAP in its previously published financial statements for the year ended 31 December 2004. The analysis below shows a reconciliation of net assets and profit as reported under UK GAAP as at 31 December 2004 to the revised net assets and profit under IFRS as reported in these financial statements. In addition, there is a reconciliation of net assets under UK GAAP to IFRS at the transition date for this company, being 1 January 2004.

The reconciliation includes the correction of an error identified in the Group's previously reported UK GAAP figures. In 2002, when the Group became part of the E.ON AG Group, an exercise was undertaken to reassess the asset lives of the Group's generation plant. The useful economic lives of the plant were extended as a result of this assessment. During the process of identifying UK to IFRS adjustments, management became aware that the depreciation calculations under UK GAAP had not been correctly updated to reflect these increased lives. The balance sheet at 1 January 2004 has been adjusted to increase fixed assets under UK GAAP by £34m, with an equal entry to the profit and loss account reserve, reinstating depreciation that should not have been charged to that date. Deferred tax of £10m has also been recorded, resulting in a net opening profit and loss account reserve adjustment of £24m. Depreciation charged during 2004 has been reduced by £26m, offset by deferred tax of £8m.

Reconciliation of profit for the year ended 31 December 2004

	£m
Under UK GAAP, as previously reported	**278**
Prior year adjustment	18
Under UK GAAP, restated	**296**
Increase / (decrease) net of tax in respect of	
Post retirement benefits	27
Leasing (IAS 17 / IFRIC 4)	(11)
Capitalised interest	(2)
Capitalised software	8
Deferred tax	14
Business Combinations	103
Principles of consolidation	2
Share based payments	(1)
Revenue recognition	(20)
Other	(1)
Under IFRS	**415**

Notes to the financial statements
for the year ended 31 December 2005 (continued)

34 Reconciliation of net assets and profit under UK GAAP to IFRS (continued)

Reconciliation of shareholders' equity at 1 January 2004
(Date of transition to IFRS)

	£m
Under UK GAAP, as previously reported	**2,450**
Prior year adjustment	24
Under UK GAAP, restated	**2,474**
Increase / (decrease) net of tax in respect of	
Post retirement benefits	(287)
Leasing (IAS 17 / IFRIC 4)	10
Capitalised interest	44
Capitalised software	18
Deferred tax	(90)
Business Combinations	5
Principles of consolidation	(18)
Share based payments	(1)
Revenue recognition	26
Other	(1)
Under IFRS	**2,180**

Reconciliation of shareholders' equity at 31 December 2004

	£m
Under UK GAAP	**2,736**
Prior year adjustment	42
Under UK GAAP, restated	**2,778**
Increase / (decrease) net of tax in respect of:	
Post retirement benefits	(260)
Leasing (IAS 17 / IFRIC 4)	(1)
Capitalised interest	42
Capitalised software	26
Deferred tax	(141)
Business Combinations	173
Principles of consolidation	(16)
Share based payments	(2)
Revenue recognition	6
Other	(2)
Under IFRS	**2,603**

34 Reconciliation of net assets and profit under UK GAAP to IFRS (continued)

Reconciliation of shareholders' equity under IFRS at 31 December 2004 to shareholders' equity under IFRS at 1 January 2005

The Group has taken advantage of the exemption within IFRS 1 'First-time Adoption of International Financial Reporting Standards' not to prepare comparative information in accordance with IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement'. Consequently an additional reconciliation has been prepared showing the movement in shareholders' equity between the balance sheet at 1 January 2005 including IAS 32/IAS 39 and the balance sheet excluding these standards at 31 December 2004.

	£m
Shareholders' equity under IFRS at 31 December 2004 (prior to adoption of IAS32 & IAS 39)	**2,603**
Adjustment on implementation of IAS 32 & IAS 39	105
Shareholders' equity at 1 January 2005 (after adoption of IAS32 & IAS 39)	**2,708**

Explanations of differences between UK GAAP and IFRS giving rise to adjustments in the reconciliations

Post retirement benefits

Under UK GAAP, the Group applied SSAP 24 - Accounting for Pension Costs ("SSAP 24") under which post retirement benefit surpluses and deficits were spread over the expected average remaining service lives of relevant current employees. Under IAS 19 - Employee Benefits ("IAS 19") the basis of calculation of the surplus or deficit differs from SSAP 24. In addition, at the date of transition, the Group has chosen to recognise actuarial gains and losses directly in shareholders' equity resulting in the recognition of the entire deficit at 1 January 2004 being recognised on the balance sheet. Subsequent actuarial gains and losses exceeding 10% of the present value of the obligation are spread over employees' remaining working lives.

Leasing

Under UK GAAP, the Group's combined heat and power plants were all accounted for as fixed assets in accordance with FRS 15 – Tangible fixed assets. Income from contracts related to the plants was recognised as revenue. Under IFRS, certain CHP plants and related contracts are required to be accounted for as finance leases in accordance with IFRIC 4 and IAS 17 – Leases. Consequently the fixed assets have been removed from the balance sheet and finance lease receivables have been recorded. Interest income is recognised on the finance lease receivables.

34 Reconciliation of net assets and profit under UK GAAP to IFRS (continued)

Capitalised Interest

Under UK GAAP, the Group capitalised finance costs related to fixed assets only when associated with specifically identifiable borrowings for a particular project. Under IFRS, interest incurred on general borrowings is also capitalised in property, plant and equipment where allowable under IAS 16 – Property, Plant and Equipment.

Software

Under UK GAAP, the Group did not capitalise internally developed software. IAS 39 – Intangible Assets allows the capitalisation of costs incurred internally providing certain recognition criteria are met. The Group has capitalised additional costs within intangible fixed assets that will be amortised over their estimated useful economic life.

Deferred Tax

Under UK GAAP, deferred tax was provided for all timing differences that had originated but not reversed at the balance sheet date. Under IFRS deferred tax is recognised in respect of temporary differences, being the differences between the book recorded value and the tax base of assets and liabilities. In addition, under UK GAAP it was Group policy to discount the deferred tax provision. Under IFRS, discounting of the deferred tax provision is not permitted.

The impact on the deferred tax liability of recording other IFRS adjustments has been included within the impact shown for each adjustment.

Business Combinations

Under UK GAAP, the Group amortised goodwill associated with business combinations over its useful economic life. Under IFRS 3 – Business Combinations ("IFRS 3"), any goodwill acquired in a business combination is recognised as an asset and is not amortised. Instead, goodwill is reviewed for impairment annually.

As described in Note 1, the Group elected to adopt the exemption allowed under IFRS 1 not to apply IFRS 3 to business combinations prior to the Group's transition date of 1 January 2004. Accordingly, the only adjustment to the carrying value of goodwill at that date is the segregation out of goodwill of the carrying value of intangible assets that would have been recognised independently under IFRS. Charges for subsequent goodwill amortisation under UK GAAP have been reversed.

Business combinations made during 2004 have been reassessed in accordance with IFRS 3, with fair value adjustments and goodwill being adjusted accordingly. The principal adjustments were the derecognition of a severance provision and the recognition of deferred tax on acquisition of Midlands Electricity.

34 Reconciliation of net assets and profit under UK GAAP to IFRS (continued)

Principles of consolidation

Under UK GAAP, an undertaking is determined to be a subsidiary if any of the control criteria in FRS 2 – Accounting for subsidiary undertakings apply. The concept of control is similar under IAS 27 – Consolidated and Separate financial statements. SIC-12 – Consolidation – Special Purpose Entities ("SIC-12") provides additional guidance stating that if an entity has rights to obtain the majority of the benefits or retains the majority of the residual or ownership risks for another entity then in substance control may exist. The Group has examined all of its ownership interests and concluded that certain power station arrangements are required to be consolidated under IFRS in accordance with the principles of SIC-12. This results in 100% of the assets, liabilities and results of operations being recognised in the Group's financial statements, alongside the recognition of minority interests. Under UK GAAP, these operations were treated as joint ventures and were equity accounted.

Share based payments

Under UK GAAP, no cost was recognised in respect of E.ON AG stock appreciation rights to which certain executives are entitled. On transition to IFRS the Group has followed the principles of IFRS 2 – Share based Payment ("IFRS 2") and has recognised the fair value of share-based payments to employees based on grants of SARs from 7 November 2002 (the effective date of IFRS 2). The cost of the SARs is recognised in the income statement over the expected vesting period.

Revenue Recognition

Under UK GAAP, revenue recognition is based on principles from a range of different accounting standards and the application guidance within FRS 5 – Reporting the substance of transactions. Under IFRS, IAS 18 – Revenue ("IAS 18") has specific guidance relating to revenue recognition. The group has changed the timing of revenue recognition in its associate such that revenue on an electricity supply contract is recognised on a straight line basis in accordance with IAS 18.

In addition, under UK GAAP, the group recognised revenue on certain oil and gas swaps in line with the run-out of certain gas contracts, resulting in deferred income on the balance sheet. IFRS requires that the contracts are considered independently and under IAS 18 revenue is recognised on settlement of the transaction.

Other

Other differences on transition from UK GAAP to IFRS are not individually material and primarily relate to the timing of recognition of provisions

34 Reconciliation of net assets and profit under UK GAAP to IFRS (continued)

IFRS presentation adjustments

In addition to the adjustments above that cause changes to shareholders' equity and profit for the year, the following reclassifications have been made that impact certain line items.

Revenue Recognition

In the income statement, the energy trading activities undertaken by the Group are presented on a net basis within revenue under IFRS. Unrealised gains and losses on net open physical positions and realised gains and losses on liquidated positions are all included within revenue. Under UK GAAP, liquidated sales were included within revenue and liquidated purchases, along with unrealised gains and losses on net open positions were included within cost of sales.

Share of results of associates

Under UK GAAP, the Group's share of associates' operating profit, interest and tax are classified within their respective profit and loss account captions. IFRS requires that, where equity accounting is adopted, the post tax share of results of associates is separately disclosed as a single line item in the profit and loss account.

Short term provisions

Under UK GAAP, provisions are presented on the balance sheet separately from creditors and include both current and non-current elements. Under IFRS, the current portion of provisions is included in current liabilities.

Other

Balances related to pensions, leases, taxation and translation reserves are required to be presented separately under IFRS and have therefore been shown separately in the IFRS balance sheet or appropriate footnotes to the financial statements.

Financial Instruments

The Group adopted IAS32 and IAS39 from 1 January 2005. These standards set out the accounting rules surrounding the recognition, measurement, disclosure and presentation of financial instruments.

As described in Note 20, the Group holds a variety of financial instruments including various derivatives. Under UK GAAP, the majority of these derivatives were not recorded on the balance sheet. IAS39 requires that derivatives that do not qualify for the own use exemption are recorded as either assets or liabilities in the balance sheet and are measured at fair value. Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the income statement as they arise.

34 Reconciliation of net assets and profit under UK GAAP to IFRS (continued)

Shareholders' equity increased by £105 million at 1 January 2005. This represents the recognition of the fair value of treasury and commodity derivatives on the balance sheet, offset by the recognition of deferred tax.

E.ON UK PLC

COMPANY ACCOUNTS

For the year ended 31 December 2005

Independent auditors' report to the shareholder of E.ON UK plc

We have audited the parent company financial statements of E.ON UK plc for the year ended 31 December 2005 which comprise the Balance Sheet and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of E.ON UK plc for the year ended 31 December 2005.

Respective responsibilities of directors and auditors
The directors' responsibilities for preparing the Annual Report and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company 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 parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the parent company financial statements, if the company has not kept proper accounting records, if 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 parent company 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 parent company financial statements. Our responsibilities do not extend to any other information.

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 parent company financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company'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 parent company 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 parent company financial statements.

Opinion
In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2005; and

- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

26 June 2006

E.ON UK PLC

BALANCE SHEET
as at 31 December 2005

	Note	31 December 2005 £m	31 December 2004 (restated) £m
Fixed Assets			
Intangible assets			
Goodwill	5	**26**	28
Other	5	**41**	-
Total Intangible assets		**67**	28
Tangible assets	6	**1,241**	1,084
Investments			
Investments in associates	7	**2**	2
Investments in subsidiaries	7	**3,602**	3,337
Other	7	**17**	24
Total investments		**3,621**	3,363
Commodity and other derivative financial instruments	13	**44**	-
		4,973	4,475
Current assets			
Stocks	8	**177**	132
Debtors: amounts falling due within one year	9	**3,869**	2,240
Commodity and other derivative financial instruments	13	**1,414**	-
Cash and short term deposits		**28**	8
		5,488	2,380
Creditors: amounts falling due within one year			
Loans and overdrafts	10	**(2,138)**	(994)
Commodity and other derivative financial instruments	13	**(699)**	-
Trade and other creditors	11	**(3,905)**	(2,824)
Net current liabilities		**(1,254)**	(1,438)
Total assets less current liabilities		**3,719**	3,037

E.ON UK PLC

BALANCE SHEET
as at 31 December 2005 (continued)

	Note	31 December 2005 £m	31 December 2004 (restated) £m
Creditors: amounts falling due after more than one year			
Long-term loans	12	**(1,295)**	(820)
Commodity and other derivative financial instruments	13	**(1)**	-
Other creditors	14	**(1)**	(1)
Provisions for liabilities and charges	15	**(101)**	(62)
Deferred tax	16	**(243)**	(113)
Net assets		**2,082**	2,041
Capital and reserves			
Called-up share capital	17	**325**	325
Share premium account	18	**97**	97
Capital reserve	18	**474**	474
Capital redemption reserve	18	**85**	85
Profit and loss account	18	**1,101**	1,060
Equity shareholder's funds	19	**2,082**	2,041

The financial statements on pages 93 to 125 were approved by the Board on 26 June 2006 and signed on its behalf by:

G J Bartlett

Graham John Bartlett
Director

The accounting policies and notes on pages 95 to 125 form an integral part of these financial statements

Notes to the financial statements
for the year ended 31 December 2005

1 Accounting Policies

Nature of operations

The principal business in the UK is the generation, trading and wholesale of electricity and gas.

Basis of preparation of accounts

The financial statements are prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards and the Companies Act 1985.

There is no difference between the profit on ordinary activities before taxation and the retained profit for the year stated in Note 2 and their historical cost equivalents. Values of assets and liabilities vested in the Company on 31 March 1990 under the Transfer Scheme made pursuant to the Electricity Act 1989 (the Transfer Scheme) are based on their historical cost to the Central Electricity Generating Board (CEGB).

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. Actual results can differ from those estimates.

Change in accounting policy

The Company has adopted Financial Reporting Standard 17, 'Retirement Benefits' (FRS 17), Financial Reporting Standard 25, 'Financial instruments: Disclosure and presentation' (FRS 25) and Financial Reporting Standard 26, 'Financial instruments: measurement' (FRS 26) during the year. The adoption of each of these standards represents a change in accounting policy.

FRS 17 replaces Statement of Standard Accounting Practice 24, 'Accounting for Pension Costs' (SSAP 24). The most significant impact of this change is on the Company's accounting for its defined benefit pension schemes. The Company participates in a group pension scheme and is unable to identify its share of the underlying assets and liabilities of the group pension scheme. Consequently, under FRS 17 the Company accounts for its contributions to the group pension scheme as if the scheme was a defined contribution scheme and accounts for contributions payable to the group pension scheme in the accounting period in which they fall due. Under SSAP24, the Company accounted for the majority of the Group's defined benefit costs and charged costs to the profit and loss account so as to spread the cost of pensions over the employees remaining working lives. Adoption of FRS 17 has been treated as a change in accounting policy and all comparative information presented has been restated. The impact of adopting FRS 17 at 1 January 2004 was to increase net assets at 31 December 2004 by £94 million. Profit for the year ended 31 December 2004 was increased by £4 million.

Notes to the financial statements
for the year ended 31 December 2005 (continued)

The Company has taken the exemption allowed in paragraph 108D of FRS 26 that for accounting periods that commence before 1 January 2007, restated comparative information to comply with FRS 26 and FRS 25 is not required. Comparative data has therefore been prepared in accordance with UK GAAP that applied at that time. The main adjustments that would be required to comply with these standards would be the recognition on the balance sheet of the fair value of the Company's derivative financial instruments. The Company holds several derivative instruments (described below). Movements in the fair value of the Company's derivative instruments would pass through the profit and loss account or through the profit and loss account reserve, depending on whether hedge accounting treatment was being applied. The impact of the adoption of FRS 25 and FRS 26 at 1 January 2005 was to recognise the fair value of the derivatives held by the Company on the balance sheet, with corresponding entries to the profit and loss account reserve of £114 million.

Prior year adjustment

During the year, the Company's management have become aware of a material error in previously disclosed information. In 2002, when the Company became part of the E.ON AG Group, an exercise was undertaken to reassess the asset lives of the Group's generation plant. The useful economic lives of the plant were extended as a result of this assessment. During the Group's process of identifying UK to IFRS adjustments, management became aware that the depreciation calculations under UK GAAP had been incorrectly updated to reflect these increased lives. The balance sheet at 1 January 2004 has been adjusted to increase the net book value of fixed assets by £34 million, with an equal entry to the profit and loss account reserve, reinstating depreciation that should not have been charged to that date. Deferred tax of £9 million has also been recorded, resulting in a net opening profit and loss account reserve adjustment of £24 million. Depreciation charged during 2004 has been reduced by £26 million, offset by deferred tax of £7 million, resulting in a net impact to retained profit of £18 million during 2004 and a total adjustment to the profit and loss account reserve of £42 million at 31 December 2004.

Going concern

Not withstanding the fact that the Company has net current liabilities, the directors have prepared the financial statements on the going concern basis. The directors have received confirmation from Powergen Limited, the intermediate parent undertaking, of its intention to financially support the Company such that they 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.

Turnover

Turnover within the United Kingdom comprises revenue from the generation, trading and wholesale of electricity and gas. Turnover excludes Value Added Tax.

Provisions

Provisions are recognised in the balance sheet when the Company 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 and related fixed asset are recognised in respect of the estimated total discounted cost of decommissioning generating assets. The resulting fixed asset is depreciated on a straight-line basis, and the discount is amortised over the useful life of the associated power stations.

Future operating costs are not provided for.

Foreign exchange

Assets and liabilities expressed in foreign currencies are translated to Sterling at rates of exchange ruling at the end of the financial year.

Transactions denominated in foreign currencies are translated to Sterling at the exchange rate ruling on the transaction date. As set out below and as permitted by FRS 26, prior to 1 January 2005 the Company followed UK GAAP hedge accounting in place prior to FRS 26 and monetary assets and liabilities denominated in foreign currencies were translated at hedged rates where matching forward foreign exchange contracts had been entered into.

Differences on exchange arising from the re-translation of the opening net investment in subsidiaries, associated undertakings and joint ventures 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 gains and losses. All other realised foreign exchange differences are taken to the profit and loss account in the year in which they arise.

Financial instruments (policies applied in the preparation of the financial statements for the year-ended 31 December 2005)

The accounting policies below have been applied in preparing the financial information for the year-ended 31 December 2005, following the application of FRS 25 and FRS 26 on 1 January 2005.

Fixed asset investments

Investments in subsidiaries and associates are stated at original cost plus subsequent loans advanced or amounts invested. Provision is made for any impairment in the value of investments.

Other investments are treated as available for sale and are carried at fair value. Unrealised gains and losses on available for sale investments are recognised in equity until the investment is disposed of.

Debt Instruments

In accordance with FRS 26, all borrowings are initially stated at the fair value of consideration received after deduction of directly attributable transaction costs. The issue costs and interest payable on bonds are charged to the income statement at a constant rate over the life of the bond. Any premium or discount arising on the early repayment of borrowings is written off to the profit and loss account as incurred or received.

Derivative Instruments

The Company uses a range of derivative instruments, including interest rate swaps, cross-currency swaps and energy-based options and futures contracts and foreign exchange contracts. Derivative instruments are used for hedging purposes, apart from certain energy-based options and futures contracts, which are used for trading purposes. Wherever possible, the Company takes the own use exemption permitted by FRS 26 for commodity contracts entered into and held for the purpose of the Company's own purchase, sale or usage requirements. Commodity contracts that do not qualify for own use exemption, including those entered into for trading purposes are accounted for in accordance with the policy below. Certain commodity derivatives qualify as designated hedges of future cash flows.

Derivative instruments are recorded as either assets or liabilities in the balance sheet and measured at fair value. Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the profit and loss account as they arise.

Changes in the value of instruments that are designated and effective as hedges of future cash flows ("cash flow hedges") are recognised directly in equity, with any ineffective portion recognised immediately in the profit and loss account.

Changes in the value of derivative instruments that are designated as hedges of the changes in fair value of assets or liabilities ("fair value hedges") are recognised in the profit and loss account. A movement in fair value in the hedged item that is attributable to the risk being hedged is also recognised in the profit and loss account, resulting in any ineffectiveness being recognised immediately in the profit and loss account.

Exchange gains or losses arising on financial instruments that are designated and effective as hedges of the Company's net investment in overseas subsidiaries are recorded directly in equity, with any ineffective portion recognised immediately in the profit and loss account.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or no longer qualifies for hedge accounting. At that time, any cumulative gains or losses relating to cash flow hedges recognised in equity are recognised in the profit and loss account in the same periods in which the hedged item affects net profit or loss. If a hedged transaction is no longer expected to occur, any net cumulative gain or loss recognised in equity is immediately transferred to the profit and loss account.

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.

Financial instruments (policies applied in the preparation of financial statements for the year-ended 31 December 2004)

The accounting policies below have been applied in preparing the financial information for the year-ended 31 December 2004.

Fixed asset investments

Fixed asset investments are stated at original cost plus subsequent loans advanced or amounts invested. Provision is made for any impairment in the value of investments.

Debt instruments

All borrowings are initially stated at the fair value of consideration received after deduction of issue costs. The issue costs and interest payable on bonds are charged to the profit and loss account at a constant rate over the life of the bond. Any premium or discount arising on the early repayment of borrowings is written off to the profit and loss account as incurred or received.

Derivative Instruments

The company uses a range of derivative instruments, including interest rate swaps, cross-currency swaps and energy-based options and futures contracts and foreign exchange contracts and swaps. Derivative instruments are used for hedging purposes, apart from energy-based options and futures contracts, which are used for trading purposes. The accounting policy for each instrument is set out below. Interest differentials on derivative instruments are charged to the profit and loss account as interest costs in the period to which they relate. Changes in the market value of options and futures trading contracts are reflected in the profit and loss account in the period in which the change occurs.

a) Interest rate swaps

Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these agreements are recognised as adjustments to interest expense over the period of the contracts.

b) Forward currency contracts

The Company enters into forward currency contracts for the purchase and/or sale of foreign currencies in order to manage its exposure to fluctuations in currency rates. With the exception of contracts used for translation hedging purposes, unrealised gains and losses on currency contracts are not accounted for until the maturity of the contract. The cash flows from forward purchase currency contracts are classified in a manner consistent with the underlying nature of the hedged transaction.

c) Currency swaps

Currency swap agreements are used to manage foreign currency exposures and are accounted for using hedge accounting. In order to qualify for hedge accounting the instrument must be identified to a specific foreign currency asset or liability and must be an effective hedge. Foreign currency loans, where the repayment of principal is hedged by currency swaps, are included in the balance sheet at the closing exchange rate. The fair value of the swap is also recognised. Interest on the loan is charged to the profit and loss account at the hedged rate.

d) Commodity Instruments

The Company makes use of energy trading derivative financial instruments, a certain proportion of which relate to proprietary trading activities. The instruments relating to these activities are traded in an established and liquid market place. Open derivative positions are marked to market through operating costs.

Notes to the financial statements for the year ended 31 December 2005 (continued)

Intangible Fixed Assets

Goodwill

Purchased goodwill is capitalised in the balance sheet and amortised on a straight-line basis through the profit and loss account over its estimated useful economic life of 20 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 cost of goods sold.

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

Tangible fixed assets

Tangible fixed assets are stated at original cost, less accumulated depreciation and any provision for impairment. Impairment losses and any subsequent reversals are recognised in the period in which they are identified. In the case of assets constructed by the Company, directly related overheads and commissioning costs are included in cost.

Major assets in the course of construction are included in tangible fixed assets on the basis of expenditure incurred at the balance sheet date. Where borrowings are specifically financing the construction of a major capital project with a long period of development, interest payable, not exceeding the actual amount incurred during the relevant period of construction, is capitalised as part of the cost of the asset and written off over the economic useful life of the asset.

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 tangible fixed assets. Assets are depreciated over their estimated useful lives or, in the case of leased assets, over the lease term if shorter. Estimated useful lives are reviewed periodically. No depreciation is provided on freehold land or assets in the course of construction.

The estimated useful lives for the other principal categories of fixed assets are:

Asset	*Life in years*
Generating assets	25-45
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.

Fuel stocks and stores

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

Cash and short-term deposits

Short-term deposits include cash at bank and in hand, and certificates of tax deposit.

Taxation

The tax charge for the year is based on the profits or losses on ordinary activities for the year and takes into account full provision for deferred tax in respect of timing differences on a discounted basis, using the approach set out in Financial Reporting Standard 19 'Deferred tax' (FRS 19). Such timing differences arise primarily from the differing treatment for taxation and accounting purposes of provisions and depreciation of fixed assets. Deferred tax liabilities are recognised in respect of all timing differences that have originated but not reversed at the balance sheet date. Deferred tax assets are recognised when it is more likely than not that they will be recovered.

Cash flow statement

The Company is a wholly owned subsidiary undertaking of E.ON AG, the ultimate parent undertaking of the E.ON AG Group, and is included in the publicly available consolidated financial statements of E.ON AG. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of Financial Reporting Standard 1 (revised 1996).

Notes to the financial statements for the year ended 31 December 2005 (continued)

Related party transactions

The Company is exempt under the terms of Financial Reporting Standard 8, Related Party Transactions, from disclosing related party transactions with entities that are part of the E.ON AG Group or investees of the E.ON AG Group.

Pension costs

The Company contributes to a funded group pension scheme operated by the Company, the assets of which are invested in a separate trustee-administered fund. The Company is unable to identify its share of the underlying assets and liabilities of the group pension scheme. The Company has accounted for its contribution to the group pension scheme as if the scheme was a defined contribution scheme and accounts for contributions payable to the group pension scheme in the accounting period in which they fall due.

Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease.

Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet, when the Company has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or realise the asset and settle the liability simultaneously.

**Notes to the financial statements
for the year ended 31 December 2005 (continued)**

2 Profit of the Company

The profit attributable to shareholders for the financial year of the Company is £59 million (year ended 31 December 2004 (restated) £59 million profit). The Company is not publishing a separate profit and loss account as permitted by Section 230 of the Companies Act 1985.

3 Operating costs

Auditors' remuneration in respect of the Company was £0.6 million (2004: £0.3 million).

4 Directors remuneration

The total remuneration of the Company's directors, together with details of the individual remuneration of the highest paid director are as follows:

All directors	**Year ended 31 December 2005 £**	Year ended 31 December 2004 £
Aggregate emoluments	**2,189,445**	2,313,999

Highest paid director	**Year ended 31 December 2005 £**	Year ended 31 December 2004 £
Total emoluments, excluding gains on the exercise of share options and benefits under long-term incentive schemes	**955,625**	911,003
Defined benefit pension scheme:		
- Accrued pension at end of year	**112,180**	88,830

During the year three (2004 nil) directors exercised Stock Appreciation Rights over shares in the ultimate parent company, E.ON AG, that they were awarded for services to the E.ON UK Group.

Notes to the financial statements for the year ended 31 December 2005 (continued)

5 Intangible fixed assets

	Goodwill £m	Other £m	Total £m
Cost			
At 31 December 2004	32	-	**32**
Additions	-	41	**41**
At 31 December 2005	**32**	**41**	**73**
Amortisation			
At 31 December 2004	4	-	4
Charge for the year	2	-	2
At 31 December 2005	**6**	**-**	**6**
Net book value at 31 December 2005	**26**	**41**	**67**
Net book value at 31 December 2004	28	-	28

Other intangible assets primarily comprise emission rights and are not amortised.

6 Tangible fixed assets

	Generating assets £m	Other assets £m	Total £m
Cost			
At 31 December 2004	3,082	186	3,268
Additions	109	13	122
Group transfers	123	5	128
Disposals	(312)	(19)	(331)
At 31 December 2005	**3,002**	**185**	**3,187**
Depreciation			
At 31 December 2004 (restated)	2,019	165	2,184
Charge for the year	82	9	91
Disposals	(312)	(17)	(329)
At 31 December 2005	**1,789**	**157**	**1,946**
Net book value at 31 December 2005	**1,213**	**28**	**1,241**
Net book value at 31 December 2004 (restated)	1,063	21	1,084

Company assets include freehold land and buildings with a net book value of £71 million (year ended 31 December 2004: £95 million).

Notes to the financial statements for the year ended 31 December 2005 (continued)

7 Investments

	Subsidiary investment Equity £m	Associate investment Equity £m	Other Investments £m	Total £m
At 31 December 2004	3,337	2	24	3,363
Adoption of FRS 26	-	-	1	1
Revaluation surplus transfer to equity	-	-	1	1
Additions	265	-	1	266
Disposals	-	-	(10)	(10)
At 31 December 2005	**3,602**	**2**	**17**	**3,621**

Other investments include the following:

	At 31 December 2005 £m	At 31 December 2004 £m
Listed equity securities – UK	1	-
Listed gilts – UK	**16**	15
Unlisted debt	-	9
	17	24

Interests in subsidiary undertakings

Details of the Company'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 Company as a whole.

Name	Class of share capital	Proportion of nominal value of issued equity shares and voting rights held by the Group or the Company %	Country of incorporation or registration	Principal business activities
Powergen International Limited	Ordinary shares	100	England and Wales	Holding company for international activities
Powergen Retail Limited	Ordinary shares	100	England and Wales	Supply of electricity and supply, trading and shipping of gas in the UK
Powergen (East Midlands Investment)	Ordinary shares	100	England and Wales	Holding company for distribution activities
Powergen Renewables Holdings Limited	Ordinary shares	100	England and Wales	Holding company for renewable activities

Notes to the financial statements for the year ended 31 December 2005 (continued)

7 Investments (continued)

Associates

Details of the Company's principal investments in associates are as follows:

	Accounting reference date	Country of incorporation or registration	Shares held	Percentage of capital held directly or indirectly by the Company
Biogeneration Limited	31 March	England and Wales	Ordinary shares	50%

The principal activity of this associate is the generation of electricity from biomass. The share capital of the company is £1,000.

8 Stocks

	At 31 December 2005 £m	At 31 December 2004 £m
Fuel stocks	**153**	109
Stores	**24**	23
	177	132

9 Debtors: amounts falling due within one year

	At 31 December 2005 £m	At 31 December 2004 (restated) £m
Trade debtors	**619**	396
Other debtors	**108**	50
Prepayments and accrued income	**47**	60
Amounts due from parent undertaking and fellow subsidiaries	**3,095**	1,734
	3,869	2,240

The amounts due from parent undertaking and fellow subsidiaries are non interest bearing and repayable on demand.

10 Loans and overdrafts

	At 31 December 2005 £m	At 31 December 2004 £m
Bank overdrafts	**62**	98
Short term loans from parent undertaking and fellow subsidiaries	**2,032**	868
Other short-term loans	**44**	28
	2,138	994

Short-term funding is provided through inter-company facilities.

The weighted average interest rate on all short-term loans during the year was 5.1% (year ended 31 December 2004: 3.9%).

11 Trade and other creditors falling due within one year

	At 31 December 2005 £m	At 31 December 2004 (restated) £m
Trade creditors	**817**	510
Amounts owed to parent undertaking and fellow subsidiaries	**166**	140
Amounts owed to subsidiaries	**2,704**	1,918
Corporation tax	**21**	74
Other taxation and social security	**12**	3
Accruals and other creditors	**185**	179
	3,905	2,824

The amounts due to parent undertaking, fellow subsidiaries and subsidiaries are non interest bearing and repayable on demand.

12 Long term loans

	At 31 December 2005 £m	At 31 December 2004 £m
Amounts owed to external debt holders		
8.5% Sterling Bond 2006	-	44
5% Euro Eurobond 2009	181	187
Intra-Group swaps	-	(15)
	181	172
6.25% Sterling Eurobond 2024	3	3
Loan Notes 2007	4	-
	188	219
Amounts owed to fellow group undertakings		
8.5% Sterling Bond 2006	-	206
5% Euro Eurobond 2009	162	167
Intra-Group swaps	-	(13)
	162	154
6.25% Sterling Eurobond 2024	243	241
Long term loan	702	-
	1,107	601
	1,295	820

None of the bonds outstanding at 31 December 2005 has any financial covenants.

13 Financial Instruments

Treasury Instruments

As part of the financing of its normal operating activities, the Company holds a variety of financial instruments including swaps, futures, 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 Group Financial Review.

Commodity Instruments

Within the ordinary course of business the Company 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 Company's expected sale, purchase or usage requirements. Such contracts are not in the scope of FRS 26.

Certain commodity contracts are held for trading and are within the scope of FRS 26. These are recognised on the balance sheet at fair value with the movements in fair value recognised in the Company profit and loss account. The Company 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 profit and loss account 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 profit and loss account.

Valuation

The fair value of derivative instruments is sensitive to movements in underlying market rates and other relevant variables. The Company assesses and monitors the fair value of derivative instruments on a periodic basis. Fair values for each derivative financial instrument are determined as being equal to the price at which one party would assume the rights and duties of another party and calculated using common market valuation methods with reference to available market data as of the balance sheet date.

13 Financial Instruments (continued)

The following is a summary of the methods and assumptions for the valuation of financial instruments:

- 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 are valued by the use of valuation models that include average probabilities and take into account individual contract details and variables.

In accordance with FRS 26, the Company 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 Company has identified several embedded derivatives within its long term gas contracts. These contracts satisfy the criteria of paragraph 5 of FRS 26 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 £122 million. Gains and losses arising from the movement in the value of embedded derivatives flow through the profit and loss account as hedge accounting is not available. £46 million was charged to the profit and loss account during 2005 in respect of fair value movements related to embedded derivatives.

As discussed in Note 1, the Company applied FRS 25 and FRS 26 from 1 January 2005. Disclosures for the year ended 31 December 2005 are made in accordance with FRS 25. Disclosures relating to the year ended 31 December 2004 are presented on the basis of UK GAAP applied at that time.

13 Financial Instruments (continued)

Amounts recognised in respect of derivative financial instruments are as follows:

	Assets £m	Liabilities £m
At 31 December 2005		
Interest rate swaps	17	(1)
Cross currency swaps	23	(7)
Forward foreign currency contracts	7	(3)
Commodity swaps	112	(58)
Commodity forward contracts	1,299	(509)
Embedded derivatives within long term gas contracts	-	(122)
	1,458	(700)

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.

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
Commodity forward contracts		
Less than 1 year	196	(5)
1 to 5 years	44	-
	240	**(5)**

13 Financial Instruments (continued)

Maturities of derivative financial instruments designated as fair value hedges at the balance sheet date were:

	Contracts with positive fair values £m	Contracts with negative fair values £m
Interest rate swaps		
Greater than 5 years	-	(1)

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
Interest rate swaps	17	-
Cross currency swaps	23	(7)
Foreign currency forward contracts	7	(3)
Commodity swaps	112	(58)
Commodity forward contracts	1,059	(504)
Embedded derivatives within long term gas contracts	-	(122)
Total	**1,218**	**(694)**

The notional principal amount of derivatives and maturities at 31 December 2005 are as follows:

	Within 1 year £m	1 – 5 years £m	After 5 years £m	Total £m
Interest rate swaps	543	-	242	785
Cross currency swaps	548	-	-	548
Foreign currency forward contracts	364	-	-	364
Commodity swaps	570	-	-	570
Commodity forward contracts	3,405	601	-	4,006
Embedded derivatives within long term gas contracts	1,204	-	-	1,204
	6,634	**601**	**242**	**7,477**

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 2018 and interest rate swaps, cross currency swaps, foreign currency forward contracts, commodity swaps and commodity forward contracts that expire over the next 5 years.

13 Financial Instruments (continued)

Fair value of non-derivative financial instruments

The estimated fair value of principal non-derivative financial instruments held or issued to finance the group's operations is as follows.

	Note	**31 December 2005** Book Value £m	Fair value £m	31 December 2004 Book Value £m	Fair Value £m
Long term borrowings	(ii)	**(1,295)**	**(1,363)**	(820)	(918)
Short term debt	(i)(iv)	**(2,138)**	**(2,138)**	(994)	(994)
Cash and short term deposits	(iii)	**28**	**28**	8	8

(i) The fair value of short term debt approximates to the carrying value due to the short maturity of these loans.
(ii) The fair value of the long term debt has been stated at quoted market value
(iii) The fair value of short term deposits approximates to carrying value due to the short maturity of instruments held.
(iv) The fair values shown for short and long-term debt do not take account of the fair values of cross currency swaps shown above.

The estimated fair value of the Company's other financial assets and liabilities as at 2004, is as follows (information provided in accordance with previous UK GAAP) :

	Note	31 December 2004 Book Value £m	Fair Value £m
Instruments held to manage the interest rate and currency profile:			
Foreign currency contracts	(i)	-	(18)
Foreign currency swaps	(i)	-	12
Interest rate swaps	(i)	-	25
Investments held for financial energy trading purposes:			
Energy derivatives held for trading	(ii)	1	1
Derivatives held to manage the financial profile	(iii)	-	11

(i) The fair values shown for short and long-term debt do not take account of the fair values of cross currency swaps shown above
(ii) The fair value of energy derivatives is based on quoted market value
(iii) Derivatives held to manage financial profile relate to oil swaps valued at quoted market value

Notes to the financial statements for the year ended 31 December 2005 (continued)

13 Financial Instruments (continued)

Maturity of financial liabilities

The maturity profile of the carrying amount of the company's non-current liabilities, at 31 December was as follows:

	At 31 December 2005 £m	At 31 December 2004 £m
In more than one year but not more than two years	**4**	250
In more than two years but not more than five years	**1,045**	326
In more than five years	**246**	244
	1,295	820

At 31 December 2005 there were £339 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, with the exception of the Powergen Limited facility, expire within 12 months from the balance sheet date. These facilities comprise:

Facility	Total facility £m	Amount undrawn at 31 December 2005 £m	Expiry date	Fees
E.ON UK plc – committed facility from E.ON AG *	870	35	21 December 2010	10bp
E.ON UK plc – committed facility from Powergen Limited	950	220	25 July 2008	-
E.ON UK plc – committed facility from Raab Karcher Electronic Systems plc	300	84	21 December 2010	-
	2,120	**339**		

* Drawings include £83 million from Fidelia Corporation, a fellow subsidiary undertaking of E.ON AG, as these drawings fall under the E.ON AG facility.

13 Financial Instruments (continued)

Foreign exchange risk management

The Company enters into foreign exchange contracts in accordance with its hedging policies. These policies are discussed under 'Foreign exchange risk management' in the Group Financial Review.

There are no material monetary assets or liabilities of the Company 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.

Information on contracts held at 31 December 2005 is included in the disclosures above. At 31 December 2004, the net Sterling notional amounts of each foreign currency the Group has contracted to purchase (or sell) were as follows:

	At 31 December 2004 £m
US Dollars	18
Euros	19
	37

The weighted average time to maturity of foreign exchange contracts at 31 December 2004 was nine months.

The notional amounts of foreign currency swaps held at 31 December 2004 were as follows:

	At 31 December 2004 £m
Foreign currency swaps into Sterling	444

Notes to the financial statements
for the year ended 31 December 2005 (continued)

13 Financial Instruments (continued)

Interest rate risk management

The Company 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, as described in the Group Financial Review. Information on contracts held at 31 December 2005 is included in the disclosures above. The notional amounts of instruments used at 31 December 2004 can be summarised as follows:

	At 31 December 2004 £m
Interest rate swap contracts	**754**

The weighted average time to maturity of interest rate swap contracts at 31 December 2004 was 3 years.

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
	£m	£m	£m	%	Years
At 31 December 2005					
Sterling	**3,062**	**2,563**	**499**	**9.0**	**9.6**
Euros	**371**	**371**	**-**	**-**	**-**
	3,433	**2,934**	**499**	**9.0**	**9.6**

	Total	Floating rate financial liabilities	Fixed rate financial liabilities		
				Weighted average interest rate	Weighted average period for which rate is fixed
	£m	£m	£m	%	Years
At 31 December 2004					
Sterling	1,766	1,113	653	8.9	7.0
Euros	48	48	-	-	-
	1,814	1,161	653	8.9	7.0

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.

13 Financial Instruments (continued)

In addition to the above, the Company's provisions include £1 million (2004: £3 million) for contract provisions (see note 14) which meet the definition of financial liabilities under FRS 26 and, previously, Financial Reporting Standard 13 'Derivatives and other financial instruments'. 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.

At 31 December 2005, the Company held £28 million (2004: £8 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.

14 Other creditors falling due after more than one year

	At 31 December 2005 £m	At 31 December 2004 £m
Accruals and other creditors	**1**	1

15 Provisions for liabilities and charges

Movements on provisions comprise:

	31 December 2004	Charged / (released) to the profit and loss account	Amortisation of discount	Provisions utilised	**31 December 2005**
	£m	£m	£m	£m	**£m**
Liability and damage claims	12	(10)	-	-	**2**
Contract provisions	3	-	-	(2)	**1**
Decommissioning	47	1	3	(8)	**43**
Emissions obligations	-	55	-	-	**55**
	62	46	3	(10)	**101**

The liability and damage claims provision includes reserves in respect of potential claims for pension rationalisation costs. Given the inherent uncertainty surrounding the timing of any potential claims, it is not possible to estimate when these amounts will crystallise.

Contract provisions at 31 December 2005 relate to out of the money electricity purchase contracts, acquired on the purchase of Central Networks East, and will be utilised over the period to 2008, when the contracts terminate.

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.

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

Notes to the financial statements for the year ended 31 December 2005 (continued)

16 Deferred tax

An analysis of the full provision and discounted provision for deferred tax recognised at 31 December 2005 is as follows:

	At 31 December 2005 £m	At 31 December 2004 (restated) £m
Accelerated capital allowances	**226**	**215**
Other timing differences	**76**	**(47)**
Undiscounted provision for deferred tax	**302**	**168**
Discount	**(59)**	**(55)**
Discounted provision for deferred tax	**243**	**113**

The undiscounted liability in respect of accelerated capital allowances and other timing differences is calculated at 30% in both periods.

17 Share capital

The share capital of the Company comprises:

	At 31 December 2005 £m	At 31 December 2004 £m
Authorised		
1,050,000,002 ordinary shares of 50p each	**525**	525
Allotted, called-up and fully paid		
649,241,799 ordinary shares of 50p each	**325**	325

Notes to the financial statements for the year ended 31 December 2005 (continued)

18 Reserves

	Share premium account £m	Special capital reserve £m	Capital redemption reserve £m	Profit and loss account £m
At 31 December 2004 as previously reported	97	474	85	918
Prior year adjustment – Correction of asset lives	-	-	-	44
Prior year adjustment – Adoption of FRS 17	-	-	-	98
At 31 December 2004 (restated)	97	474	85	1,060
Adoption of FRS 26 (net of tax)	-	-	-	114
Cash flow hedges (net of tax)	-	-	-	108
Profit for year	-	-	-	59
Dividends	-	-	-	(240)
At 31 December 2005	**97**	**474**	**85**	**1,101**

The share premium account, 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 CEGB's net assets were vested in its successor companies.

19 Reconciliation of movements in shareholder's funds

	31 December 2005 £m	31 December 2004 £m
Profit for the financial year	59	37
Dividends	(240)	-
	(181)	37
Prior year adjustments	-	142
Adoption of FRS 26	114	-
Cash flow hedges (net of tax)	108	-
Net movement in shareholders' funds	41	179
Opening shareholder's funds	2,041	1,862
Closing shareholder's funds	2,082	2,041

20 Pension commitments

At 31 December 2004, the Company had both statutorily approved defined benefit pension schemes and several smaller statutorily approved defined contribution schemes.

The Company participates in the UK industry-wide scheme, the Electricity Supply Pension Scheme (ESPS), for the majority of its UK based employees. This is a funded scheme of the defined benefit type, with assets invested in separate trustee administered funds. At 31 December 2005, the Group has four separate funds with the ESPS: the Powergen fund, the East Midlands Electricity fund, the TXU fund and the Midlands Electricity Fund. An actuarial valuation of the ESPS is normally carried out every three years by the Scheme's independent, professionally qualified actuary, who recommends the rates of contribution payable by each group participating in the scheme. In intervening years the actuary reviews the continuing appropriateness of the rates.

The latest published actuarial valuation of the ESPS was at 31 March 2004. Particulars of this actuarial valuation are shown below. The 2004 valuation revealed a combined deficit across all four schemes of £729 million. Details of the market value of assets implicit in these valuations, and the major assumptions used in the preparation of these valuations were:

	Powergen fund	East Midlands Electricity fund	TXU fund	Midlands Electricity fund	Total
Valuation deficit	£229m	£93m	£282m	£125m	£729m
Market value of assets	£1,250m	£817m	£793m	£841m	£3,701m
Funding level	84.5%	90%	74%	87.1%	79%

All the schemes were valued using the same assumptions which are as follows	
– average nominal rate of return on investments (pre-retirement)	6.2%
– average nominal rate of return on investments (post-retirement)	5.2%
– average nominal rate of annual increase in salaries	3.9%
– average nominal rate of annual increase in pensions	3.0%
Inflation rate	2.9%
Method of valuation used	Projected unit

The funding policy differs from the accounting policy in that it uses a more conservative basis for valuation.

20 Pension commitments (continued)

The contributions paid by the Company are accounted as if the scheme were a defined contribution scheme, as the Company is unable to identify its share of the underlying assets and liabilities in the scheme. The cost of contributions to the group scheme amount to £445,622,793 (2004: £12,411,300), being 16.1 percent of pensionable salary (excluding the one-off payment discussed below), and are based on pension costs across the group as a whole.

Contributions during 2005 were significantly higher due to a one-off payment into the pension scheme of £432 million. It has been agreed with the trustees that regular contributions to the scheme are to remain at the same level for the next three years.

An amount of £1 million (2004: £1 million) is included within other creditors, being the outstanding contributions to the Company scheme.

21 Commitments and contingent liabilities

a) At 31 December 2005, the Company had commitments contracted but not provided of £109 million (31 December 2004: £12 million) for capital expenditure.

b) The Company 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 Company.

The directors are of the opinion, having regard to legal advice received, the Company'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 Company's financial position, results of operations or liquidity.

21 Commitments and contingent liabilities (continued)

c) Complaints were made to the European Commission by the National Association of Licensed Opencast Operators (NALOO) and the South Wales Small Mines Association (SWSMA) against, amongst others, the Company and National Power plc in 1990 (NALOO and SWSMA) and 1994 (NALOO only). The complaints alleged breaches of EU law by the Central Electricity Generating Board 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 both complaints, on legal grounds, in 1998, which decisions were appealed by NALOO and, separately, by some former members of SWSMA. In 2003, the Court of Justice of the European Communities found in favour of NALOO, overturning the Commission's rejection of the complaint and whilst judgement has not yet been given in the appeal by the former SWSMA members all of the parties have agreed that this has now become devoid of purpose, in the light of the NALOO decision. The Commission indicated its intention to reject the complaints on their merits, but offered the parties the opportunity to negotiate a settlement to avoid further litigation by appeal. Settlement discussions have taken place following a meeting called by the Commission in January 2006. These discussions were based upon The Commission's calculation that the remaining NALOO and SWSMA claimants had total maximum claims of £11.2m and £ 1.6m, respectively and that a payment of the order of 5-15% of the maximum claims was appropriate. However, no settlement has been reached.

d) The Company 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 2005 the Company's future commitments for the supply of coal under all its contractual arrangements totalled £535 million (31 December 2004: £333 million).

The Company also has purchase contracts for peat to burn in Edenderry power station. At 31 December 2005 the Company's future purchase commitment totalled £18 million (31 December 2004: £17 million).

The Company is also committed to purchase gas under various long term gas supply contracts including the supply of gas to the Company's three UK power stations. At 31 December 2005 the estimated minimum commitment for the supply of gas under all these contracts totalled £2,937 million (31 December 2004: £1,687 million).

21 Commitments and contingent liabilities (continued)

The Company is also committed to power purchase contracts for the supply of electricity. At 31 December 2005 the total contractual commitment for the Company was £753 million (31 December 2004: £435 million).

e) In the normal course of business the Company 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 2005 the Company had the following operating lease commitments:

	31 December 2005 Property £m	31 December 2004 Property £m
Annual commitments expiring under non-cancellable operating leases expiring:		
Within one year	**5**	1
Within two to five years	**17**	5
After five years	**27**	23
	49	29

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

22 Ultimate parent undertaking and controlling party

The immediate parent undertaking is Powergen Group Investments, with the ultimate UK parent undertaking being E.ON UK Holding Company Limited. The ultimate parent undertaking and controlling party is E.ON AG, a company incorporated in Germany, which is the parent company of the largest group and the 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