E.ON UK PLC

GROUP REPORT AND ACCOUNTS

for the year ended 31 December 2006

Registered No: 2366970

E.ON UK PLC

Directors' report for the year ended 31 December 2006

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 2006.

Principal activities, review of business and future developments

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

The underlying level of the business during the year was good, reflected by a substantial increase in cash generated from operations to £772 million. The loss for the year is largely driven by a £1,006 million loss on valuation of derivative contracts, caused by a decrease in forward gas and power prices in the latter part of the year. This loss is primarily non-cash.

The Group's funding is substantially through loans from the parent undertaking. At present, the parent undertaking provides these facilities through short term borrowings and as a result the Group continues to hold net current liabilities at the year end.

The directors believe the present level of activity of the Group will be sustained in the current year.

Descriptions of the development of the Group's businesses during the financial year under report and the outlook for the future are given below. The 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. As of 31 December 2006, E.ON UK supplied approximately 8.4 million customer accounts, of which 7.7 million were residential customer accounts and 0.7 million were small and medium-sized business and industrial customer accounts. During the year, there was a net decrease in the total number of customer accounts of approximately 0.2 million as some customers switched suppliers in the wake of retail price increases described below. E.ON UK continues to focus on reducing the costs of its retail business, through efficiency improvements, more economic procurement of services and the utilisation of lower cost sales channels.

Residential Customers

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

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

In an environment of rising wholesale energy prices and increasing environmental costs, E.ON UK, like other suppliers, implemented a number of electricity and gas price increases affecting residential users in 2006. Although the precise level of increases varied by supplier, E.ON UK's increases in 2006 amounted to 30 percent for electricity and 47 percent for gas at national average prices for an Ofgem average consuming customer. E.ON UK has also implemented a package of measures to limit the effects of rising wholesale costs by offering subsidised energy efficient products including cavity wall and loft insulation to a significant proportion of its customers.

Small and Medium-Sized Business and Industrial and Commercial Customers

The number of accounts in this sector totalled approximately 0.7 million as of 31 December 2006. In this sector, E.ON UK sold 29.7 TWh of electricity and 40.1 TWh of gas in 2006, as compared with 31.3 TWh of electricity and 46.1 TWh of gas in 2005. E.ON UK's focus in this area remains on acquiring and retaining the most profitable contracts available.

Energy Wholesale

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

Power Generation

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

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

In December 2006, E.ON UK divested Edenderry Power Limited and Edenderry Power Operations Limited, which operates a 120 MW peat-fired plant in the Republic of Ireland, to Bord na Mona plc. E.ON UK also owns a minority interest in a company that operates a gas-fired power plant in Turkey.

E.ON UK is planning significant investments to improve its generation capacity. This is partly to replace capacity which will be taken out of production in coming years due to applicable environmental regulations. In particular, in 2007 E.ON UK plans to commence construction of a 1,200 MW gas-fired station at its Isle of Grain site in Kent. The existing oil-fired station will be retained, whilst new technology is expected to create one of the most efficient power stations in the

UK. A planning application has also been submitted for the construction of two new highly efficient coal units at the Kingsnorth power station site in Kent, with the commencement of construction targeted for 2008 and production by 2013.

Renewable Energy

E.ON UK plans to grow its renewable electricity generation business in response to UK regulatory initiatives. E.ON UK's wind generation projects are developed by E.ON UK Renewables Limited. E.ON UK is already one of the leading developers and owner/operators of wind farms in the UK, with interests in 20 operational onshore and offshore wind farms with total capacity of 197 MW, of which 183 MW is attributable to E.ON UK. Potential onshore and offshore projects with an aggregate capacity of approximately 1,139 MW are now in the development phase (compared with 1,100 MW in the development phase in 2005).

During 2004, E.ON UK completed construction of a large offshore wind farm site with a capacity of approximately 60 MW at Scroby Sands off the coast of East Anglia. The Scroby Sands project builds on E.ON UK's success in commissioning the UK's first offshore wind farm at Blyth during 2001. E.ON UK started construction in the fourth quarter of 2006 of an 18 MW onshore wind farm in Cambridgeshire called Stags Holt, which is expected to become operational by the third quarter of 2007.

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

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

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

As a part of its balanced approach, E.ON UK seeks to 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 2005 to 31 March 2006, E.ON UK achieved 95 percent of its renewables obligation through own generation and purchases.

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

Energy Trading

E.ON UK's energy trading unit engages in asset-based energy trading in gas and electricity markets to assist E.ON UK in commercial risk management and the 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.

Energy trading activities include:

- Purchasing of coal, gas and oil for power stations;
- Dispatching generation and selling the electrical output and ancillary services provided by E.ON UK's power stations;
- Purchasing gas and electricity as required for E.ON UK's retail portfolio;
- Managing the net position and risks of E.ON UK's generation and retail portfolio;
- Managing renewable obligations for the retail portfolio through long-term purchases and trading of ROCs;
- Purchasing and/or trading of CO2 emission certificates and other environmental products, including Levy Exempt Certificates (issued in relation to the UK Climate Change Levy); and
- Achieving portfolio optimisation and risk management.

E.ON UK also engages in a controlled amount of proprietary trading in gas, power, coal, oil and CO2 emission certificates markets in order to take advantage of market opportunities and to maintain the highest levels of market understanding required to support its optimisation and risk management activities. The following table sets forth E.ON UK's electricity and gas proprietary trading volumes for 2006 and 2005:

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

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

In its energy trading operations, E.ON UK uses a combination of bilateral contracts, forwards, futures, options contracts and swaps traded over-the-counter or on commodity exchanges. E.ON UK also undertakes relatively low levels of trading in other commodities, including ROCs, environmental products and weather derivatives. All of E.ON UK's energy trading operations, including its limited proprietary trading, are subject to E.ON's risk management policies for energy trading.

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

The supply of gas for E.ON UK's combined cycle gas turbine ("CCGT") and CHP plants is sourced through non-interruptible long-term gas supply contracts with gas producers (certain of which contain take or pay provisions), and through purchases on the forward and spot markets. Since October 2004, E.ON Ruhrgas has been a significant supplier of natural gas to E.ON UK pursuant to a long-term supply contract between the parties. The agreed framework for the E.ON Ruhrgas contract is essentially that of a "take or pay" arrangement. Risk management arrangements in respect of the volume and price risks associated with E.ON UK's gas supply contracts are conducted through trading on the spot, over-the-counter and bilateral markets.

Distribution

Central Networks East plc ('CNE') and Central Networks West plc ('CNW'), both wholly owned subsidiaries of the Company, 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.

E.ON Energy Services

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

Other activities

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

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

E.ON UK acquired minority equity stakes in companies operating electricity generation plants in England, Pakistan and Turkey as part of its Midlands Electricity acquisition. Following disposals in 2004 and 2005, the only remaining stake in overseas electricity generation plants is a 31 percent interest in Trakya Electric Uretin ve Ticaret A.S., which owns and operates a 478 MW CCGT plant in Turkey.

Results and dividends

The loss attributable to shareholders for the financial year to 31 December 2006 was £332 million (2005: a restated profit of £641 million).

The directors do not recommend payment of a final dividend (year ended 31 December 2005 £nil). During the year, no interim dividend was paid (2005: £240 million).

Directors and their interests

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

Dr Paul Golby	
Graham Bartlett	
Dr Burckhard Bergmann	
Dr Wulf Bernotat	
Jarri Sandstrom	
Robert Taylor	
Dr Johannes Teyssen	(appointed 1 May 2007)
John Crackett	(appointed 4 July 2007)
Dr Erhard Schipporeit	(resigned 6 December 2006)
Dr Anthony Cocker	(resigned 4 July 2007)
Nicholas Horler	(resigned 31 August 2007)

Information on directors' emoluments is given in Note 6 to the Accounts, on page 52.

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 2006 and 31 December 2005 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 eligible employees are able to participate in the E.ON UK Share Incentive Plan. This is a share incentive plan that enables employees to develop a greater involvement in E.ON AG, through share ownership. Share schemes of this kind help to reinforce that link and give employees the opportunity to share in the success of the company they work for.

Contributions for political and charitable purposes

Donations to charitable organisations during the financial year by the Group amounted to £28,943 (2005: £74,673). It is the Company's policy not to make cash donations to any political party. However, the Company does undertake activities, such as event sponsorship, which are not designed to support or influence support for any particular political party; which are covered under *The Political Parties, Elections and Referendums Act 2000* and must be disclosed. During the year, the Company sponsored an event at the Labour party conference and purchased passes to the Liberal Democrat, Labour and Conservative Party conferences. In addition, certain E.ON UK employees undertook a nuclear fact finding trip to Sweden with the Conservative Shadow Energy Minister. The total cost required to be disclosed as political donations was £8,155 (2005: £6,500).

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 35 days (2005: 41 days).

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 in place sufficient borrowing facilities such that the Group and the Company can meet their obligations as they fall due for a period of at least twelve months from the date of the directors' approval of these financial statements. Borrowing facilities are shown in Note 20.

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

Directors' responsibilities

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

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

In preparing these financial statements the directors are required to:

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

The directors confirm that they have complied with the above requirements in preparing the financial statements. In addition, as far as each director is aware, there is no relevant audit information of which the auditors are unaware and each of the directors have taken all the steps that he ought to have taken in order to make himself aware of any relevant audit information and to establish that the auditors are aware of such information.

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

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

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

Graham Bartlett
Director
E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG

3 October 2007

E.ON UK PLC

Financial review for the year ended 31 December 2006

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

Overview

E.ON UK and its associated companies are actively involved in electricity generation, distribution, retail and trading. As of 31 December 2006, E.ON UK owned or through joint ventures had an attributable interest in 10,547 MW of generation capacity, including 359 MW of CHP plants and 233 MW of operational wind and hydroelectric generation capacity. E.ON UK served approximately 8.4 million electricity and gas customer accounts at 31 December 2006 and its Central Networks business served 4.9 million customer connections.

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 has been treated as a separate segment for 2006. The new energy services business was part of Central Networks and Retail during 2005.

Accounting Policies

During the year the Group has changed its accounting policy for post retirement benefits. On adoption of IFRS on 1 January 2004, the Group applied the "corridor" method of recognising actuarial gains and losses, whereby actuarial gains and losses exceeding 10 percent of the present value of the obligation were spread over employees' remaining working lives. During its transition to IFRS, the E.ON AG Group has adopted a policy of recognising actuarial gains and losses in full on the balance sheet. E.ON UK has therefore changed its policy to be in line with the rest of the E.ON AG Group. E.ON UK believes that this provides greater clarity of the Group's position to users of the accounts. Further details of the impact of this change are given in Note 1 on page 32.

Prior year adjustment

During the year, the Group's management became aware of a material error in previously disclosed financial statements. The error can be split into two main components. Firstly, on transition to IFRS, the deferred tax liability was calculated incorrectly in respect of certain intangible assets and property, plant and equipment. The second error primarily relates to the accounting for deferred tax in acquisition balance sheets and uncertain tax positions post acquisition. Further details of the impact of this change are given in Note 1 on page 32.

Principal risks and uncertainties

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

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

Competition

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

Continuous monitoring of cost pressures for wholesale electricity and gas prices, distribution and metering costs as well as monitoring of competitor activity enables the Group to optimise their response to changing circumstances.

Commodity prices

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

The Group continues to be hedged in accordance with approved policies using both forward and structured markets.

Credit risk – financial instruments

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

Weather

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

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

Asset Performance

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

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

Creditor Risk – customer/debtors

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

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

Key Performance Indicators (KPIs)

Non-financial key performance indicators for each of the business units are shown below:

KPI	Results		Commentary
	2006	2005	
UK Business			
Safety LTIFR (The Lost Time Injury Frequency Rate is measured by the number of lost time injuries per 1,000,000 hours worked)	3.28	4.79	The safety of people is of vital importance to the business. The business has worked hard to reduce the number of accidents and this is reflected within the improved statistics.

Financial review for the year ended 31 December 2006 (continued)

KPI	Results 2006	Results 2005	Commentary
UK Business (continued)			
Total Gas volumes sold/used (TWh)	194	183	Gas volumes can be segmented in Retail sales, market sales and gas utilised at power stations. Retail sales reduced due to lower customer numbers and weather. Gas utilised at power stations reduced as margins from coal fired power stations were more attractive. Market sales increased as a result of lower volume requirements from the Retail business and increased product optimisation.
Total Power volumes sold (TWh)	74	75	The net position of retail sales and market sales is broadly similar year on year.
Energy Wholesale			
Generating capacity (MW)	10,547	10,547	Generation capacity is unchanged.
Generation production (TWh)	36	37	Generation production is slightly lower due to an unplanned outage at Ratcliffe power station following an industrial accident.
Central Networks			
Volumes distributed (TWh)	57	57	Volumes are unchanged year on year.
Customer minutes lost (Figures are for both licences for Regulatory years 05/06 and 04/05 as audited and published by Ofgem.)	147	163	The business is determined to improve customer service and will continue to invest to maintain the underlying reliability of the network and develop operational incident response to further reduce the number and duration of interruptions.

Financial review for the year ended 31 December 2006 (continued)

KPI	Results 2006	Results 2005	Commentary
Retail			
Customer numbers (million)	8.4	8.6	Customer numbers reduced as customers switched suppliers in the wake of price increases.
Energy watch complaints	6,052	16,494	The performance has improved considerably since 2005. The improvement has been achieved by focusing on a range of customer service initiatives such as a dedicated customer complaints line, new clearer bill formats and empathy training for our staff.
Energy Services			
Domestic connections	33,405	-	
Meter reading performance	96.4%	-	

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

Group financial results

The Group's loss before tax and impairment and integration costs and profits less losses on disposal of investments/businesses for the year ended 31 December 2006 was £260 million, compared to a profit of £899 million for the same period last year. The loss before tax was £461 million compared with £801 million profit for the previous twelve months.

Financial review for the year ended 31 December 2006 (continued)

Revenue

Group revenue grew by £1,606 million during the year to £8,534 million, an increase of 23 percent. Revenue in the UK increased primarily as a result of significantly increased sales in the Energy Wholesale and Retail businesses. This increase was primarily attributable to higher retail prices driven by higher energy prices, the effects of which were partially offset by lower volumes resulting from warmer weather and changes in consumer behaviour. In addition higher sales were recognised in the wholesale market reflecting both higher energy prices and increased market sales volumes.

Sales in the regulated distribution business increased to £584 million in 2006 from £557 million in 2005. The sales increase was principally attributable to tariff changes.

External revenue is further analysed below:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
UK Operations		
Energy Wholesale	**2,155**	1,487
Distribution	**443**	427
Retail	**5,857**	5,014
E.ON Energy Services	**79**	-
	8,534	6,928

Operating Costs

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

	Year ended 31 December 2006 £m	Year ended 31 December 2005 (restated) £m
Fuel costs	**963**	607
Power purchases and other costs of sales	**5,343**	4,560
Staff costs	**442**	369
Depreciation, including relevant impairments	**248**	240
Intangible asset amortisation, including relevant impairments	**198**	61
Derivative losses / (gains)	**1,006**	(402)
Other operating charges, including restructuring costs	**762**	680
	8,962	6,115

Financial review for the year ended 31 December 2006 (continued)

Fuel costs rose substantially in 2006 due to significant increases in coal and gas purchase costs driven by high market prices. E.ON UK's production fell from 37.3 billion kWh in 2005 to 35.9 billion kWh in 2006, primarily due to an unplanned outage at Ratcliffe power station. Average day ahead gas prices in the UK for 2006 were 42 pence per therm, 2 percent higher than during 2005.

Power purchase and other costs of sales increased significantly due to higher wholesale power prices.

Staff costs at £442 million were 20 percent higher than in the previous year due to the transfer in house of a number of staff from an external service provider and increased hiring of technical personnel within the E.ON Energy Services business. Staff numbers at 31 December 2006 totalled 15,621 all of which were based in the UK.

The depreciation charge is broadly in line with 2005 increasing from £240 million in 2005 to £248 million in 2006. Intangible asset amortisation, including relevant impairments increased to £198 million from £61 million, reflecting an impairment of £132 million in respect of the Group's contractual development rights for gas storage at Holford.

Large derivative losses of £1,006 million have been incurred during the year, primarily as a result of the fall in gas and power forward prices in the latter part of the year. These movements are primarily unrealised, non-cash movements offsetting gains that have been recognised previously.

Other operating charges included the costs of running the UK businesses and supporting corporate infrastructure. Other operating charges have increased during 2006 primarily due to higher repairs and maintenance cost, higher IT costs and increased bad debt costs.

Operating income

Other operating income was £202 million this year compared with £187 million in the year to 31 December 2005. The increase primarily relates to gains from derivative instruments (£48 million), income from meter asset provision and maintenance of £24 million, consulting income of £12 million and profits on disposal of businesses of £18 million. These are offset by a reduction in other income from the new connections business. This now forms a large part of the E.ON Energy Services segment and is shown within turnover and cost of sales.

Impairment and integration costs

Included in operating costs are impairment and integration costs before tax amounting to £219 million in 2006 compared with £103 million in 2005. During 2006 certain CHP assets were impaired by £24 million and an onerous contract provision of £52 million was recorded on CHP contracts. The impairments 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, impairments of £143 million have been made on assets related to the Group's gas storage site at Holford. The impairments have arisen as costs to complete the project exceed the costs anticipated when the project commenced. In 2005 integration costs of £13 million (primarily Midlands Electricity) were incurred and CHP impairment charges were £90 million.

Operating (loss) / profit

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

	Year ended 31 December 2006 £m	Year ended 31 December 2005 (restated) £m
UK Operations		
Energy Wholesale	**(695)**	479
Distribution	**334**	350
Retail	**338**	387
E.ON Energy Services	**7**	-
Central / Unallocated	**(210)**	(216)
Group operating (loss) / profit after impairment and integration costs	**(226)**	1,000
Net finance costs	**(239)**	(211)
Share of results of associates after tax	**4**	12
(Loss) / profit before tax	**(461)**	801

Group operating losses totalled £226 million for the year compared with profits of £1,000 million in the same period to 31 December 2005. Within this total, wholesale and trading losses were £695 million compared to profits of £479 million in 2005, a fall of £1,174 million. This primarily reflects net commodity derivative losses in 2006 of £936 million, compared to gains of £388 million, a fall of £1,324 million. Derivative losses are primarily unrealised non-cash movements. This is reflective of the decrease in gas and power forward prices in the latter part of the year.

Distribution profits decreased from £350 million to £334 million primarily due to general cost increases and high fault volumes during 2006.

Financial review for the year ended 31 December 2006 (continued)

Within the retail business, profits decreased by £49 million to £338 million primarily due to the increased revenue resulting from the 2006 price rises being offset by increased commodity costs.

Interest costs

E.ON UK's interest costs increased from £211 million to £239 million due to higher average debt during 2006 than in 2005 (£4,527 million in 2006 compared to £4,187 million in 2005).

Treasury management

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

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

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

E.ON AG's central financing strategy

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

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

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

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 cash flows arising on trading and construction contracts and foreign currency denominated debt which impact the income statement) and translation exposures (the value of foreign currency liabilities and assets in the balance sheet). E.ON UK's policy is to hedge all contractually committed transaction exposures, as soon as the commitment arises. E.ON UK will also hedge less certain cash flows if this is appropriate.

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

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

Interest rate risk management

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

Credit risk management

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

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 20 to the accounts.

At 31 December 2006, the Group had total borrowings of £4,409 million (2005: £4,482 million) including £963 million of long-term loans and £3,446 million of short-term loans and overdrafts.

At 31 December 2006, the Group had £34 million of cash and short-term investments (2005: £68 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 2006 was therefore £4,375 million, compared to £4,414 million at 31 December 2005. The average interest rate for the year, when compared to average net borrowings, was 5.74 percent compared with 5.92 percent in the previous year.

Gearing (net debt as a percentage of net assets excluding net debt) was 64 percent at 31 December 2006 compared with 60 percent at the end of 2005.

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.

Financial review for the year ended 31 December 2006 (continued)

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 credit amounted to £127 million for the year compared with a £158 million charge for the same period to 31 December 2005. The effective rate was 28 percent compared with 20 percent in the year to 31 December 2005. The main reasons for the effective rate not being 30 percent in either period are adjustments to current and deferred tax provisions in respect of prior year items, non deductible expenses and non taxable income.

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 2006 which comprise the Consolidated Income Statement, the Consolidated Balance Sheet, the Consolidated 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 2006.

Respective responsibilities of directors and auditors

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

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

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

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's 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.

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

Basis of audit opinion

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

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

Opinion

In our opinion:

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

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
5 October 2007

E.ON UK PLC

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 2006

	Note	Year ended 31 December 2006 £m	Year ended 31 December 2005 (restated) £m
Revenue	2	**8,534**	6,928
Operating costs excluding impairment and integration costs	3	**(8,743)**	(6,012)
Impairment and integration costs	4	**(219)**	(103)
Total operating costs		**(8,962)**	(6,115)
Other operating income	3	**202**	187
Operating (loss) / profit		**(226)**	1,000
Finance income	7	**31**	34
Finance costs	7	**(270)**	(245)
Group's share of associates' profit after tax		**4**	12
(Loss) / profit before tax		**(461)**	801
Taxation	8	**127**	(158)
(Loss) / profit for the year		**(334)**	643
(Loss) / profit attributable to:			
Minority interest	29	**(2)**	2
Shareholders	27	**(332)**	641
		(334)	643

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

The accounting policies and the notes on pages 32 to 92 form part of these financial statements.

GROUP STATEMENT OF TOTAL RECOGNISED INCOME AND EXPENSE
for the year ended 31 December 2006

	Year ended 31 December 2006 £m	Year ended 31 December 2005 (restated) £m
(Loss) / profit for the year from continuing operations	(334)	643
Loss / (profit) attributable to minority interests	2	(2)
(Loss) / profit attributable to shareholders	(332)	641
Cash flow hedge fair value (losses) / gains	(269)	147
Cash flow hedge gains transferred to the income statement	(54)	(1)
Translation losses transferred to the income statement	1	-
Gains on available for sale securities	-	1
Actuarial gains on pension scheme arrangements	155	110
Tax on items taken directly to equity	51	(77)
Total recognised (loss) / income for the year	(448)	821

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

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Retained earnings	-	89
Other reserves	-	16
	-	105

Adjustments to retained earnings at 1 January 2005 as a result of a change in accounting policy and corrections of errors: (*Note 1*)

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Retained earnings	-	(352)
	-	(352)

The accounting policies and the notes on pages 32 to 92 form part of these financial statements.

E.ON UK PLC

CONSOLIDATED BALANCE SHEET
as at 31 December 2006

	Note	31 December 2006 £m	31 December 2005 (restated) £m
Non-current assets			
Intangible assets			
Goodwill	9	**2,495**	2,495
Other	9	**454**	581
Total intangible assets		**2,949**	3,076
Property, plant and equipment	10	**4,461**	4,267
Interests in associates	11	**8**	7
Available for sale investments	13	**18**	18
Financial receivables	14	**13**	28
Commodity and other derivative financial instruments	20	**-**	57
		7,449	7,453
Current assets			
Inventories	15	**267**	224
Trade and other receivables	16	**2,508**	1,922
Commodity and other derivative financial instruments	20	**1,396**	1,407
Cash and cash equivalents		**34**	68
		4,205	3,621
Total Assets		**11,654**	11,074

E.ON UK PLC

CONSOLIDATED BALANCE SHEET
as at 31 December 2006 (continued)

	Note	31 December 2006 £m	31 December 2005 (restated) £m
Current Liabilities			
Borrowings	18	**3,446**	2,463
Commodity and other derivative financial instruments	20	**1,946**	699
Trade and other payables	17	**1,804**	1,587
Current tax liabilities		**209**	121
Provisions	22	**116**	73
		7,521	4,943
Non-current Liabilities			
Borrowings	19	**963**	2,019
Commodity and other derivative financial instruments	20	**26**	1
Provisions	22	**90**	93
Deferred tax	23	**506**	841
Pension liability	21	**65**	240
		1,650	3,194
Total Liabilities		**9,171**	8,137
Shareholders' equity			
Ordinary shares	24	**325**	325
Share premium	26	**97**	97
Retained earnings	27	**1,591**	1,814
Other reserves	28	**476**	701
Total shareholders' equity		**2,489**	2,937
Minority interest in equity	29	**(6)**	-
Total equity		**2,483**	2,937
Total liabilities and equity		**11,654**	11,074

Approved by the Board on 25 September 2007

Graham Bartlett
Director

3 October 2007

The accounting policies and the notes on pages 32 to 92 form part of these financial statements.

E.ON UK PLC

CONSOLIDATED CASH FLOW STATEMENT
for the year ended 31 December 2006

	Note	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Cash flows from operating activities			
Cash generated from operations	30	**772**	304
Interest received		**6**	8
Interest paid		**(306)**	(204)
Tax paid		**(65)**	(69)
Dividends received from associates		**5**	9
Net cash from operating activities		**412**	48
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets		**(504)**	(384)
Acquisitions (net of cash acquired)		**(2)**	(246)
Purchase of other financial assets		**(11)**	-
Finance lease principal receipts		**19**	18
Proceeds from sale of property, plant & equipment		**1**	3
Proceeds from sale of investments		**16**	20
Net cash used in investing activities		**(481)**	(589)
Cash flows from financing activities			
Proceeds from issue of new borrowings		**3,357**	2,017
Repayment of borrowings		**(3,302)**	(1,198)
Finance lease principal payments		**(16)**	(16)
Dividends paid to minority interests		**(4)**	(6)
Dividends paid to equity shareholder		**-**	(240)
Net proceeds from financing activities		**35**	557
Net (decrease) / increase in cash and cash equivalents		(34)	16
Cash and cash equivalents at 1 January		68	52
Cash and cash equivalents at 31 December		34	68

Notes to the financial statements for the year ended 31 December 2006

1 Accounting Policies

Basis of preparation of accounts

The financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union, International Financial Reporting Interpretations Committee ("IFRIC") interpretations and the Companies Act 1985 applicable to companies reporting under IFRS. The financial statements are prepared under the historical cost convention, except for derivative financial instruments, available for sale investments, share base payment provisions and liabilities of the Group's pension schemes that have been measured at fair value.

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

IFRS 7	Financial Instruments: Disclosures *(effective for the year beginning 1 January 2007)* Additional disclosures will be required for financial instruments

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

IFRS 8	Operating Segments *(effective for the year beginning 1 January 2009)*
IFRIC 7	Applying the Restatement Approach under IAS 29, Reporting in Hyperinflationary Economies *(effective for the year beginning 1 January 2007)*
IFRIC 8	Scope of IFRS *(effective for the year beginning 1 January 2007)*
IFRIC 10	Interim Financial Reporting and Impairment *(effective for the year beginning 1 January 2007)*
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions *(effective for the year beginning 1 January 2008)*
IFRIC 12	Service Concession Arrangements *(effective for the year beginning 1 January 2008)*

Change in Accounting Policy

During the year the Group has changed its accounting policy for post retirement benefits in order to be in line with E.ON AG Group policy. On adoption of IFRS on 1 January 2004, the Group applied the "corridor" method of recognising actuarial gains and losses, whereby actuarial gains and losses exceeding 10 percent of the present value of the obligation were spread over employees' remaining working lives. During its transition to IFRS, the E.ON AG Group has adopted a policy of recognising actuarial gains and losses in full on the balance sheet. E.ON UK has therefore changed its policy to be in line with the rest of the E.ON AG Group. E.ON UK believes that this provides greater clarity of the Group's position to users of the account. Annual actuarial gains and losses will pass through retained earnings.

1 Accounting Policies (continued)

The impact of this change of accounting policy at 1 January 2005 was to increase the post retirement benefit provision by £137 million, decrease the deferred tax provision by £41 million and decrease retained earnings by £96 million. During 2005, additional gains of £110 million have been posted to retained earnings, offset by deferred tax of £33 million.

Prior year adjustment

During the year, the Group's management became aware of a material error in previously disclosed financial statements. The error can be split into two main components.

Firstly, on transition to IFRS, the deferred tax liability was calculated incorrectly in respect of certain intangible assets and property, plant and equipment. At 1 January 2005, the impact of this adjustment was to increase the deferred tax liability by £255 million, with a corresponding decrease in reserves. There is no additional impact in later periods.

The second error primarily relates to the accounting for deferred tax in acquisition balance sheets and uncertain tax positions post acquisition. The impact at 1 January 2005 of restating for these errors was to decrease the deferred tax liability by £6 million. In addition, adjusting for the errors identified reduces goodwill by £42 million, increases property, plant and equipment by £7 million, decreases current tax liabilities by £13 million and reduces minority interests by £15 million. The impact on opening reserves is £1 million. During 2005, operating costs of £68 million have been recognised with a corresponding impact on goodwill and further goodwill of £8 million has been recognised. Other intangible assets of £40 million have been recognised, the deferred tax provision has been reduced by a further £25 million and current tax has been increased by £4 million. The tax expense has been reduced by £69 million.

1 Accounting Policies (continued)

The following table reconciles previously reported figures to restated figures.

	Previously reported	Accounting policy change (Pensions)	Deferred Tax	Restated
At 1 January 2005				
Retained earnings	1,599	(96)	(256)	1,247
Minority Interests	21	-	(15)	6
2005 Income statement				
Operating costs	(6,047)	-	(68)	(6,115)
Taxation	(227)	-	69	(158)
Profit for the year	642	-	1	643
Actuarial gains	-	110	-	110
Tax on items taken directly to equity	(44)	(33)	-	(77)
2005 Balance sheet				
Goodwill	2,597	-	(102)	2,495
Other intangible assets	541	-	40	581
Property Plant & Equipment	4,260	-	7	4,267
Current tax liability	130	-	(9)	121
Deferred tax liability	625	(8)	224	841
Pension liability	213	27	-	240
Retained earnings	2,088	(19)	(255)	1,814
Minority Interests	15	-	(15)	-

Judgement in applying accounting policies and key sources of estimation uncertainty

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

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

1 Accounting Policies (continued)

Impairment of goodwill and indefinite lived intangible assets

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

Revenue recognition – unread gas and electricity meters

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

Determination of fair values of derivatives

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

The use of valuation models requires the Group to make assumptions and estimates regarding the volatility of derivative contracts at the balance sheet date and actual results could differ significantly due to fluctuations in value influencing market data. Further detail is provided in Note 20.

1 Accounting Policies (continued)

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. 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 property, plant and equipment and finance lease receivables

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

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

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

Commodity contracts

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

Emissions trading scheme

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

1 Accounting Policies (continued)

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 in place sufficient borrowing facilities such that the Group and the Company can meet their obligations as they fall due for a period of at least twelve months from the date of the directors' approval of these financial statements. Borrowing facilities are shown in Note 20.

Basis of consolidation

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

Business combinations

The Group's share of profits less losses of associated undertakings 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 passed. These amounts are taken from the latest audited financial statements of the relevant undertakings, except where the accounting reference date of the undertaking is not coterminous with the parent company, where management accounts are used.

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

Revenue

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

1 Accounting Policies (continued)

Revenue from the sale of electricity and gas to industrial, commercial and domestic customers is recognised when earned on the basis of a contractual agreement with the customer; it reflects the value of the volume supplied, including an estimated value of the volume supplied to customers between the date of their last meter reading and the year end.

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

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

Segmental Reporting

For management purposes, the Group is currently organised into four operating divisions – Energy Wholesale, Distribution, Retail and E.ON Energy Services. Management has chosen these divisions as the basis on which the Group reports its primary segment information, although the newly formed E.ON Energy Services business unit does not meet the thresholds requiring disclosure as a segment under IAS 14 'Segment Reporting'. 2005 reported segments have not been restated due to the size of the segment and the practicality of carving out the 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 the Group has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

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

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

1 Accounting Policies (continued)

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

Future operating costs are not provided for.

Foreign exchange

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

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

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

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

1 Accounting Policies (continued)

Deferred income

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

Financial instruments

Investments

For associated undertakings that are subject to equity accounting, the Group's share of the net assets of the associated undertaking 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 or other income in the income statement as they arise.

1 Accounting Policies (continued)

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, or else within operating costs. A movement in fair value of 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.

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.

1 Accounting Policies (continued)

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.

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 on a straight-line basis over their useful economic life, generally between 3 and 5 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 fair value.

Other

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

Asset	*Life in years*
Customer Base	7-10

Emission rights and ROCs 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.

1 Accounting Policies (continued)

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 Property, Plant and Equipment on the basis of expenditure incurred at the balance sheet date. Where borrowings are used to finance the construction of a major capital project with a long period of development, interest payable is capitalised as part of the cost of the asset and written off over the economic useful life of the asset. Where specific borrowings are used, the amount capitalised is based on actual interest payable. Where general borrowings are used, the amount capitalised is based on the weighted average cost of capital of the Group, not exceeding the actual expenditure incurred during the relevant period of construction.

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

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 principal categories of fixed assets are:

Asset	*Life in years*
Generating assets	25-45
Distribution and transmission networks	40-60
Other assets	3-40

1 Accounting Policies (continued)

Overhaul of generation plant

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

Impairment

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

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

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

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

Leases

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

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.

1 Accounting Policies (continued)

Inventories

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

Cash and cash equivalents

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

Taxation

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

The tax charge for the year is based on the taxable profits or losses on ordinary activities for the year. Deferred tax is provided in full, using the liability method, on temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

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

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

1 Accounting Policies (continued)

Pensions

The Group provides pension benefits through both defined benefit and defined contribution schemes. The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, adjusted for past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. Defined benefit pension scheme costs are attributed to the income statement over the period of service of the employee. Past service costs are recognised immediately to the extent that the benefits are already vested, otherwise are amortised on a straight line basis over the vesting period. Actuarial gains and losses are recognised through the Statement of Total Recognised Income and Expense as incurred, as discussed above in "Change of Accounting Policy" on page 32. 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 cash settled share based payment schemes administered by the ultimate parent company, E.ON AG. Two schemes are currently in operation – the E.ON Stock Appreciation Rights Scheme and the E.ON Share Performance Scheme. The Group accounts for these schemes in accordance with IFRS 2 "Share-based payment". The liability is measured initially and at each reporting date, based on fair value, by applying the Monte Carlo option pricing model, taking into account rights granted and service rendered to date. Costs are recognised in the income statement over the expected vesting period.

**Notes to the financial statements
for the year ended 31 December 2006 (continued)**

2 Segmental Reporting

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

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

Notes to the financial statements for the year ended 31 December 2006 (continued)

2 Segmental Reporting (continued)

Year ended 31 December 2005 (restated)	Energy Wholesale	Distribution	Retail	Central / Unallocated	Eliminations	Group
	£m	£m	£m	£m	£m	£m
External revenue	1,487	427	5,014	-	-	6,928
Inter-segment revenue	3,325	130	24	-	(3,479)	-
Total revenue	4,812	557	5,038	-	(3,479)	6,928
Segment result	479	350	387	(216)		1,000
Finance income						34
Finance costs						(245)
Share of results of associates after tax	1	-	-	11		12
Profit before tax						801
Tax charge						(158)
Profit for the year from continuing activities						643
Total assets	9,295	3,641	6,998	(8,860)		11,074
Total liabilities*	5,899	1,511	3,134	(2,407)		8,137
Other segment items						
Capital expenditure (including acquisitions)	271	234	3	11		519
Depreciation	116	99	3	8		226
Amortisation of intangible assets	2	-	57	2		61
Goodwill	68	308	1,250	869		2,495

* 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.

3 Operating costs and other operating income

Operating costs were as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 (restated) £m
Fuel costs	963	607
Power purchases and other costs of sales	5,343	4,560
Staff costs (Note 6)	442	369
Depreciation, including relevant impairments	248	240
Intangible asset amortisation, including relevant impairments	198	61
Derivative losses / (gains)	1,006	(402)
Other operating charges, including restructuring costs	762	680
Operating costs, after impairment and integration costs	8,962	6,115
Operating costs, before impairment and integration costs	8,743	6,012
Impairment and integration costs (Note 4)	219	103

Foreign exchange losses of £14 million were recognised in the profit and loss account (2005: £1 million loss).

Operating costs also include:	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Repairs and maintenance costs	120	106
Research and development costs	6	5
Operating leases charges	41	27
Loss on disposal of property, plant and equipment	1	4
Auditors' remuneration for:		
Audit services: Audit of the Company and consolidated accounts	1.1	0.9
Other services: Audit of the Company's subsidiaries pursuant to legislation	0.6	0.5
Other services pursuant to legislation	0.3	0.3
Tax services	0.1	0.1

The largest component of other operating income in 2006 is derivative gains of £48 million. Other operating income also includes income from meter asset provision and maintenance of £24 million, PowerTechnology consulting income of £12 million, profit on disposal of businesses of £18 million and income from engineering services of £8 million. Gains on disposal of property, plant and equipment of £1 million were also recognised. The new connections business is now held within Energy Services and due to the expanding nature of these operations results are included within turnover and cost of sales. 2005 has not been restated due to the size of the Energy Services segment and the practicality of carving out the information.

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.

4 Impairment and integration costs

Impairment and integration costs comprise:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Impairment and onerous contract recognition costs before taxation	**219**	90
Integration costs before taxation	**-**	13
Impairment and integration costs before taxation	**219**	103
Tax on impairment costs	**(66)**	(27)
Tax on integration costs	**-**	(4)
Impairment and Integration costs after taxation	**153**	72

Year ended 31 December 2006

During the year finance lease receivables relating to CHP plants were impaired by £16 million and CHP property, plant and equipment was impaired by £8 million. Furthermore, an onerous contract of £52m was recognised with respect to CHP contracts. The impairments and onerous contracts 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. Consequently, in some cases the current estimate of unavoidable costs of meeting the obligations under the contacts exceeds the economic benefits expected to be received under it. A tax credit of £23 million arose as a result of these charges. CHP plants are within the Energy Wholesale segment.

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

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 arose as a result of rising wholesale gas prices resulting in increased costs on CHP contracts that receive a relatively fixed price per unit of output. 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.

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

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

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profits less losses on disposal of investments / businesses (including provisions) before taxation	**18**	5
Tax on profits less losses on disposal of investments / businesses (including provisions)	**(3)**	-
Profits less losses on disposal of investments / businesses (including provisions) after taxation	**15**	5

Year ended 31 December 2006

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

Year ended 31 December 2005

During the year E.ON UK disposed of its 40 percent 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.

Notes to the financial statements
for the year ended 31 December 2006 (continued)

6 Employee information, including directors' remuneration

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

	Year ended 31 December 2006	Year ended 31 December 2005
Total operations (including Corporate Centre)	**15,621**	12,121

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

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Wages and salaries	**389**	346
Social security costs	**40**	31
Other pension costs (Note 21)	**53**	32
	482	409
Capitalised in fixed assets	**(40)**	(40)
Charged in profit and loss account as staff costs	**442**	369

The key management compensation costs were:

	Year ended 31 December 2006 £	Year ended 31 December 2005 £
Salaries and short-term employee benefits	**5,484,521**	3,729,484
Post-employment benefits	**816,450**	515,790
Share based payments	**2,556,838**	1,113,914
	8,857,809	5,359,188

Notes to the financial statements for the year ended 31 December 2006 (continued)

7 Finance Income and Costs

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Interest receivable		
From fellow E.ON group undertakings	**1**	1
Other	**30**	33
Finance Income	**31**	34
Interest payable		
Loans from fellow E.ON group undertakings	**(240)**	(218)
Other loans	**(27)**	(24)
Unwinding of discount in provisions	**(3)**	(3)
Finance Costs	**(270)**	(245)
Net Finance Costs	**239**	(211)

8 Taxation

	Year ended 31 December 2006 £m	Year ended 31 December 2005 (restated) £m
Current tax:		
United Kingdom Corporation tax at 30%	**138**	80
Over provision in prior year	**15**	(35)
Overseas taxation	**-**	1
Total current tax charge	**153**	46
Deferred tax:		
Origination and reversal of timing differences	**(272)**	191
Over provision in prior period	**(8)**	(79)
Total deferred tax (credit)/charge (Note 23)	**(280)**	112
Tax (credit)/charge on profit on ordinary activities	**(127)**	158

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 2006 £m	Year ended 31 December 2005 (restated) £m
(Loss) / profit on ordinary activities before tax	**(461)**	801
Less Group's share of associates' profit after tax	**(4)**	(12)
(Loss) / profit on ordinary activities excluding associates' profit	**(465)**	789
Tax (credit) / charge on profit on ordinary activities at 30%	**(140)**	237
Effects of:		
Prior year adjustment	**7**	(114)
Expenses not deductible for tax purposes	**10**	35
Non-taxable income	**(4)**	-
Total current tax (credit)/charge	**(127)**	158

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

Notes to the financial statements for the year ended 31 December 2006 (continued)

9 Intangible assets

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

(Restated)	Goodwill	Software	Customer Lists	Other	Total
	£m	£m	£m	£m	£m
Cost					
At 1 January 2005	2,540	120	451	35	3,146
Acquisitions	15	-	13	96	124
Additions	-	13	-	145	158
Disposals	(60)	-	-	(55)	(115)
At 31 December 2005	**2,495**	**133**	**464**	**221**	**3,313**
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	**2,495**	**41**	**319**	**221**	**3,076**

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

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

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

9 Intangible assets (continued)

The recoverable amounts of goodwill have been assessed based on value in use calculations using cash flow projections based on approved financial plans. These plans cover period in excess of five years on account of the long term nature of the Groups' assets. Growth rate assumptions used were based on management's expectations of market development. The annual growth rate used to determine cash flows in the long term ranges from 1 percent to 3 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.

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

Distribution

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

Retail

A 10 year cash flow forecast is built up from medium term plans (extended out based on management views on sustainable retail margins and future volume growth). In addition a terminal value is applied to the annual cash flows in year 10.

Energy Wholesale

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

Energy Services

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

UK Centre

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

9 Intangible assets (continued)

The reduction in goodwill in 2005 arose as a result of the recognition of a previously unrecognised deferred tax asset on the acquisition of TXU. At the time of the acquisition, the deferred tax asset did not satisfy the criteria in IFRS 3 "Business Combinations" for separate recognition. IFRS 3 requires that on recognition of such a deferred tax asset that the carrying value of goodwill is reduced. Further detail on the impairment of other intangible assets is provided in note 4.

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 2006	3,609	4,040	593	8,242
Additions	272	183	54	509
Exchange differences	(1)	-	-	(1)
Disposals	(260)	(2)	(123)	(385)
At 31 December 2006	**3,620**	**4,221**	**524**	**8,365**
Depreciation				
At 1 January 2006	2,098	1,507	370	3,975
Charge for the year	132	77	20	229
Impairment	19	-	-	19
Exchange differences	-	-	-	-
Disposals	(221)	-	(98)	(319)
At 31 December 2006	**2,028**	**1,584**	**292**	**3,904**
Net book value at 31 December 2006	**1,592**	**2,637**	**232**	**4,461**

Additions in 2006 include capitalised borrowing costs amounting to £2 million (2005: £nil). The net book value of property, plant and equipment held under finance leases is £65 million (2005: £84 million).

Group assets include assets in the course of construction at a cost of £32 million (2005: £nil).

Notes to the financial statements
for the year ended 31 December 2006 (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 2005	3,646	3,828	574	8,048
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	593	8,242
Depreciation				
At 1 January 2005	2,246	1,433	346	4,025
Charge for the year	116	74	36	226
Impairment	14	-	-	14
Acquisitions	26	-	-	26
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	223	4,267

11 Interests in associates

	Associates - Net Assets £m	Associates - Loans £m	Total £m
Net assets			
At 1 January 2006	6	1	7
Retained profits	4	-	4
Dividends received	(5)	-	(5)
Additions	2	-	2
At 31 December 2006	7	1	8

No goodwill is recorded within interests in associates.

Notes to the financial statements for the year ended 31 December 2006 (continued)

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%
E.ON IS UK Limited	31 December	England and Wales	Ordinary shares	49%

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

During the year, the Group acquired 49% of the share capital of E.ON IS UK Limited ("E.ON IS") for a consideration of £2 million. On 1 January 2006, certain IT equipment and software was sold to E.ON IS UK. Following the sale, E.ON UK has entered into an IT services agreement with E.ON IS UK for the provision of IT and other related services (Note 33). The principal activity of E.ON IS is to provide a shared IT services to the Group. The share capital of E.ON IS is £4 million.

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

	At 31 December 2006 £m	At 31 December 2005 £m
Share of assets	**139**	140
Share of liabilities	**(132)**	(134)
Share of net assets	**7**	6
Revenue	**106**	51
Operating profit	**25**	23

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
Powergen (East Midlands) Loan Notes *+	Ordinary shares	100	England and Wales	Financing
E.ON UK CHP Limited *	Ordinary and preference shares	100	England and Wales	Sale of energy services involving the construction of CHP plant
East Midlands Electricity Distribution Holdings +	Ordinary shares	100	England and Wales	Intermediate holding company
Ergon Overseas Holdings Limited +	Ordinary shares	100	England and Wales	Investment company
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 2006	**18**
Revaluation	**-**
At 31 December 2006	**18**

Available for sale financial assets include the following:

	At 31 December 2006 £m	At 31 December 2005 £m
Listed equity securities – UK	**2**	2
Listed gilts – UK	**16**	16
	18	18

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

	At 31 December 2006 £m	At 31 December 2005 £m
Finance lease receivables	**13**	28
	13	28

Further details are provided in Note 16.

15 Inventories

	At 31 December 2006 £m	At 31 December 2005 £m
Fuel stocks	**197**	156
Stores	**70**	68
	267	224

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

Notes to the financial statements for the year ended 31 December 2006 (continued)

16 Trade and other receivables

	At 31 December 2006 £m	At 31 December 2005 £m
Trade receivables	2,457	1,847
Less: Provision for impairment of receivables	(182)	(118)
Trade receivables - net	2,275	1,729
Other receivables	13	27
Prepayments and accrued income	121	77
Finance lease receivables	3	5
Amounts due from parent undertaking and fellow subsidiaries	96	84
	2,508	1,922

In addition to the increase in the provision for impairment of receivables a further £86 million was charged to the Income Statement during 2006 to write down trade receivables (2005: £nil).

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

	31 December 2006		31 December 2005	
	Gross Investment £m	Net Investment £m	Gross Investment £m	Net Investment £m
Within 1 year	35	35	34	34
Within 1-5 years	128	72	139	77
After 5 years	174	105	198	116
Impairment	(285)	(196)	(321)	(194)
	52	16	50	33

Unearned finance income at 31 December 2006 amounted to £36 million (2005: £17 million)

17 Trade and other payables

	At 31 December 2006 £m	At 31 December 2005 £m
Trade payables	**908**	1,141
Amounts owed to parent undertaking and fellow subsidiaries	**357**	190
Other taxation and social security	**9**	11
Accruals and other creditors	**506**	243
Deferred income	**24**	2
	1,804	1,587

18 Borrowings: amounts falling due within one year

	At 31 December 2006 £m	At 31 December 2005 £m
Bank overdrafts	**8**	17
Short term loans from parent undertaking and fellow subsidiaries	**3,330**	2,385
Loan notes 2007	**2**	-
Other short-term loans	**89**	43
Finance lease payable	**17**	18
	3,446	2,463

Short-term funding is provided through inter-company facilities. The weighted average interest rate on all short-term loans during the year was 6.25 percent (2005: 5.1 percent).

19 Borrowings: Amounts falling due after more than one year

	At 31 December 2006 £m	At 31 December 2005 £m
Amounts owed to external debt holders		
7.45% US Dollar Yankee Bond 2007	-	100
5% Euro Eurobond 2009	177	181
6.25% Sterling Eurobond 2024	8	3
2012 Loan	10	12
Loan notes 2007	-	4
Loan notes 2008	2	-
Finance lease payable	19	34
	216	334
Amounts owed to fellow group undertakings		
7.45% US Dollar Yankee Bond 2007	-	140
7.375% Sterling Bond 2007	-	154
7.05% US Dollar Yankee Bond 2007	-	142
6.46% US Dollar Yankee Bond 2008	126	142
5% Euro Eurobond 2009	159	162
6.25% Sterling Eurobond 2024	222	243
Long term loans	240	702
	747	1,685
	963	2,019

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

None of the bonds outstanding at 31 December 2006 have any financial covenants.

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

	At 31 December 2006 £m	At 31 December 2005 £m
Within one year	**18**	18
Within two to five years	**20**	38
	38	56
Future finance charges on finance leases	**(2)**	(4)
Present value of finance lease liabilities	**36**	52

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

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

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

Commodity Instruments

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

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

20 Financial Instruments (continued)

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, including options, are valued by the use of valuation models. These models use probability weighted expected values for gas prices and other indices, taking into account individual contract details such as volume and price formula.

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 £33 million (2005: £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.

Notes to the financial statements
for the year ended 31 December 2006 (continued)

20 Financial Instruments (continued)

During 2006, £89 million was credited (2005: £46 million charge) to the income statement in respect of fair value movements related to embedded derivatives.

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

	Assets (£m)		Liabilities (£m)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Interest rate swaps	**4**	17	**-**	(1)
Cross currency swaps	**9**	29	**(54)**	(7)
Foreign currency forward contracts	**4**	7	**(26)**	(3)
Commodity swaps	**74**	112	**(80)**	(58)
Commodity forward contracts	**1,302**	1,299	**(1,777)**	(509)
Embedded derivatives within long term gas contracts	**-**	-	**(33)**	(122)
Options	**3**	-	**(2)**	-
	1,396	1,464	**(1,972)**	(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)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Cross currency swaps				
Less than 1 year	**-**	-	**(24)**	-
1 to 5 years	**-**	13	**(12)**	-
Commodity forward contracts				
Less than 1 year	**2**	196	**(137)**	(5)
1 to 5 years	**-**	44	**(14)**	-
	2	253	**(187)**	(5)

Notes to the financial statements for the year ended 31 December 2006 (continued)

20 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)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Interest rate swaps				
Greater than 5 years	-	-	-	(1)
	-	-	-	(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)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Interest rate swaps	**4**	17	**-**	-
Cross currency swaps	**9**	16	**(18)**	(7)
Foreign currency forward contracts	**4**	7	**(26)**	(3)
Commodity swaps	**74**	112	**(80)**	(58)
Commodity forward contracts	**1,300**	1,059	**(1,626)**	(504)
Embedded derivatives within long term gas contracts	**-**	-	**(33)**	(122)
Options	**3**	-	**(2)**	-
	1,394	1,211	**(1,785)**	(694)

The notional principal amount of derivatives and maturities at 31 December 2006 are as follows:

	Within 1 year £m	**1 – 5 years £m**	**After 5 years £m**	**Total £m**
Interest rate swaps	336	-	-	336
Cross currency swaps	672	127	-	799
Foreign currency forward contracts	666	-	-	666
Commodity swaps	1,082	-	-	1,082
Commodity forward contracts	10,005	46	-	10,051
Embedded derivatives within long term gas contracts	682	-	-	682
Options	4	-	-	4
	13,447	**173**	**-**	**13,620**

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 2012 and interest rate swaps, cross currency swaps, foreign currency forward contracts, commodity swaps and commodity forward contracts that expire over the next 5 years.

Maturity of financial liabilities

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

	2006 £m	2005 £m
In more than one year but not more than two years	**143**	557
In more than two years but not more than five years	**589**	1,214
In more than five years	**231**	248
	963	2,019

20 Financial Instruments (continued)

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 2006		31 December 2005	
	Note	Book Value £m	Fair value £m	Book Value £m	Fair Value £m
Borrowings: amounts falling due after more than one year	(ii)	**(963)**	**(1,258)**	(2,019)	(2,031)
Borrowings: amounts falling due within one year	(i)(vii)	**(3,446)**	**(3,446)**	(2,463)	(2,463)
Cash and cash equivalents	(iii)	**34**	**34**	68	68
Available for sale investments	(iv)	**18**	**18**	18	18
Financial receivables: amounts falling due after more than one year	(v)	**13**	**13**	28	28
Financial receivables: amounts falling due within one year	(vi)	**3**	**3**	5	5

(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.

(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 value of financial receivables: amounts falling due within one year approximates to the carrying value due to the short maturity of these receivables.

(vii) The fair values shown for borrowings do not take account of the fair values of cross currency swaps shown above.

Notes to the financial statements for the year ended 31 December 2006 (continued)

20 Financial Instruments (continued)

At 31 December 2006 there were £3,448 million of undrawn committed borrowing facilities available to the Group, all of which were inter-company facilities which did not contain any material covenant restrictions and which expire between 2007 and 2011. These facilities comprise:

Facility	Total facility £m	Amount undrawn at 31 December 2006 £m	Expiry date	Fees
E.ON UK plc – committed facility from E.ON AG	870	590	21 December 2010	10bp
E.ON UK plc – committed facility from E.ON UK Holding Company Limited	3,000	2,760	6 March 2011	19bp
E.ON UK plc – committed facility from Powergen Group Investments	300	74	21 December 2010	-
E.ON UK plc – committed facility from Ergon Financial Management Ltd	2,400	24	2 July 2007	8bp
	6,570	**3,448**		

Foreign exchange risk management

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

There are no material monetary assets or liabilities of the Group that are not denominated in the functional currency of the entity concerned, other than certain non-Sterling borrowings which have either been swapped back into Sterling or treated as hedges of net investments in overseas operations.

Interest rate risk management

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

Notes to the financial statements for the year ended 31 December 2006 (continued)

20 Financial Instruments (continued)

Interest rate risk profile of financial liabilities:

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

	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	190	181	5.0	3.5
Dollars	524	-	524	7.1	1.7
	4,482	2,771	1,711	7.4	4.1

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 £61 million (2005: £1 million) for contract provisions (see Note 22) which meet the definition of financial liabilities under IAS 39. These financial liabilities are considered to be floating rate liabilities as, in establishing the provisions, the cash flows have been discounted. The discount rate is re-appraised at each reporting date to ensure that it reflects current market assessments of the time value of money and the risks specific to the liability.

At 31 December 2006, the Group held £34 million (2005: £68 million) of financial assets in the form of Sterling bank deposits, and £nil (2005: £nil) 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 2006, E.ON UK had registered defined benefit pension schemes, a registered hybrid pension scheme and a registered defined contribution scheme.

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. . An actuarial valuation of the ESPS is normally carried out every three years by the Scheme's independent actuary, who recommends the rates of contribution payable by participating employers. In intervening years the actuary reviews the continuing appropriateness of the rates. The last actuarial valuation of the ESPS was at 31 March 2004.

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

	31 December 2006	31 December 2005
Average nominal rate of annual increase in salaries	4.00%	4.00%
Average nominal rate of annual increase in pensions	3.00%	2.80%
Discount rate	5.10%	4.80%
Inflation rate	3.00%	2.80%

In determining the defined benefit obligation as at 31 December 2006 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. An allowance has been made for future longevity improvements using an adjustment that is approximately in line with the projections in the CMI Bureau's short cohort tables.

Notes to the financial statements for the year ended 31 December 2006 (continued)

21 Pension scheme arrangements (continued)

The amounts recognised in the balance sheet are as follows:

	31 December 2006 £m	31 December 2005 (restated) £m
Fair value of plan assets	**4,969**	4,917
Present value of funded obligations	**(5,014)**	(5,135)
	(45)	(218)
Present value of unfunded obligations	**(20)**	(22)
Net liability recognised in the balance sheet	**(65)**	(240)

The amounts recognised in the income statement are as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Current service cost	**45**	32
Interest cost	**240**	243
Expected return on plan assets	**(261)**	(263)
Past service cost	**8**	28
Net cost recognised in the income statement	**32**	40

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

	Year ended December 2006 £m	Year ended 31 December 2005 £m
Opening defined benefit obligation	**5,157**	4,704
Service cost	**45**	32
Interest cost	**240**	243
Transfers in	**-**	26
Actuarial (gains)/losses	**(169)**	374
Past service cost	**8**	28
Contributions by plan participants	**14**	12
Benefits paid	**(261)**	(262)
Closing defined benefit obligation	**5,034**	5,157

21 Pension scheme arrangements (continued)

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

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Opening fair value of plan assets	**4,917**	3,907
Expected return on scheme assets	**261**	263
Transfers in	**-**	26
Actuarial (losses)/gains	**(14)**	484
Contributions by employer	**52**	487
Contributions by plan participants	**14**	12
Benefits paid	**(261)**	(262)
	4,969	4,917

The Group expects to contribute £49 million to its defined benefit pension plans in the year to 31 December 2007. During 2005 a special contribution of £432 million was made by the Company to reduce the deficit in the scheme.

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

	Expected return		Fair value of assets	
	31 December 2006 %	31 December 2005 %	31 December 2006 %	31 December 2005 %
Equity instruments	**8.6**	7.6	**27**	46
Debt instruments	**4.9**	5.0	**64**	48
Property	**7.7**	6.1	**6**	5
Other assets	**-**	-	**3**	1
	5.9	5.5	**100**	100

The expected return on assets has been determined following advice from external advisors 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)

During the year the Group has changed its accounting policy for post retirement benefits in order to be in line with E.ON AG Group policy. This has resulted in annual actuarial gains and losses passing through retained earnings. Further discussion of this change in accounting policy can be found on page 32.

Cumulative actuarial gains and losses recognised in equity:

	31 December 2006 £m	31 December 2005 £m
Loss at start of year	**(27)**	(137)
Actuarial gains recognised in the year	**155**	110
Gain / (loss) at end of year	**128**	(27)

History of experience adjustments:

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

22 Provisions

Movements on provisions comprise:

	31 December 2005	Charged / (released) to the income statement	Revision of estimated cash flows	Accretion of discount	Provisions utilised	Disposals	**31 December 2006**
	£m	£m	£m	£m	£m	£m	**£m**
Liability and damage claims	2	(1)	-	-	-	-	**1**
Decommissioning	59	1	4	3	(2)	-	**65**
Contract provisions	1	60	-	-	-	-	**61**
Restructuring	3	-	-	-	(2)	-	**1**
Emissions obligations	47	62	-	-	(47)	(2)	**60**
ROCs	50	14	-	-	(50)	-	**14**
Share based payments	4	2	-	-	(2)	-	**4**
	166	138	4	3	(103)	(2)	**206**

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

	31 December 2006 £m	31 December 2005 £m
Current	**116**	73
Non-current	**90**	93
	206	166

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 2006 primarily relate to certain out of the money CHP contracts. The provisions will be utilised over the onerous portions of the contracts, currently estimated to be years up to and including 2009.

Notes to the financial statements
for the year ended 31 December 2006 (continued)

22 Provisions (continued)

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

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

ROCs 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 2006 is as follows:

	At 31 December 2006 £m	At 31 December 2005 (restated) £m
Accelerated capital allowances	**800**	843
Other timing differences	**(294)**	(2)
Provision for deferred tax	**506**	841
Provision at 1 January (restated)	**841**	557
Adjustment for adoption of IAS 39	**-**	44
Acquisitions and disposals	**(5)**	51
Deferred tax (credit) / charge for year	**(280)**	112
Taken to equity	**(50)**	77
Provision at end of year	**506**	841

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

23 Deferred Tax (continued)

	At 31 December 2006 £m	At 31 December 2005 (restated) £m
Intangibles	10	32
Investments	(7)	(7)
Tangible fixed assets	800	843
Receivables	(7)	351
Derivatives	(176)	-
Financial Liabilities	16	(12)
Operating liabilities	(2)	(132)
Pensions provision	(90)	(116)
Provisions	(12)	(83)
ACT	(33)	(60)
Unrealised capital losses	8	8
Other	(1)	17
DT liability for 31 December 2006 balance sheet	506	841

The deferred tax liability due after more than one year is £506m.

24 Share capital

The share capital of the Company comprises:

	At 31 December 2006 £m	At 31 December 2005 £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

Stock Appreciation Rights

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 2006, 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 (€) *	61.10	44.80	37.86	50.70
Base price of Dow Jones STOXX Utilities Index (€)	268.66	211.58	202.14	262.44
Number of participants in year of issuance	31	13	21	18
Number of SARs issued	77,044	62,325	90,927	58,859
Exercise hurdle (exercise price exceeds the price at issuance by at least %)	10	10	10	10
Exercise hurdle (minimum exercise, €) *	67.21	49.28	41.65	55.77
Maximum exercise gain (€)	65.35	49.05	-	-
Out performance of benchmark index?	yes	yes	yes	yes

* Adjusted for special dividend distribution

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. This cap on gains took effect for the first time in the 2006 fiscal year.

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

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

	Tranche 7	Tranche 6	Tranche 5	Tranche 4
Price of E.ON AG stock on 31 December 2006 (€)	102.83	102.83	102.83	102.83
Fair value on 31 December 2006 (€)	41.87	47.38	61.43	48.52
Swap rate (%)	4.03	4.03	4.04	4.04
Volatility of the E.ON AG stock (%)	25.81	26.22	26.29	25.46
Volatility of the Dow Jones STOXX Utilities Index (Price €) (%)	14.66	14.85	14.96	14.74
Correlation	0.6802	0.6896	0.7066	0.7382
Last dividend paid by E.ON AG (€)	2.75	2.75	2.75	2.75
Dividend yield of Dow Jones STOXX Utilities Index (Price €) (in %)	4.36	4.36	4.36	4.36

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 2006, 1,869 SARs (2005: 32,718) of tranche four, 6,268 SARs (2005: 49,259) of tranche five and 62,325 (2005: nil) of tranche six were exercised on an ordinary basis. 4,511 SARs (2005: nil) of tranche seven were exercised on an extraordinary basis. No options were exercised prior to their normal exercise window and no SARs expired. The gain to the holders on exercise was £2 million (2005: £1 million).

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 2006 amounted to £4 million (2005: £4 million). The total cost of the stock option program in 2006 amounted to £2 million (2005: £3 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 1 January 2005	-	55,028	88,025	46,554
SARs granted in 2005	77,044	7,297	-	-
SARs exercised in 2005	-	-	(49,529)	(32,718)
SARs outstanding as of 31 December 2005	77,044	62,325	38,496	13,836
SARs exercised in 2006	(4,511)	(62,325)	(6,268)	(1,869)
SARs outstanding as of 31 December 2006	72,533	-	32,228	11,967
SARs exercisable at year end	-	-	32,228	11,967
Provision as of 1 January 2005 (£m)	-	-	2	-
Gain to holders in 2005 (£m)	-	-	(1)	-
Expense in 2005 (£m)	1	2	-	-
Provision as of 31 December, 2005 (£m)	1	2	1	-
Gain to holders in 2006 (£m)	-	(2)	-	-
Expense in 2006 (£m)	1	-	1	-
Provision as of 31 December, 2006 (£m)	**2**	**-**	**2**	**-**
Average gain to holders per option in 2006 (£)	19	32	34	26
Difference between cash and equity-settled transactions (£m)	(1)	(1)	(1)	-

The average gain per stock option exercised during the year ended 31 December 2006 amounted to £19 in tranche 7 (2005: £nil), £32 in tranche 6 (2005: £nil), £34 in tranche 5 (2005: £21) and £26 in tranche 4 (2005: £12).

At 31 December 2006 none of the SARs in the seventh tranche were exercisable due to the vesting period not having expired. The vesting period for the SARs in the sixth tranche ended on 31 December 2006.

25 Share based payments (continued)

E.ON Share Performance Plan

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

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

	Tranche 1
Date of issuance	2 January 2006
Term	3 years
Target value at issuance (€)	79.22
Number of participants in year of issuance	33
Number of Performance Rights issued	15,832
Maximum cash amount (€)	237.66

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

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

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

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

25 Share based payments (continued)

The fair value of the Performance Rights in accordance with IFRS2 is calculated using a recognised option pricing model (Monte Carlo simulation). This model simulates a large number of difference scenarios for the E.ON AG stock and the benchmark, the Dow Jones STOXX Utilities Index (Total Return EUR). As all payments to plan participants take place on a specified date, no assumptions concerning exercise behaviour are made in this model.

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

	Tranche 1
Price of E.ON AG stock on 31 December 2006 (€)	102.83
Fair value on 31 December 2006 (€)	58.54
Swap rate (%)	4.04
Volatility of the E.ON AG stock (%)	19.65
Volatility of the Dow Jones STOXX Utilities Index (Total Return €) (%)	12.40
Correlation	0.8273
Last dividend paid by E.ON AG (€)	2.75
Dividend yield of the E.ON AG stock (in %)	2.67

The liability recognised on the balance sheet at 31 December 2006 and the total cost of the programme in 2006 amounted to less than £1 million (2005: £nil).

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

	Tranche 1
Performance Rights outstanding as of 31 December 2005	-
Performance Rights granted in 2006	15,833
Performance Rights outstanding as of 31 December 2006	15,833

Performance Rights exercisable at year end -

There were no gains on exercise during 2006 as none of the Performance Rights in the first tranche were exercisable due to the term not having expired.

26 Share premium account

	2006 £m	2005 £m
At 1 January and 31 December	**97**	97

27 Retained earnings

	£m
At 1 January 2005 (as previously stated)	1,599
Change of accounting policy (note 1)	(96)
Prior year adjustment (note 1)	(256)
At 1 January 2005 (restated)	1,247
Adoption of IAS 39 (net of tax)	89
Retained profit for the year	641
Actuarial gains and losses (net of tax)	77
Dividends	(240)
At 31 December 2005	1,814
Retained loss for the year	(332)
Actuarial gains and losses (net of tax)	109
At 31 December 2006	1,591

Notes to the financial statements for the year ended 31 December 2006 (continued)

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 2005	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**
Disposals	-	-	-	1	-	-	1
Cash flow hedges (net of tax)	-	-	-	-	(226)	-	(226)
At 31 December 2006	**85**	**474**	**1**	**-**	**(108)**	**24**	**476**

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 renewables business and Cottam Development Centre.

29 Equity minority interests

The Group	31 December 2006 £m	31 December 2005 £m
At 1 January	-	6
Profit and loss account	(2)	2
Dividends paid to minority interests	(4)	(6)
Minority interests arising on acquisition	-	114
Purchase of minority interest	-	(116)
At 31 December	**(6)**	-

30 Cash flow from operating activities

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

	2006 £m	2005 (restated) £m
Net (loss)/profit	(334)	643
Adjustments for:		
Tax (credit)/ charge	(127)	158
Amortisation and impairment of intangible fixed assets	198	61
Depreciation and impairments of property, plant and equipment	248	240
Other impairments and onerous contract recognition	68	76
Loss on disposal of property, plant and equipment	1	4
Gains on disposal of property, plant and equipment	(1)	-
Profit on sale of investments	(18)	(5)
Net interest	239	211
Share of results of associate after taxation	(4)	(12)
Non cash losses/(gains) on commodity and other derivative financial instruments	980	(352)
Other non-cash differences	-	39
Changes in working capital (excluding effects of acquisitions and disposal of subsidiaries)		
Increase in Inventories	(142)	(116)
Increase in Trade and other receivables	(282)	(485)
Increase in Payables	(72)	328
Decrease in Pensions liability	(18)	(427)
Increase/(Decrease) in Provisions	36	(59)
Cash generated from continuing operations	772	304

31 Commitments and contingent liabilities

a) At 31 December 2006, the Group had commitments contracted but not provided of £327 million (2005: £109 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 CEGB in its coal purchasing practices prior to 1990. Under the arrangements for electricity privatisation, it is possible that either or both of the Company and National Power plc (through its successor companies) could be liable to pay any compensation that may ultimately arise. The Commission rejected 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, in 2005, ordered that there was no need to proceed to judgment in the appeal by the former SWSMA members since this was without purpose in the light of the NALOO decision. The Commission proceeded to carry out an investigation into the substantive merits of the complaints. By decisions dated 18 June 2007 the Commission rejected the NALOO and SWSMA complaints, indicating that there were insufficient grounds for acting upon them. Appeals against the Commission's decisions have been filed with the European Court of First Instance.

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 2006, the Group's future commitments for the supply of coal under all its contractual arrangements totalled £308 million (2005: £535 million).

31 Commitments and contingent liabilities (continued)

d) 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 2006, the estimated minimum commitment for the supply of gas under all these contracts totalled £1,759 million (2005: £2,937 million).

The Group is also committed to power purchase contracts for the supply of electricity. At 31 December 2006 the total contractual commitment for the group was £930 million (2005: £753 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 2006, the Group had the following operating lease commitments:

	31 December 2006		31 December 2005	
	Property £m	**Other assets £m**	Property £m	Other assets £m
Annual commitments under non-cancellable operating leases expiring:				
Within one year	**32**	**7**	5	2
Within two to five years	**17**	**15**	18	5
After five years	**30**	**-**	27	-
	79	**22**	50	7

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 12.

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 2006 £m	Year ended 31 December 2005 £m
Expenses incurred from parent undertaking and fellow subsidiaries	**1,010**	402
Income received from parent undertaking and fellow subsidiaries	**111**	51

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

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	2006 £000	2005 £000
Purchases from associates	**4,158**	1,014
Sales to associates	**196**	87

Balance sheet items	2006 £000	2005 £000
Receivables from associates	**206**	48
Payables to associates	**561**	239

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 6.

34 Events after the balance sheet date

The Government announced measures in the Budget on 21 March 2007, to reduce the corporation tax headline rate (28% from 30%) and the rates at which capital allowances are due on expenditure in respect of plant and machinery (20% from 25%), industrial buildings (0% from 4% over the next four years) and long life assets (10% from 6%). These measures are effective from 1 April 2008. The impact on the current tax charge for the year is £nil. The estimated impact on the deferred tax balance as at 31 December 2006 would be a reduction in the provision of approximately £44m. This impact would be split between opening retained earnings and current year earnings.

E.ON UK PLC

COMPANY ACCOUNTS

For the year ended 31 December 2006

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 2006 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 2006.

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 and have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the parent company financial statements.

In addition we report to you if, in our opinion, 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 2006;
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
5 October 2007

E.ON UK PLC

COMPANY BALANCE SHEET
as at 31 December 2006

	Note	31 December 2006 £m	31 December 2005 (restated) £m
Fixed Assets			
Intangible assets			
Goodwill	5	**24**	26
Other	5	**126**	41
Total Intangible assets		**150**	67
Tangible assets	6	**1,361**	1,241
Investments			
Investments in associates	7	**4**	2
Investments in subsidiaries	7	**3,476**	3,602
Other	7	**17**	17
Total investments		**3,497**	3,621
Deferred tax	16	**16**	-
Commodity and other derivative financial instruments	13	**-**	44
		5,024	4,973
Current assets			
Stocks	8	**230**	177
Debtors: amounts falling due within one year	9	**4,728**	3,811
Commodity and other derivative financial instruments	13	**1,414**	1,414
Cash and short term deposits		**121**	28
		6,493	**5,430**
Creditors: amounts falling due within one year			
Loans and overdrafts	10	**(3,155)**	(2,138)
Commodity and other derivative financial instruments	13	**(1,922)**	(699)
Trade and other creditors	11	**(4,339)**	(3,833)
Net current liabilities		**(2,923)**	**(1,240)**
Total assets less current liabilities		**2,101**	**3,733**

E.ON UK PLC

COMPANY BALANCE SHEET
as at 31 December 2006 (continued)

	Note	31 December 2006 £m	31 December 2005 (restated) £m
Creditors: amounts falling due after more than one year			
Long-term loans	12	**(808)**	(1,295)
Commodity and other derivative financial instruments	13	(14)	(1)
Other creditors	14	-	(1)
Provisions for liabilities and charges	15	**(120)**	(101)
Deferred tax	16	-	(243)
Net assets		**1,159**	2,092
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	**178**	1,111
Equity shareholder's funds	19	**1,159**	2,092

The financial statements on pages 95 to 124 were approved by the Board on 25 September 2007 and signed on its behalf by:

Graham Bartlett
Director

3 October 2007

The accounting policies and notes on pages 97 to 124 form an integral part of these financial statements.

Notes to the parent company financial statements for the year ended 31 December 2006

1 Accounting Policies

Nature of operations

The principal business in the UK is the generation, trading and wholesale of electricity and gas. The Company is also the holding company for the distribution and retail companies.

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 loss for the year stated in Note 2 and its historical cost equivalent. 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.

Prior year adjustment

During the year, the Company's management have become aware of a material error in previously disclosed financial information.

On 31 December 2005, a sale of assets and liabilities occurred from the Company's B2B business to Powergen Limited that was not recognised in the 2005 financial statements. The following assets and liabilities have been removed from the 2005 balance sheet to reflect the sale - trade receivables of £259 million, trade payables of £23 million, other tax and social security of £37 million and other creditors of £7 million. Consideration was in the form of intercompany receivables of £201 million, resulting in an increased 2005 profit for the financial year of £10 million.

Going concern

Not withstanding the fact that the Company have net current liabilities, the directors have prepared the financial statements on the going concern basis. The directors have in place sufficient borrowing facilities such that the Company can meet its obligations as they fall due for a period of at least twelve months from the date of the directors' approval of these financial statements.

Notes to the parent company financial statements for the year ended 31 December 2006

1 Accounting Policies (continued)

Turnover

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

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.

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.

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.

1 **Accounting Policies (continued)**

Financial Instruments

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.

1 **Accounting Policies (continued)**

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.

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 fair value.

1 Accounting Policies (continued)

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 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.

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.

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 income generating unit to which the asset belongs.

1 **Accounting Policies (continued)**

Stocks

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) 'cash flow statements' (FRS 1).

Related party transactions

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

1 Accounting Policies (continued)

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.

2 Profit of the Company

The loss for the financial year of the Company is £693 million (2005: £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 £0.7 million (2005: £0.6 million) this is broken down as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Auditors' remuneration for:		
Audit services: Audit of the parent company accounts	0.4	0.3
Other services: Other services pursuant to legislation	0.3	0.3

Notes to the parent company financial statements for the year ended 31 December 2006 (continued)

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 2006 £	Year ended 31 December 2005 £
Aggregate emoluments	**3,460,756**	2,189,445

Retirement benefits are accruing to four (2005: four) directors under a defined benefit scheme. During the year no directors exercised options over shares they were rewarded for services to the E.ON Group (2005: none). During the year six (2005: three) 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.

Highest paid director	Year ended 31 December 2006 £	Year ended 31 December 2005 £
Total emoluments, excluding gains on the exercise of share options and benefits under long-term incentive schemes	**1,480,201**	955,625
Defined benefit pension scheme:		
- Accrued pension at end of year	**142,470**	112,180

During the year the highest paid director 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.

5 Intangible fixed assets

	Goodwill £m	Other £m	Total £m
Cost			
At 31 December 2005	32	41	73
Additions	-	126	126
Disposals	-	(41)	(41)
At 31 December 2006	**32**	**126**	**158**
Amortisation			
At 31 December 2005	6	-	6
Charge for the year	2	-	2
At 31 December 2006	**8**	**-**	**8**
Net book value at 31 December 2006	**24**	**126**	**150**
Net book value at 31 December 2005	26	41	67

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 2005	3,002	185	3,187
Additions	247	5	252
Disposals	(210)	(116)	(326)
Group Transfers	8	-	8
At 31 December 2006	**3,047**	**74**	**3,121**
Depreciation			
At 31 December 2005	(1,789)	(157)	(1,946)
Charge for the year	(98)	(1)	(99)
Disposals	192	93	285
At 31 December 2006	**(1,695)**	**(65)**	**(1,760)**
Net book value at 31 December 2006	**1,352**	**9**	**1,361**
Net book value at 31 December 2005	1,213	28	1,241

Company assets include freehold land and buildings with a net book value of £124 million (2005: £71 million).

7 Investments

	Subsidiary investment	Associate investment		Total
	Equity £m	Equity £m	Other Investments £m	£m
At 31 December 2005	3,602	2	17	3,621
Revaluation surplus transfer to equity	-	-	-	-
Additions	78	2	-	80
Impairment	(94)	-	-	(94)
Disposals	(110)			(110)
At 31 December 2006	**3,476**	**4**	**17**	**3,497**

The impairment primarily represents a reduction in the carrying value of the Company's investment in Holford Gas Storage Limited. The impairment has arisen as costs to complete the project exceed the costs anticipated when the project commenced.

Notes to the parent company financial statements for the year ended 31 December 2006 (continued)

7 Investments (continued)

Other investments include the following:

	At 31 December 2006 £m	At 31 December 2005 £m
Listed equity securities – UK	**1**	1
Listed gilts – UK	**16**	16
	17	17

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
E.ON UK Renewables Limited	Ordinary shares	100	England and Wales	Holding company for renewable activities

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
E.ON IS UK Limited	31 December	England and Wales	Ordinary shares	49%

7 Investments (continued)

During the year the Company purchased a 49% share of E.ON IS UK Limited (E.ON IS). IT assets were transferred from the Company to E.ON IS during the year at their net book value of £29 million. The principal activity of E.ON IS is to provide a shared IT service to the E.ON UK group. The share capital of E.ON IS is £4 million.

8 Stocks

	At 31 December 2006 £m	At 31 December 2005 £m
Fuel stocks	194	153
Stores	36	24
	230	177

9 Debtors: amounts falling due within one year

	At 31 December 2006 £m	At 31 December 2005 (restated) £m
Trade debtors	526	360
Other debtors	22	108
Prepayments and accrued income	51	47
Other taxation	25	-
Amounts due from parent undertaking and fellow subsidiaries	4,104	3,296
	4,728	3,811

Amounts due from parent undertaking and fellow subsidiaries are unsecured, a combination of interest free and interest bearing, denominated in Sterling and repayable on predetermined dates. Interest bearing loans are set at LIBOR plus 50 to 70 basis points.

10 Loans and overdrafts

	At 31 December 2006 £m	At 31 December 2005 £m
Bank overdrafts	220	62
Short term loans from parent undertaking and fellow subsidiaries	2,933	2,032
Other short-term loans	2	44
	3,155	2,138

10 Loans and overdrafts (continued)

Short-term funding is provided through inter-company facilities. Amounts owed to parent undertaking and fellow subsidiaries are unsecured, incur interest at LIBOR plus 20 to 47.5 basis points, are denominated in Sterling, Euro and US Dollar and are repayable on predetermined dates.

The weighted average interest rate on all short-term loans during the year was 5.1% (2005: 3.9%).

11 Trade and other creditors falling due within one year

	At 31 December 2006 £m	At 31 December 2005 (restated) £m
Trade creditors	**805**	794
Amounts owed to parent undertaking and fellow subsidiaries	**321**	166
Amounts owed to subsidiaries	**3,033**	2,700
Corporation tax	**(30)**	20
Other taxation and social security	**8**	(25)
Accruals and other creditors	**202**	178
	4,339	3,833

Amounts owed to parent undertaking and fellow subsidiaries are unsecured, incur interest at LIBOR plus 20 to 47.5 basis points, are denominated in Sterling, Euro and US Dollar and are repayable on predetermined dates.

Amounts owed to subsidiaries are unsecured, a combination of interest free and interest bearing, are denominated in Sterling, Euro and US Dollar and are repayable on predetermined dates. Interest bearing loans are set at LIBOR plus 47.5 to 50 basis points.

12 Long term loans

	At 31 December 2006 £m	At 31 December 2005 £m
Amounts owed to external debt holders		
5% Euro Eurobond 2009	177	181
6.25% Sterling Eurobond 2024	8	3
Loan Notes 2008	1	4
	186	188
Amounts owed to fellow group undertakings		
5% Euro Eurobond 2009	159	162
6.25% Sterling Eurobond 2024	223	243
Long term loan	240	702
	622	1,107
	808	1,295

None of the bonds outstanding at 31 December 2006 have any financial covenants.

Amounts owed to fellow group undertakings are unsecured.

The long term loan is payable to E.ON UK Holding Company, is repayable in 2011 and incurs interest at LIBOR plus 47.5 basis points.

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, 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, including options, 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 £33 million (2005: £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. During 2006, £89 million (2005: £46 million) was charged to the profit and loss account in respect of fair value movements related to embedded derivatives.

13 Financial Instruments (continued)

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

	Assets (£m)		Liabilities (£m)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Interest rate swaps	**4**	17	**-**	(1)
Cross currency swaps	**27**	23	**(18)**	(7)
Foreign currency forward contracts	**4**	7	**(26)**	(3)
Commodity swaps	**74**	112	**(80)**	(58)
Commodity forward contracts	**1,302**	1,299	**(1,777)**	(509)
Embedded derivatives within long term gas contracts	**-**	-	**(33)**	(122)
Options	**3**	-	**(2)**	-
	1,414	1,458	**(1,936)**	(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)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Commodity forward contracts				
Less than 1 year	**2**	196	**(137)**	(5)
1 to 5 years	**-**	44	**(14)**	-
	2	240	**(151)**	(5)

Notes to the parent company financial statements for the year ended 31 December 2006 (continued)

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)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Interest rate swaps				
Greater than 5 years	-	-	-	(1)
	-	-	-	(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)	
	At 31 December 2006	At 31 December 2005	**At 31 December 2006**	At 31 December 2005
Interest rate swaps	4	17	-	-
Cross currency swaps	27	23	(18)	(7)
Foreign currency forward contracts	4	7	(26)	(3)
Commodity swaps	74	112	(80)	(58)
Commodity forward contracts	1,300	1,059	(1,626)	(504)
Embedded derivatives within long term gas contracts	-	-	(33)	(122)
Options	3	-	(2)	-
	1,412	1,218	**(1,785)**	(694)

The notional principal amount of derivatives and maturities at 31 December 2006 are as follows:

	Within 1 year £m	**1 – 5 years £m**	**After 5 years £m**	**Total £m**
Interest rate swaps	336	-	-	336
Cross currency swaps	630	-	-	630
Foreign currency forward contracts	666	-	-	666
Commodity swaps	1,082	-	-	1,082
Commodity forward contracts	10,005	46	-	10,051
Embedded derivatives within long term gas contracts	682	-	-	682
Options	4	-	-	4
	13,405	**46**	-	**13,451**

13 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	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 2012 and interest rate swaps, cross currency swaps, foreign currency forward contracts, commodity swaps and commodity forward contracts that expire over the next 5 years.

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.

		31 December 2006		31 December 2005	
	Note	Book Value £m	Fair value £m	Book Value £m	Fair Value £m
Long term borrowings	(ii)	**(808)**	**(859)**	(1,295)	(1,363)
Short term debt	(i)(iv)	**(3,155)**	**(3,155)**	(2,138)	(2,138)
Cash and short term deposits	(iii)	**121**	**121**	28	28

(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.

Notes to the parent company financial statements for the year ended 31 December 2006 (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 2006 £m	At 31 December 2005 £m
In more than one year but not more than two years	**1**	4
In more than two years but not more than five years	**575**	1,045
In more than five years	**232**	246
	808	1,295

At 31 December 2006 there were £3,448 million of undrawn committed borrowing facilities available to the Company, all of which were inter-company facilities which did not contain any material covenant restrictions and which expire between 2007 and 2011. These facilities comprise:

Facility	Total facility £m	Amount undrawn at 31 December 2006 £m	Expiry date	Fees
E.ON UK plc – committed facility from E.ON AG	870	590	21 December 2010	10bp
E.ON UK plc – committed facility from E.ON UK Holding Company Limited	3,000	2,760	06 March 2011	19bp
E.ON UK plc – committed facility from Powergen Group Investments	300	74	21 December 2010	-
E.ON UK plc – committed facility from Ergon Financial Management Ltd	2,400	24	02 July 2007	8bp
	6,570	**3,448**		

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.

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.

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 2006					
Sterling	**3,627**	**3,396**	**231**	**6.3**	**17.3**
Euros	**336**	**159**	**177**	**5.0**	**2.7**
	3,963	**3,555**	**408**	**5.7**	**11.0**

	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	190	181	5.0	3.5
	3,433	2,753	680	7.9	8.0

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 £3 million (2005: £1 million) for contract provisions (see note 15) 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 2006, the Company held £121 million (2005: £28 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 2006 £m	At 31 December 2005 £m
Accruals and other creditors	-	1

15 Provisions for liabilities and charges

Movements on provisions comprise:

	31 December 2005	Charged / (released) to the profit and loss account	Accretion of discount	Provisions utilised	**31 December 2006**
	£m	£m	£m	£m	**£m**
Liability and damage claims	2	(1)	-	-	**1**
Contract provisions	1	2	-	-	**3**
Decommissioning	43	-	1	(2)	**42**
Emissions obligations	55	28	-	(9)	**74**
	101	29	1	(11)	**120**

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 2006 relate in the main to an onerous lease of our New Broad Street Office which is no longer used by the Company.

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.

16 Deferred tax

An analysis of the full provision and discounted provision for deferred tax recognised at 31 December 2006 is as follows:

	At 31 December 2006 £m	At 31 December 2005 £m
Accelerated capital allowances	**237**	226
Other timing differences	**(251)**	76
Undiscounted provision for deferred tax	**(14)**	302
Discount	**(2)**	(59)
Discounted provision for deferred tax	**(16)**	243

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 2006 £m	At 31 December 2005 £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

18 Reserves

	Share premium account £m	Special capital reserve £m	Capital redemption reserve £m	Profit and loss account (restated) £m
At 31 December 2005	97	474	85	1,111
Cash flow hedges (net of tax)	-	-	-	(240)
Loss for year	-	-	-	(689)
At 31 December 2006	**97**	**474**	**85**	**182**

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 2006 £m	31 December 2005 (restated) £m
(Loss) / Profit for the financial year	**(693)**	59
Dividends	-	(240)
	(693)	(161)
Prior year adjustments	-	10
Adoption of FRS 26	-	114
Cash flow hedges (net of tax)	**(240)**	108
Net movement in shareholders' funds	**(933)**	51
Opening shareholder's funds	**2,092**	2,041
Closing shareholder's funds	**1,159**	2,092

20 Pension commitments

At 31 December 2006, 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 2006, 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 £14,812,690 (2005: £445,622,793), being 15.9 percent of pensionable salary.

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 (2005: £1 million) is included within other creditors, being the outstanding contributions to the Company scheme.

21 Commitments and contingent liabilities

a) At 31 December 2006, the Company had commitments contracted but not provided of £327m million (2005: £109 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, in 2005, ordered that there was no need to proceed to judgment in the appeal by the former SWSMA members since this was without purpose in the light of the NALOO decision. The Commission proceeded to carry out an investigation into the substantive merits of the complaints. By decisions dated 18 June 2007 the Commission rejected the NALOO and SWSMA complaints, indicating that there were insufficient grounds for acting upon them. The complainants may appeal the Commission's decisions. Appeals against the Commission's decisions have been filed with the European Court of First Instance.

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 2006, the Company's future commitments for the supply of coal under all its contractual arrangements totalled £745 million (2005: £535 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 2006, the estimated minimum commitment for the supply of gas under all these contracts totalled £3,793 million (2005: £2,937 million).

The Company is also committed to power purchase contracts for the supply of electricity. At 31 December 2006, the total contractual commitment for the Company was £1,444 million (2005: £753 million).

e) The Company has issued guarantees to third parties to support its subsidiaries' activities, particularly around gas and power procurement and banking activities. At 31 December 2006, the credit risk exposure under financial guarantees issued by E.ON UK plc in support of subsidiaries was £637 million (2005: £452 million)

21 Commitments and contingent liabilities (continued)

f) 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.

g) At 31 December 2006 the Company had the following operating lease commitments:

	31 December 2006	31 December 2005
	Property £m	Property £m
Annual commitments expiring under non-cancellable operating leases expiring:		
Within one year	**32**	5
Within two to five years	**17**	17
After five years	**30**	27
	79	49

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 Events after the balance sheet date

The Government announced measures in the Budget on 21 March 2007, to reduce the corporation tax headline rate (28% from 30%) and the rates at which capital allowances are due on expenditure in respect of plant and machinery (20% from 25%), industrial buildings (0% from 4% over the next four years) and long life assets (10% from 6%). These measures are effective from 1 April 2008.

23 Ultimate parent undertaking and controlling party

The immediate parent undertaking is Powergen Group Investments. The ultimate parent undertaking in the UK is 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:

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