E ON AG
Form 20-F
March 09, 2006

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As filed with the Securities and Exchange Commission on March 9, 2006.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 20-F

(Mark One)

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended: December 31, 2005

OR

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

OR

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

Date of event requiring this shell company report .

For the transition period from to

Commission file number: 1-14688

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

Federal Republic of Germany	**E.ON-Platz 1, D-40479 Düsseldorf, GERMANY**
(Jurisdiction of Incorporation or Organization)	(Address of Principal Executive Offices)

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

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

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2005, 659,153,552 outstanding Ordinary Shares with no par value.

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No þ

Note checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 o Item 18 þ

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

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

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As used in this annual report,

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

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

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

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

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

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

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

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

Degussa refers to Degussa AG and its consolidated subsidiaries, in which E.ON now owns a minority interest, and which collectively comprised E.ON s former Degussa division.

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

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

MEMC refers to MEMC Electronic Materials, Inc. and its consolidated subsidiaries, which collectively comprised E.ON s former silicon wafers division.

Unless otherwise indicated, all amounts in this annual report are expressed in European Union euros (euros or EUR or), United States dollars (U.S. dollars or dollars or $), British pounds (GBP), Swedish krona (SEK öre (öre). Beginning in 1999, the reporting currency is the euro. Amounts formerly stated in German marks (marks or DM) have been translated into euro using the fixed rate of DM 1.95583 per 1.00. Amounts stated in dollars, unless otherwise indicated, have been translated from euros at an assumed rate solely for convenience and should not be

construed as representations that the euro amounts actually represent such dollar amounts or could be converted into dollars at the rate indicated. Unless otherwise stated, such dollar amounts have been translated from euros at the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) on December 30, 2005, which was $1.1842 per 1.00. Such rate may differ from the actual rates used in the preparation of the consolidated financial statements of E.ON as of December 31, 2005, 2004 and 2003, and for each of the years in the three-year period ended December 31, 2005, included in Item 18 of this annual report (the Consolidated Financial Statements), which are expressed in euros, and, accordingly, dollar amounts appearing in this annual report may differ from the actual dollar amounts that were

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translated into euros in the preparation of such financial statements. For information regarding recent rates of exchange, see Item 3. Key Information Exchange Rates.

Beginning in 2000, E.ON has prepared its financial statements in accordance with generally accepted accounting principles in the United States (U.S. GAAP). Formerly, the Company prepared its financial statements in accordance with generally accepted accounting principles in Germany as prescribed by the German Commercial Code (*Handelsgesetzbuch,* the Commercial Code) and the German Stock Corporation Act (*Aktiengesetz,* the Stock Corporation Act). Sales and adjusted EBIT presented in this annual report for each of E.ON s segments are based on the consolidated accounts of the E.ON Group as shown in Note 31 (Segment Information) of the Notes to Consolidated Financial Statements under the captions External sales and Adjusted EBIT and are presented prior to the elimination of intersegment transactions. Adjusted EBIT is the measure pursuant to which the Group has evaluated the performance of its segments and allocated resources to them since 2004. Adjusted EBIT is an adjusted figure derived from income/(loss) from continuing operations (before intra-Group eliminations when presented on a segment basis) before income taxes and minority interests, excluding interest income. Adjustments include net book gains resulting from disposals, as well as cost-management and restructuring expenses and other non-operating earnings of an exceptional nature. In addition, interest income is adjusted using economic criteria. In particular, the interest portion of additions to provisions for pensions and nuclear waste management is allocated to adjusted interest income. E.ON uses adjusted EBIT as its segment reporting measure in accordance with Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131). However, on a consolidated Group basis adjusted EBIT is considered a non-GAAP measure that must be reconciled to the most directly comparable GAAP measure. For a reconciliation of Group adjusted EBIT to net income for each of 2005, 2004 and 2003, see Item 5. Operating and Financial Review and Prospects Results of Operations Business Segment Information.

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

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

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PART I

Item 1. Identity of Directors, Senior Management and Advisers.

Not applicable.

Item 2. Offer Statistics and Expected Timetable.

Not applicable.

Item 3. Key Information.

SELECTED FINANCIAL DATA

The selected financial data presented below in accordance with U.S. GAAP as of and for each of the years in the five-year period ended December 31, 2005 have been excerpted from or are derived from the Consolidated Financial Statements of E.ON as of and for the period ended December 31, 2005, 2004, 2003, 2002 and 2001, respectively.

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

	Year Ended December 31,					
	2005(1)	2005	2004	2003	2002	2001
	(in millions, except share amounts)					
Statement of Income Data:						
Sales	$ 66,788	56,399	46,742	44,109	35,300	36,041
Sales excluding electricity and natural gas taxes(2)	61,406	51,854	42,384	40,223	34,367	35,347
Income/(Loss) from continuing operations before income taxes	8,536	7,208	6,355	5,165	(947)	2,502
Income/(Loss) from continuing operations after income taxes(3)	5,841	4,932	4,505	4,020	(276)	2,403
Income/(Loss) from continuing operations	5,186	4,379	4,027	3,575	(901)	1,950
Income/(Loss) from discontinued operations(4)	3,594	3,035	312	1,512	3,487	124
Net income	8,771	7,407	4,339	4,647	2,777	2,048
Basic earnings/(Loss) per share from continuing operations	7.87	6.64	6.13	5.47	(1.38)	2.89
Basic earnings (Loss) per share from discontinued operations, net(4)	5.45	4.61	0.48	2.31	5.35	0.18

Basic earnings per share from net income(5)	13.31	11.24	6.61	7.11	4.26	3.03
Balance Sheet Data:						
Total assets	$ 149,875	126,562	114,062	111,850	113,503	101,659
Long-term financial liabilities	12,499	10,555	13,540	14,884	17,576	9,308
Stockholders equity(6)	52,678	44,484	33,560	29,774	25,653	24,462
Number of authorized shares		692,000,000	692,000,000	692,000,000	692,000,000	692,000,000

(1) Amounts in this column are unaudited and have been translated solely for the convenience of the reader at an exchange rate of $1.1842 = 1.00, the Noon Buying Rate on December 30, 2005.

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(2) Laws in Germany and other European countries in which E.ON operates require the seller of electricity to collect electricity taxes and remit such amounts to tax authorities. Similar laws also require the seller of natural gas to collect and remit natural gas taxes to tax authorities.

(3) Before minority interest of 553 million for 2005, as compared with 478 million, 445 million, 625 million and 453 million for 2004, 2003, 2002 and 2001, respectively.

(4) For more details, see Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.

(5) Includes earnings per share from the first-time application of new U.S. GAAP standards of (0.01), 0.00, (0.67), 0.29 and (0.04) for 2005, 2004, 2003, 2002 and 2001, respectively.

(6) After minority interests.

DIVIDENDS

The following table sets forth the annual dividends paid per ordinary unit bearer share of E.ON AG (each, an Ordinary Share) in euros, and the dollar equivalent, for each of the years indicated. Prior to the introduction of the euro in 2002, dividends were declared and paid in marks. For convenience, the dividend amount for 2001 has been translated from marks into euros at the fixed rate of 1.95583. The table does not reflect the related tax credits available to German taxpayers who receive dividend payments. Owners of Ordinary Shares who are United States residents should be aware that they will be subject to German withholding tax on dividends received. See Item 10. Additional Information Taxation.

Year Ended December 31,	Dividends Paid per Ordinary Share with no par value	$(1)
2001	1.60	1.49
2002	1.75	1.96
2003	2.00	2.39
2004	2.35	3.04
2005(2)(3)	2.75	3.26

(1) Translated into dollars at the Noon Buying Rate on the dividend payment date, which typically occurred during the second quarter of the following year, except for the 2005 amount, which has been translated at the Noon Buying Rate on December 30, 2005.

(2) The dividend amount for the year ended December 31, 2005 is the amount proposed by E.ON s Supervisory Board and Board of Management and has not yet been approved by its stockholders. Prior to the payment of the dividends, a resolution approving such amount must be passed by E.ON s stockholders at the annual general meeting to be held on May 4, 2006.

(3) E.ON s Supervisory Board and Board of Management have also proposed an extra dividend for 2005 of 4.25 per Ordinary Share, resulting from the proceeds from the sale of E.ON s remaining 42.9 percent stake in Degussa. For details on this transaction, see Item 5. Operating and Financial Review and Prospects Overview. The extra

dividend has not yet been approved by E.ON s stockholders. Prior to the payment of this dividend, which will be made together with the regular dividend amount for the year ended December 31, 2005, a resolution approving such amount must be passed by E.ON s stockholders at the annual general meeting to be held on May 4, 2006. See also Item 8. Financial Information Dividend Policy.

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EXCHANGE RATES

Until December 31, 1998, the mark took part in the European Monetary System (EMS) exchange rate mechanism. Within the EMS, exchange rates could fluctuate within permitted margins, fixed by central bank intervention. Against currencies outside the EMS, the mark had, in theory, free floating exchange rates, although central banks sometimes tried to confine short-term exchange rate fluctuations by intervening in foreign exchange markets. As of December 31, 1998, the mark had a fixed value relative to the euro of 1.95583, and therefore was no longer traded on currency markets as an independent currency. As of January 1, 2002, the euro replaced the mark as legal tender in Germany.

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

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

Period	Average(1)	High	Low	Period-End
2001	0.8909			0.8901
2002	0.9495			1.0485
2003	1.1411			1.2597
2004	1.2478			1.3538
2005	1.2400			1.1842
September		1.2538	1.2011	
October		1.2148	1.1914	
November		1.2067	1.1667	
December		1.2041	1.1699	
2006				
January		1.2287	1.1980	
February		1.2100	1.1860	

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

On March 6, 2006, the Noon Buying Rate was $1.2002 per 1.00.

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RISK FACTORS

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

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

Standardized documentation of risks and countermeasures;

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

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

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

External

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

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

Since 1998, liberalization of the electricity markets in the EU has greatly altered competition in the German electricity market, which was formerly characterized by numerous strong competitors. Following liberalization, significant consolidation has taken place in the German market, resulting in four major interregional utilities: E.ON, RWE AG (RWE), Vattenfall Europe AG (Vattenfall Europe) and EnBW Energie Baden-Württemberg AG (EnBW). In addition, the market for electricity trading has become more liquid and competitive, with a total trading volume of approximately 602 terawatt hours (TWh) at the European Energy Exchange (EEX) spot and futures market in 2005. Liberalization of the German electricity market also caused prices to decrease beginning in 1998, although prices have increased since 2001. Retail prices now exceed 1998 levels, and prices for sales to distributors and industrial customers have also increased. These price increases have generally been driven by increases in the price of fuel, as well as regulatory and other costs, with the result that competitive pressure on margins continues to exist. Higher wholesale prices are also expected to lead to the construction of new generation facilities, thereby increasing competition and the pressure on margins when the first such facilities come into operation. Although the Company intends to compete vigorously in the changed German electricity market, it cannot be certain that it will be able to develop its business as successfully as its competitors. For information about new regulatory changes that will affect the German electricity market, see the discussion on changes in laws and regulations below.

Outside Germany, the electricity markets in which the Company operates are also subject to strong competition. The Company has significant U.K. and Swedish operations in electricity generation, distribution and supply, on both the wholesale and retail levels. Increased competition from new market entrants and existing market participants could adversely affect the Company s U.K. or Swedish market share in both the retail and wholesale sectors. In the United States, E.ON U.S., the Company s primary U.S. subsidiary, is exposed to

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wholesale price and fuel cost risks with respect to its non-regulated operations, whose rates are not set by governmental regulators, and which represent a minority of E.ON U.S. s business. The Company cannot guarantee it will be able to compete successfully in the United Kingdom, the Nordic countries, the United States, Eastern Europe, Italy or other electricity markets where it is already present or in new electricity markets the Company may enter. E.ON Ruhrgas also faces risks associated with increased competition in the gas sector; see Item 4. Information on the Company Business Overview Pan-European Gas Competitive Environment and Regulatory Environment Germany: Gas.

Changes in applicable laws and regulations could materially and adversely affect the Company s financial condition and results of operations.

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

For example, the EU adopted new electricity and gas directives in 2003 which required changes to the electricity and gas industries of some EU member states, including Germany. One of the requirements is that an independent regulatory authority be established in each member state to oversee access to the electricity and gas networks. According to the directives, this regulatory body should have the authority to set or approve network access charges or, alternatively, the methodologies used for calculating them, as well as the power to control compliance with the charges or methodologies once they are set. In Germany, the relevant legislation came into force in July 2005 and the German legislature authorized the Federal Network Agency (*Bundesnetzagentur* or the BNetzA, previously called the Regulatory Authority of Telecommunications and Post) to act as the required independent regulatory body. The new German energy legislation and the appointment of the BNetzA to oversee access to German electricity and gas networks has changed the previous system of negotiated third party network access in the electricity and gas industries in Germany. Although the new legislation has already come into force, the Company cannot yet predict all of the consequences of the new system, as the exact interpretation of some of the new regulatory rules is still pending. The Company cannot be certain that the appointment of a regulator and changes to the current system of network access, as well as other changes introduced as part of the new regime, will not have a negative effect on its electricity and gas businesses in Germany, including the network charges E.ON Energie and E.ON Ruhrgas may charge for network access. In Sweden, new legislation was also adopted in order to comply with the requirements of the EU s electricity and gas directives, and the Company cannot be certain that the new requirements will not have a negative effect on its Swedish operations.

The EU has also adopted a directive requiring member states to establish a greenhouse gas emissions allowance trading scheme, under which permits to emit a specified amount of carbon dioxide (CO_2 emission certificates) are to be allocated to affected power stations and other industrial installations. Most member states, including Germany, the Netherlands and Sweden, have already passed the required legislation and allocated the necessary CO_2 emission certificates free of charge, and the United Kingdom has also made an initial allocation of certificates (with a possibility that the U.K. government may appeal its CO_2 emissions allocation to try to claim additional allowances). Although the Company does not generally expect the introduction of the emissions trading scheme to have a negative impact on its operations, the fact that the directive has only recently been implemented in some EU member states and not yet implemented in others makes it impossible for the Company to predict how the trading of CO_2 emission certificates will develop or what long-term impact, if any, the new regime will have on its financial condition and results of operations. However, in 2005, companies of both the U.K. and Central Europe market units had to purchase additional CO_2 emission certificates on the market, with a resultant increase in operating costs. For more information, see Item 4. Information on the Company Regulatory Environment and Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31, 2005 Compared with Year Ended December 31, 2004.

In Germany, the Company s nuclear power plants are among its cheapest source of power, and, along with hydroelectric and lignite-based power plants, are used primarily to cover the Company s base load power requirements. In June 2001, E.ON, together with the other German operators of nuclear power stations, reached

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an agreement with the German federal government to phase out the generation of nuclear power in Germany; this agreement was reflected in an amendment of Germany s nuclear energy law in April 2002. For more information about the planned phase-out of nuclear power stations in Germany, see Item 4. Information on the Company Business Overview Central Europe. The amended law provides that the delivery of spent nuclear fuel rods for reprocessing was allowed until June 30, 2005. Following this deadline, nuclear plant operators are required to store spent fuel elements on the premises of their nuclear plants. The Company is currently constructing five interim on-site storage facilities, of which two are expected to go into operation in the first quarter of 2006, with the remaining three scheduled to be ready between November 2006 and February 2007. In the interim, the relevant facilities are storing spent fuel elements in existing storage pools. The construction costs of these storage facilities are expected to be significant, and the Company may incur higher than anticipated costs in phasing out its nuclear energy operations.

In addition, in the summer of 2005 the Competition Directorate-General of the EU Commission launched a sector inquiry concerning the electricity and gas markets in the EU. It is possible that antitrust inspections of individual companies may be conducted in the context of this inquiry, and any such inspections could potentially result in the affected companies being required to make material changes to their operations. It also cannot be excluded that this inquiry could encourage or result in legislative initiatives (at the EU or national level) that would seek to increase the current level of competition in the EU energy market.

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

As described above, EU directives provide that the regulatory authority which was appointed in Germany should have the power to set or approve network access charges or, alternatively, the methodologies used for calculating them. This could lead to lower network fees for E.ON s electricity and gas transportation and distribution businesses in Germany.

In Germany, the state antitrust authorities in Bavaria, Thuringia, Schleswig-Holstein, Baden-Wuerttemberg and Lower Saxony, as well as the Federal Cartel Office, have launched investigations of certain utilities with allegedly high gas tariffs to determine whether these gas prices constitute market abuse. These investigations affect some utilities in which Thüga and E.ON Energie hold interests. As a result of ongoing discussions with the Federal Cartel Office, E.ON s regional sales companies have agreed to enable their residential customers to switch gas suppliers as from April 1, 2006. Although a similar investigation by the Federal Cartel Office against subsidiaries of E.ON Energie has been closed without any charges being brought, that office has since opened an investigation of E.ON Energie and its competitor RWE with regard to possible abuses in the markets for electricity and/or CO_2 emission certificates. The Company cannot currently predict the outcome of any of the pending investigations.

Electricity and gas prices and sales practices have also been the subject of periodic challenges by the German antitrust authorities, although to date E.ON has prevailed in such cases, sometimes on appeal after a negative ruling by a court of first instance. Currently, 54 customers of E.ON Hanse AG (E.ON Hanse) have brought a claim asserting that recent price increases violate certain provisions of the German Civil Code *(Bürgerliches Gesetzbuch)*. In order to support its case that the price increases were reasonable within the meaning of applicable law, E.ON Hanse has disclosed the basis on which it calculates prices for household customers to the District Court *(Landgericht)* in Hamburg. The court is currently examining E.ON Hanse s submissions in this respect and is expected to make an initial pronouncement in the spring of 2006. In an unrelated proceeding, E.ON Westfalen Weser AG (E.ON Westfalen Weser) has brought suit against a group of customers that have refused to pay the increased prices. No assurances can be given as to the outcome of either of these proceedings.

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

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

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effective as of July 1, 2004, although such increases remain the subject of continuing regulatory review and governmental inquiry.

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

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

A significant portion of the expenses of the Company s regional market units are made up of fuel costs, which are heavily influenced by prices in the world market for oil, natural gas, fuel oil and coal. Similarly, the majority of E.ON Ruhrgas expenses are for purchases of natural gas under long-term take or pay contracts that link the gas prices to that of fuel oil and other competing fuels. The prices for such commodities have historically been volatile and there is no guarantee that prices will remain within projected levels. The price of oil in particular rose significantly in 2005 as a result of geopolitical factors, including, but not limited to, an increase in demand in China and India, the war and post-war insurgency in Iraq, increased instability in other parts of the Middle East and a further deterioration of the economic and political situation in Venezuela and Nigeria. The Company s electricity operations do maintain some flexibility to shift power production among different types of fuel, and the Company is also partially hedged against rising fuel prices. However, increases in fuel costs could have an adverse effect on the Company s operating results or financial condition if it is not able (or not permitted by regulatory authorities) to shift production to lower-cost fuel or to adjust its rates to offset such increases in fuel prices on a timely or complete basis.

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

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

E.ON Ruhrgas currently obtains nearly 30 percent of its total gas supply from Russia pursuant to long-term supply contracts it has entered into with OOO Gazexport, a subsidiary of OAO Gazprom (Gazprom) (in which E.ON Ruhrgas holds a 3.5 percent direct interest and an additional stake of 2.9 percent). Recent events in some countries of the former Soviet Union have heightened concerns in parts of Western Europe about the reliability of Russian gas supplies. A dispute between Russia and Ukraine over the imposition of significant price increases on Russian gas delivered to Ukraine at the beginning of 2006 led to interruptions in the supply of Russian gas to Ukraine (and through Ukraine to other countries) in the early days of January. Although a political settlement was reached, the Ukrainian parliament has since rejected that settlement. In addition, historically cold temperatures in Russia have increased gas consumption, leading some Western European countries to report declines in pressure in gas pipelines and shortfalls in the volume of gas they receive from Russia, with some of those countries having announced plans to impose suggested or mandatory reductions on consumption. Although E.ON Ruhrgas has to date not experienced any interruptions in supply or declines in delivered gas volumes below those which are guaranteed to it under its long-term contracts, no assurance can be given that such interruptions or declines will not occur. The terms of E.ON Ruhrgas long-term supply contracts for Russian gas require that OOO Gazexport deliver the contracted volumes of gas to E.ON Ruhrgas at the German border, with the risk of ownership only passing to E.ON Ruhrgas at that point, but provide that such obligations can be suspended due to events of *force majeure.* Any prolonged interruption or decline in the amount of gas delivered to E.ON Ruhrgas under its contracts with OOO Gazexport or any other party would result in E.ON Ruhrgas having to use its storage reserves to make up the shortfall with respect to amounts it is contracted to deliver to customers, and could have a material adverse effect on E.ON s results of operations and financial condition.

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

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

Operational

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

E.ON Ruhrgas long-term gas contracts expose it to volume and price risks, and the validity of its longer-term supply contracts has been challenged by the German antitrust authorities.

As is typical in the gas industry, E.ON Ruhrgas enters into long-term gas supply contracts with natural gas producers to secure the supply of almost all the gas E.ON Ruhrgas purchases for resale. These contracts, which generally have terms of around 20 to 25 years, require E.ON Ruhrgas to purchase minimum amounts of natural gas over the period of the contract or to pay for such amounts even if E.ON Ruhrgas does not take the gas, a standard industry practice known as take or pay. The minimum amounts are generally about 80 percent of the firmly contracted quantities. Historically, E.ON Ruhrgas has also entered into long-term gas sales contracts with its customers, although these contracts are shorter than the gas supply contracts (for distributors and municipal utilities, which constitute the majority of E.ON Ruhrgas customers, the contracts generally have longer terms, while contracts for industrial customers usually have terms between one and five years), and, as described in more detail below, have been alleged to be unenforceable by the German Federal Cartel Office. In addition, the majority of these gas sales contracts do not include fixed take or pay provisions. Since E.ON Ruhrgas gas supply contracts have longer terms than its gas sales contracts, and commit E.ON Ruhrgas to paying for a minimum amount of gas over a long period, E.ON Ruhrgas is exposed to the risk that it will have an excess supply of natural gas in the long term should it have fewer committed purchasers for its gas in the future and be unable to otherwise sell its gas on favorable terms. Such a shortfall could result if a significant number of E.ON Ruhrgas customers (or their end customers) shifted from natural gas to other forms of energy or if E.ON Ruhrgas customers began to acquire gas from other sources. The ministerial approval E.ON obtained for the acquisition of Ruhrgas required E.ON Ruhrgas to divest its stakes in two gas distributors, as well as granting these distributors the right to terminate their gas sales contracts with E.ON Ruhrgas. The ministerial approval also gave most of E.ON Ruhrgas distribution customers the right to reduce the amounts of natural gas purchased from E.ON Ruhrgas to 80 percent of the contractually agreed amount over the period of the applicable gas sales contract, and E.ON Ruhrgas has recently voluntarily offered a similar volume reduction option to other customers, as described in more detail below. To date, most customers have decided not to exercise these options. For additional information on these developments, see Item 4. Information on the Company Business Overview Pan-European Gas Sales. If these or other developments were to cause the volume of gas E.ON Ruhrgas is able to

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

On January 13, 2006, the German Federal Cartel Office issued an order prohibiting E.ON Ruhrgas from enforcing its existing gas supply contracts with regional and local gas distributors and from entering into any new contracts that are identical or similar in nature. Such contracts have been customary in the German gas market since the industry s inception, and E.ON Ruhrgas believes that the position of the Federal Cartel Office violates basic principles of German law (including those of freedom of contract and free competition), as well as threatening the long-term security of gas supplies in Germany. Given that such questions can only be definitively resolved by the courts, E.ON Ruhrgas has filed an emergency petition with the State Superior Court *(Oberlandesgericht)* in Düsseldorf in order to prevent the order from taking effect. In the context of negotiations with the Federal Cartel Office prior to the January 13 order, E.ON Ruhrgas had already voluntarily offered those of its German distribution customers and municipal utilities that are supplied with more than 50 percent of their total gas requirements by E.ON Ruhrgas the termination of their existing contracts by October 1, 2008 in conjunction with a right to reduce their contractual amounts to 50 percent of their total gas purchases by either October 1, 2006 or October 1, 2007. No assurance can be provided as to the outcome of E.ON Ruhrgas petition or any related proceedings, or as to any impact of these matters on E.ON s results of operation and financial condition.

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

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

The Company s business strategy involves selective acquisitions and investments in its core business area of energy. This strategy depends in part on the Company s ability to successfully identify and acquire companies that enhance its business on acceptable terms. In order to obtain the necessary approvals for acquisitions, the Company may be required to divest other parts of its business, or to make concessions or undertakings which materially affect its operations. For example, the Company s efforts to obtain control of Ruhrgas through a series of purchases from the holders of Ruhrgas interests were initially blocked by the German Federal Cartel Office and then by a series of plaintiffs who succeeded in convincing the State Superior Court in Düsseldorf to issue a temporary injunction preventing the Company from completing the transaction. In order to receive the ministerial approval of the German Economics Ministry that overruled the initial decision of the Federal Cartel Office, the Company was required to make significant concessions, including committing to divest certain operations, to have E.ON Ruhrgas sell a significant quantity of natural gas at auction (with opening bids set at below-market prices) and to offer certain customers the option of reducing the volume of gas they had contracted for. In addition, in settling the claims of the plaintiffs who had received the temporary injunction, the Company agreed

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to divest certain of its operations, to provide certain of the plaintiffs with energy supply contracts and network access, and to make certain infrastructure improvements, as well as making financial payments. For more information, see Item 4. Information on the Company History and Development of the Company Ruhrgas Acquisition. Each of these matters delayed completion of the Ruhrgas acquisition and had the effect of increasing the cost of the transaction to the Company.

In February 2006, E.ON announced that it would launch an all cash tender offer for 100 percent of the share capital of Endesa, S.A. (Endesa), the largest electric utility in Spain and Portugal, which also has significant operations in Latin American and Southern Europe. E.ON intends to finance the acquisition through a combination of its own resources and new financing in the form of a committed line of credit provided by a syndicate of international banks. The offer will be subject to a number of conditions, including that E.ON acquire at least 50.01 percent of Endesa s capital stock and that Endesa s shareholders enact several changes to Endesa s Articles of Association removing corporate governance-related obstacles to E.ON s acquisition of control. The offer will also be subject to the approval of the Spanish government, which holds a golden share in Endesa, as well as antitrust and other regulatory approvals. Endesa s board of directors has not taken a formal position with regard to E.ON s proposed offer (though it has indicated that it believes that Endesa is worth more than the 27.50 per share offer price currently being proposed), nor has the Spanish government issued any formal statement as to its position on the offer. No assurance can be given that E.ON will be able to complete the transaction successfully on the proposed terms or at all. For additional information, see Item 4. Information on the Company History and Development of the Company Proposed Endesa Acquisition.

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

The Company could be subject to environmental liability associated with its nuclear and conventional power operations that could materially and adversely affect its business.

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

German law also provides that in the case of a nuclear accident in Germany, the owner of the reactor, the factory or the nuclear material storage facility is subject to liability provisions that guarantee comprehensive compensation to all injured parties. Under German nuclear power regulations, the owner is strictly liable, and the geographical scope of its liability is not limited to Germany. E.ON s Swedish nuclear power stations also expose the Company to liability under applicable Swedish law. The Company does not operate or have interests in nuclear power plants outside of Germany, Sweden and Switzerland, including in the United Kingdom, the

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United States or the countries in Eastern Europe in which it operates. The Company takes extensive safety and risk management measures in the operation of its nuclear power operations, and has mandatory insurance with respect to its nuclear operations as described in Item 4. Information on the Company Environmental Matters Germany: Electricity and Nordic. However, any claims against the Company arising in the case of a nuclear power accident could exceed the coverage of such insurance, and cause material losses to the Company.

The Company expects that it will incur costs associated with future environmental compliance, especially compliance with clean air laws. For example, the U.S. Environmental Protection Agency (EPA) has introduced regulations regarding the reduction of nitrogen oxide (NO_x) emissions from electricity generating units. These regulations require E.ON U.S. to make significant additional capital expenditures in NO_x control equipment, which are currently estimated to total approximately $407 million through 2006, of which nearly all ($405 million) has been incurred through 2005. E.ON U.S. also expects to make additional capital expenditures to reduce sulphur dioxide (SO_2) emissions from generation units totaling $743 million through 2009. E.ON U.S. expects to recover a significant portion of these costs over time from customers of its regulated utility businesses. In the United Kingdom, legislation to implement the EU Large Combustion Plants Directive is currently being discussed. The legislation is expected to require E.ON UK to make decisions as to whether it will invest in enhanced pollution control devices, reduce operating time at certain of its plants or consider closing certain plants in the future. Similarly, the German government has recently amended an ordinance of the German Federal Pollution Control Act (*Bundesimmissionsschutzgesetz,* or BImSchG) to introduce lower emission limits for air pollutants such as carbon monoxide and NO_x. This amendment requires both E.ON Energie and E.ON Ruhrgas to make investments in pollution control devices. In addition, in the United States, E.ON U.S. is also affected by a number of regional and industry-wide transmission market structure changes that have recently been introduced by the relevant authorities. Currently, none of E.ON s market units can predict the extent to which their respective operations will be affected by the new or proposed legislation and/or regulations. Revisions to existing environmental laws and regulations and the adoption of new environmental laws and regulations may result in significant increases in costs for the Company. Any such increase in costs that cannot be fully recovered from customers may adversely affect the Company s operating results or financial condition.

Although environmental laws and regulations have an increasing impact on the Company s activities in almost all the countries in which it operates, it is impossible to predict accurately the effect of future developments in such laws and regulations on the Company s future earnings and operations. Some risk of environmental costs and liabilities is inherent in particular operations and products of the Company, as it is with other companies engaged in similar businesses, and there can be no assurance that material costs and liabilities will not be incurred. For more information on environmental matters, see Item 4. Information on the Company Environmental Matters.

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

Each of Italy, Denmark, Sweden, London and large parts of the United States and Canada experienced major power outages during 2003. The reasons for these blackouts vary, although with the exception of London they involved a locally or regionally inadequate balance between power production and consumption, with single failures triggering a cascade-like shutdown of lines and power plants following overload or voltage problems. The likelihood of this type of problem has increased in recent years following the liberalization of EU electricity markets, partly due to an emphasis on unrestricted cross-border physically-settled electricity trading that has resulted in a substantially higher load on the international network, which was originally designed mainly for purposes of mutual assistance and operations optimization. As a result, there are transmission bottlenecks at many locations in Europe, and the high load has resulted in lower levels of safety reserves in the network. In Germany, where power plants are located in closer proximity to population centers than in many other countries, the risk of blackouts is lower due to shorter transmission paths and a strongly meshed network. In addition, the spread of a power failure is less likely in Germany due to the organization of the German power grid into four balancing zones. Nevertheless, the Company s German or international electricity operations could experience unanticipated operating or other problems leading to a power failure. For example, in the case of the blackout which occurred in Denmark and southern Sweden on September 23, 2003, one of the causes was an unexpected

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power failure at the Oskarshamn power plant (which is 54.5 percent owned by the Company s majority-owned subsidiary E.ON Sverige), that occurred as the plant was being reconnected to the grid following regularly scheduled maintenance. In addition, on January 8-9, 2005, a severe storm hit Sweden, destroying the electricity distribution grid in some areas in the south of the country. Approximately 250,000 E.ON Sverige customers were affected by the resulting power outage, and some customers were left without electricity for several weeks. In 2005, E.ON Sverige recorded related costs for rebuilding its distribution grid and compensating customers of approximately 140 million. The areas of the United States in which E.ON U.S. operates are also from time to time subject to severe weather, such as ice storms, which could cause power outages. In Germany, about 40 percent of the country s wind turbines are connected to the power grid of E.ON Energie, mostly in the north of Germany. In the case of a power grid failure, older wind power plants may switch off automatically; this possible separation of a number of wind power plants from the grid may in turn increase the impact of the original power failure in the grid. The Company can give no assurances that power failures involving its operations will not occur in the future, or that any such power failure would not have a negative effect on the Company s business and results of operations.

Financial

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

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

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

The Company also faces risks arising from its energy trading operations. In general, the Company seeks to hedge risks associated with volatile energy-related prices (including the prices of CO_2 emission certificates) by entering into fixed-price bilateral contracts, fuel-price indexed bilateral contracts, futures and options contracts traded on commodities exchanges, and swaps and options traded in over-the-counter financial markets. To the extent the Company is unable to hedge these risks, or enters into hedging contracts that fail to address its exposure or incorrectly anticipate market movements, it may suffer losses, some of which could be material. In addition to the risks associated with adverse price movements, credit risk is also a factor in the Company s energy marketing, trading and treasury activities, where loss may result from the non-performance of contractual obligations by a counterparty. The Company maintains credit policies and control procedures with respect to counterparties to protect it against losses associated with such types of credit risk, although there can be no assurance that these policies and procedures will fully protect the Company. The marking to market of many of E.ON s hedging instruments required by SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), has also increased the volatility of the Company s results of operations, though it has not had a material effect on E.ON s overall risk exposure. For example, in 2005, unrealized gains from the marking to market of derivatives, principally at the U.K. market unit, contributed other non-operating earnings of approximately 1.2 billion. For more information about the Company s energy trading operations, its hedging policies and the instruments used, see Item 4. Information on the Company Business Overview Central Europe Trading, Pan-European Gas Trading, U.K. Energy Wholesale Energy Trading, Trading and U.S. Midwest Power Generation Asset-Based Energy Marketing, Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31,

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2005 Compared with Year Ended December 31, 2004 and Exchange Rate Exposure and Currency Risk Management and Item 11. Quantitative and Qualitative Disclosures about Market Risk.

Item 4. Information on the Company.

HISTORY AND DEVELOPMENT OF THE COMPANY

E.ON AG is a stock corporation organized under the laws of the Federal Republic of Germany. It is entered in the Commercial Register *(Handelsregister)* of the local court of Düsseldorf, Germany, under HRB 22315. E.ON s registered office is located at E.ON-Platz 1, D-40479 Düsseldorf, Germany, telephone +49-211-45 79-0. E.ON s agent in the United States is E.ON North America, Inc., 405 Lexington Avenue, New York, NY 10174.

The State of Prussia established VEBA in 1929 when it consolidated state-owned coal mining and energy interests (hence the original name VEBA, Vereinigte Elektrizitäts- und Bergwerks-Aktiengesellschaft). Ownership of VEBA was transferred from the dissolved Prussian state to the Federal Republic of Germany. VEBA was partially privatized in 1965, leaving the German government with a 40.2 percent share. After several subsequent offerings, privatization was completed in 1987 when the German government offered its remaining 25.5 percent share to the public. During and since the privatization process, VEBA AG evolved into a management holding company, providing strategic leadership and resource allocation for the entire Group.

VEBA-VIAG MERGER

On June 16, 2000, VEBA AG merged with VIAG AG, one of the largest industrial groups in Germany. VEBA AG was subsequently renamed E.ON AG. The merger of VEBA and VIAG to form E.ON has created the second-largest industrial group in Germany, based on market capitalization at year-end 2005, with sales of 56.4 billion in 2005.

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

The merger of VEBA and VIAG was legally implemented by merging VIAG AG into VEBA AG, with VEBA AG continuing as the surviving entity. The newly-merged company then received the new name E.ON AG. On June 16, 2000, the merger was entered into the Commercial Register in Düsseldorf. Upon registration with the Commercial Register in Düsseldorf, the merger was completed and became effective for purposes of U.S. GAAP as of July 1, 2000. VIAG AG was dissolved and its assets and liabilities were transferred to VEBA AG. Simultaneously, each VIAG shareholder, with the exception of VEBA AG, received two shares of the new company in exchange for each five VIAG shares held. Pursuant to this exchange ratio, the former VIAG shareholders (with the exception of VEBA AG) therefore held 33.1 percent of the company immediately after the merger, while the former VEBA shareholders held 66.9 percent. For information about certain claims brought by former VIAG shareholders regarding the share exchange ratio used in the VEBA-VIAG merger, see Item 8. Financial Information Legal Proceedings.

POWERGEN GROUP ACQUISITION

In 2002, E.ON acquired the London- and Coventry-based British utility Powergen. As agreed between E.ON and Powergen, upon satisfaction of all conditions E.ON implemented the transaction under an alternative U.K. legal procedure known as a scheme of arrangement instead of a tender offer. The scheme of arrangement provided for the acquisition of all outstanding Powergen shares by virtue of an order of the English courts

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following approval of the transaction at a meeting of Powergen shareholders convened by order of the court. Following the receipt of the necessary regulatory approvals, E.ON completed its acquisition of the Powergen Group, which is now wholly owned by E.ON, on July 1, 2002. In March 2003, E.ON transferred LG&E Energy (Powergen s former principal U.S. operating subsidiary; now named E.ON U.S.) and its direct parent holding company to a direct subsidiary of E.ON AG. See Business Overview U.S. Midwest. In July 2004, Powergen was renamed E.ON UK.

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

For more information on E.ON UK and E.ON U.S., see Business Overview U.K. and U.S. Midwest.

RUHRGAS ACQUISITION

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

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

In May 2002, E.ON reached a definitive agreement with RAG to acquire RAG s more than 18 percent interest in Ruhrgas and to sell E.ON s majority interest in Degussa to RAG. Under the arrangement, RAG acquired a majority shareholding in Degussa in two steps. In the first step, in June 2002, RAG made a cash tender offer to Degussa s shareholders at a price of 38 per share. The parties definitive agreement provided that after completion of the tender offer RAG and E.ON would hold equal shareholdings of Degussa and would manage Degussa jointly. In the second step, E.ON sold 3.6 percent of Degussa s shares to RAG at the above price to give RAG a 50.1 percent interest in Degussa effective June 1, 2004.

On July 3, 2002, E.ON reached agreements to acquire the 40 percent interest in Ruhrgas held indirectly by Esso Deutschland GmbH, Deutsche Shell GmbH, and TUI AG, which would make E.ON the sole owner of Ruhrgas.

On July 5, 2002, E.ON was granted the ministerial approval it had requested for the acquisition of a majority shareholding in Ruhrgas. The ministerial approval was linked with stringent requirements designed to promote competition in the gas sector. Ruhrgas was required to auction 75 billion kilowatt hours (kWh) of natural gas to its competitors and to legally unbundle its transmission system from its other operations. In addition, E.ON and Ruhrgas were required to divest several shareholdings. On the same day, E.ON completed the acquisition of 38.5 percent of Ruhrgas from BP, Vodafone and ThyssenKrupp AG.

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

continued to maintain that the reasons given by the court in the summary proceedings leading to these orders did not justify its decision.

Following the issuance of the temporary injunction, on September 18, 2002, Germany s Federal Minister of Economics confirmed the essential aspects of the July 5 ministerial approval for E.ON s acquisition of Ruhrgas. However, the ministry linked its decision to a tightening of the requirements. Ruhrgas was also required to sell its stakes in Bayerngas GmbH (Bayerngas) and swb AG (swb), and all of the companies required to be disposed of were granted special rights to terminate their existing purchase agreements with E.ON and Ruhrgas on a staggered basis. In addition, customers purchasing more than 50 percent of their gas requirements from Ruhrgas were granted the right, as of October 2003, to reduce the volume of gas purchased from Ruhrgas to 80 percent of the contracted amount. Finally, Ruhrgas was required to auction 200 billion kWh of natural gas to its competitors, with the minimum bid in such auctions being lower than the average border-crossing price. The approval also provided that the ministry has the right to take further action in the event of any sale by E.ON of a controlling interest in E.ON Ruhrgas or a change in control over E.ON. On this basis, the ministry asked the State Superior Court to lift its temporary injunction. E.ON and E.ON Ruhrgas have complied with all of the conditions imposed by the ministerial approval.

On December 17, 2002, the State Superior Court decided not to lift the temporary injunction, and formal proceedings *(Hauptverfahren)* regarding the injunction started in January 2003. On January 31, 2003, E.ON reached settlement agreements with all plaintiffs who had contested the validity of the ministerial approval. In accordance with these agreements, E.ON exchanged shareholdings with certain plaintiffs and agreed to enter into gas and/or electricity supply contracts, make certain infrastructure improvements (particularly with regard to gas distribution), and provide specified access to the gas and electricity supply grids, with others, as well as agreeing to make other financial payments to the plaintiffs. In addition, Ruhrgas reconfirmed to all the parties its commitment to open and fair competition in the gas market.

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

Upon termination of the court proceedings, the Company completed the first step of the RAG/ Degussa transaction, *i.e.*, the Company acquired RAG s Ruhrgas stake for total consideration of 2.0 billion, and E.ON tendered 37.2 million of its shares in Degussa to RAG at the price of 38 per share, receiving total proceeds of 1.4 billion. Following this transaction and the completion of the tender offer to the other Degussa shareholders, RAG and E.ON each held a 46.5 percent interest in Degussa, with the remainder being held by the public. With effect from June 1, 2004, E.ON sold a further 3.6 percent of Degussa stock to RAG, giving RAG a 50.1 percent interest in Degussa. Total proceeds from the sale of this 3.6 percent stake amounted to 283 million. In December 2005, E.ON and RAG signed a framework agreement on the sale of E.ON s remaining 42.9 percent stake in Degussa to RAG. The purchase price is expected to total approximately 2.8 billion, equal to 31.50 per Degussa share. The transaction is expected to be completed by July 1, 2006.

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

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price. E.ON Ruhrgas is required to hold three more annual gas auctions. The remaining third of the volumes not sold in the first auction (approximately 6 billion kWh) will be offered in 2006.

In connection with its acquisition of Ruhrgas, E.ON seeks to achieve the following potential synergies in its market units:

In the Pan-European Gas market unit, E.ON intends to leverage its increased gas operations to improve its negotiating position with producers of natural gas, and to take advantage of pan-European gas arbitrage opportunities. For information about E.ON s planned capital investment in E.ON Ruhrgas, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

In the Central Europe market unit, E.ON expects to benefit from joint market management with regional energy companies, the integration of continental European gas trading activities and the sharing of technical expertise among the power and gas businesses. In order to integrate the Company s continental European gas trading activities conducted by D-Gas B.V. (D-Gas), E.ON Energie transferred their gas trading operations to E.ON Ruhrgas in 2004.

In the U.K. market unit, E.ON intends to use the Pan-European Gas market unit to enhance E.ON UK s gas supply and gas storage options, as well as support its trading activities. An important first step was the conclusion of a 10-year gas supply contract between E.ON Ruhrgas and E.ON UK. E.ON Ruhrgas started supplying E.ON UK with gas in October 2004.

In the Nordic market unit, E.ON also intends to use the Pan-European Gas market unit to enhance E.ON Sverige s gas supply options and expects to be able to use a joint approach for future gas infrastructure development. E.ON Ruhrgas and E.ON Sverige have also entered into a gas supply contract, pursuant to which E.ON Ruhrgas started to supply E.ON Sverige with natural gas in autumn 2005.

In addition, E.ON has identified a number of areas in which it expects to achieve cost savings through the integration of E.ON Ruhrgas and other E.ON Group companies. Major areas of potential cost savings include the reduction of procurement costs through process optimization and joint purchasing power, the integration of gas trading activities in central Europe and savings in overhead costs.

For more information on E.ON Ruhrgas, see Business Overview Pan-European Gas. For more information on the impact of this transaction on E.ON s financial condition, see Item 5. Operating and Financial Review and Prospects Overview. In addition, in connection with E.ON s on.top project, E.ON Energie transferred a number of shareholdings to E.ON Ruhrgas or to E.ON AG, and E.ON Ruhrgas transferred a number of shareholdings to E.ON Energie. These transfers, which generally took place in December 2003, or in 2004 or 2005, are described in more detail in On.top Project.

PROPOSED ENDESA ACQUISITION

On February 21, 2006, E.ON announced that it had filed a takeover offer for 100 percent of the share capital of Endesa with the Spanish Securities Commission CNMV (CNMV). According to the documents Endesa has filed with the SEC, including its Annual Report on Form 20-F for the fiscal year ending December 31, 2004 and its Form 6-K dated January 19, 2006 reporting its audited financial results for 2005 (collectively, the Endesa SEC Filings), Endesa is a limited liability company organized under the laws of the Kingdom of Spain; its ordinary shares are traded on the Madrid, Barcelona, Bilbao and Valencia stock exchanges in Spain and the Santiago Off Shore Stock Exchange in Chile, and its American Depositary Shares (ADSs) are listed on the New York Stock Exchange.

E.ON s proposed offer price is 27.50 per Endesa share and per Endesa ADS in an all cash offer, which would result in an aggregate purchase price of approximately 29.1 billion if all shares and ADSs were to be tendered. Should the offer be successful, E.ON would also expect to include Endesa s net financial liabilities, provisions and minority interests equal to approximately 26.1 billion as of December 31, 2005 (according to the Endesa SEC Filings) in its financial statements, thus bringing the aggregate transaction value to approximately 55.2 billion. E.ON intends to finance the acquisition through a combination of its own resources and new financing in the form of a committed line

of credit provided by a syndicate of international banks. If Endesa

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shareholders are paid a dividend prior to the completion of the transaction, the offer price of 27.50 per share will be reduced by the amount of the per-share dividend.

The offer document is subject to prior review and approval of the CNMV before the offer will commence. E.ON expects to file a Schedule TO relating to the offer with the SEC once the CNMV has approved the Spanish offer document.

E.ON s offer will be subject to a number of conditions, including that E.ON acquire at least 529,481,934 Endesa shares, equal to 50.01 percent of Endesa s capital stock, and that Endesa s shareholders must enact several changes to Endesa s Articles of Association removing corporate governance-related obstacles to E.ON s acquisition of control. The takeover will also be subject to the approval of the Spanish government, which holds a golden share in Endesa, to the approval of the Spanish Energy Commission (CNE), and to EU antitrust approval. Endesa s board of directors has not taken a formal position with regard to E.ON s proposed offer, though it has indicated that it believes that Endesa is worth more than the 27.50 per share offer price currently being proposed, nor has the Spanish government issued any formal statement as to its position on the offer. No assurance can be given that E.ON will be able to complete the transaction successfully on the proposed terms or at all. See also Item 3. Key Information Risk Factors.

The following information about Endesa is taken from the Endesa SEC Filings. E.ON has not independently verified such information and therefore does not accept any responsibility for its accuracy or completeness. Endesa is the largest electricity company in Spain and Portugal in terms of installed capacity and market share in generation and distribution, with a significant presence in the Southern European electricity market, in particular in Italy, and one of the largest private-sector multinational electricity companies in Latin America. The company s core business is energy. It is also involved in other activities related to its core energy business such as renewable energies and co-generation and the distribution and supply of natural gas. In addition, Endesa holds interests in other businesses such as telecommunications.

At December 31, 2004, Endesa had a total installed capacity of 46,439 MW, and in 2004, the company generated 184,951 gigawatt hours (GWh) of electricity and sold 192,519 GWh, supplying electricity to approximately 22.2 million customers in 12 countries. At that date, Endesa had 27,918 employees, 51 percent of whom were located outside Spain.

Based on Endesa s financial results for the year ended December 31, 2005, Endesa recorded net sales of 17,508 million and net income of 3,182 million in accordance with International Financial Reporting Standards (IFRS), which differ from U.S. GAAP, the basis on which E.ON prepares its consolidated financial statements.

GROUP STRATEGY

E.ON s Business Model After On.top

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

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

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

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

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

Strategy

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

Creating value from the convergence of European energy markets (*e.g.*, as the United Kingdom becomes a net importer of gas and can take advantage of greater pipeline capacity connecting it to continental Europe, E.ON will be able to supply its retail gas business in the United Kingdom from its Pan-European Gas supply business);

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

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

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

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

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

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

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

Central Europe Fortifying strong market positions and developing new growth potential through:

- consolidation of distribution and sales activities and capitalizing on opportunities from power-gas convergence;
- re-investing in power generation to maintain the strong market position;
- hedging exposure to price risks through vertical integration of generation and sales operations;
- participating in the privatization of power and downstream gas companies in eastern Central Europe, as well as selective investments in power generation; and
- continued growth in the new market of Italy, *i.e.* in power generation.

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

- selective equity investments in gas production in the North Sea and Russia;
- evaluation of LNG options (including upstream positions) to ensure long-term supply diversification;
- participation in infrastructure projects to enhance gas supply position in Europe; and

selective acquisitions of mid- and downstream companies in Europe.

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U.K. Enhancing profitability of the U.K. businesses through:
investing in flexible generation assets and low carbon intensive generating technologies, such as Combined Cycle Gas Turbine (CCGT), to maintain a low cost hedge for changes in retail electricity demand;

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

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

Nordic Strengthening E.ON s position through:
expanding its presence in power generation;

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

continued participation in gas supply and infrastructure developments.

U.S. Midwest Focusing on optimizing E.ON U.S. s current operations in Kentucky and delivering additional performance improvements. This could include investments in generation capacity if the demand for electricity grows and the U.S. regulatory authorities enable the Company to earn a return on investment that meets its stringent criteria.

As it focuses on energy, E.ON will seek to maximize the value of its remaining non-core businesses by divesting them at an appropriate time and allocating the proceeds to strategic investments. As part of its strategy to focus on its core energy business, E.ON completed its disposal of Viterra and Ruhrgas Industries GmbH (Ruhrgas Industries) in 2005 and is actively pursuing the disposal of its remaining minority interest in Degussa, which is expected to be completed during 2006. For information on Degussa, see Business Overview Other Activities.

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

ON.TOP PROJECT

Started in 2003, the on.top project resulted in a reorganization of E.ON s core energy business into five new market units. These market units, each focusing on a region in which management believes E.ON has a strong competitive position, are:

Central Europe, led by E.ON Energie AG;

Pan-European Gas, led by E.ON Ruhrgas AG;

U.K., led by E.ON UK plc;

Nordic, led by E.ON Nordic AB; and

U.S. Midwest, led by E.ON U.S. LLC (formerly LG&E Energy).

The activities of the Central Europe, Nordic, U.K. and U.S. Midwest market units include the generation, transmission, distribution and sale of energy to customers in each regional market. While focusing on electricity, these activities also include or will include distribution and sales of natural gas to retail customers. The Pan-European Gas unit focuses on the supply, transmission, storage and sale of natural gas to distributors and industrial customers in Europe, and also engages in trading and gas exploration and production activities. In addition, the market unit has primarily minority interests in a large number of German and other European municipal and regional energy distribution companies.

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The lead companies of each market unit report directly to E.ON AG. E.ON AG serves as the Group s corporate center and is responsible for the design and implementation of strategies and policies with the goal of optimizing the Group s results across the energy markets in which it is active, the pursuit of operational excellence at each of the market units through the transfer of best practice, as well as a strong role in regulatory affairs that may affect several market units at the same time. E.ON AG also has direct responsibility for strategic acquisitions throughout the Group. Human resources management and career development for 200 top executives currently working across the Group have also been centralized at the Corporate Center.

E.ON s financial reporting mirrors the E.ON group structure, with each of the five market units and the results of the enhanced Corporate Center (including consolidation effects) constituting a separate segment for financial reporting purposes. The results of E.ON s minority interest in Degussa continue to be presented outside of the core energy business as part of E.ON s Other Activities, which is reported as a separate segment. The primary measure by which management evaluates the performance of each segment in accordance with SFAS 131 is adjusted EBIT. E.ON defines this measure as an adjusted figure derived from income/(loss) from continuing operations (before intra-Group eliminations when presented on a segment basis) before income taxes and minority interests, excluding interest income. Adjustments include net book gains resulting from disposals, as well as cost-management and restructuring expenses and other non-operating earnings of an exceptional nature. In addition, interest income is adjusted using economic criteria. In particular, the interest portion of additions to provisions for pensions and nuclear waste management is allocated to adjusted interest income. Management believes that this measure is the most useful segment performance measure because it better depicts the performance of individual business units independent of changes in interest income and taxes.

As part of the implementation of the new structure, E.ON completed intra-Group transfers of shareholdings in a number of its companies in December 2003, in 2004 and in 2005. These transactions include:

The transfer by E.ON Energie to E.ON Ruhrgas of its:

67.7 percent interest in Thüga;

29.95 percent interest of its 40.0 percent interest in the Austrian company RAG Beteiligungs-Aktiengesellschaft, which owns a 75.0 percent share in the Austrian exploration and production company Rohöl-Aufsuchungs Aktiengesellschaft; the remaining 10.05 percent interest was swapped with the Austrian company EVN AG for its 31.23 percent shareholding in the Hungarian gas distribution company Közép-dunántúli Gázszolgáltató Rt. (KÖGÁZ) in April 2005;

18.8 percent interest in the Latvian gas supplier JSC Latvijas Gaze;

14.3 percent interest in the Lithuanian gas distributor AB Lietuvos Dujos; and its

gas trading company D-Gas.

The transfer by E.ON Ruhrgas to E.ON Energie of its downstream gas activities in the Czech Republic and Hungary, including its:

4.45 percent interest in the Czech gas distribution company Jihomoravská plynárenská a.s. (JMP);

27.6 percent interest in the Czech gas distribution company Západoceská plynárenská a.s. (ZCP);

24.0 percent interest in the Czech gas distribution company Prazská plynárenská Holding a.s. (PPH);

0.05 percent interest in the Czech gas distribution company Prazská plynárenská a.s. (PP);

14.3 percent interest in the Czech gas distribution company Stredoceska plynárenská a.s. (STP);

9.57 percent interest in the Czech gas distribution company Severomoravská plynárenská a.s. (SMP);

16.52 percent interest in the Czech gas distribution company Východoceská plynárenská a.s. (VCP);

49.8 percent interest in the Hungarian gas distribution company Déldunántuli Gázszolgáltató Részvenytársaság (DDGÁZ); and its

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16.3 percent interest in the Hungarian gas distribution company Fövárosi Gázmüvek Részvénytársaság (FÖGÁZ).

The transfer by E.ON Energie to E.ON AG of its 100 percent interest in E.ON Scandinavia (which has since been renamed E.ON Nordic), including its:

55.2 percent interest in Sydkraft (which has since been renamed E.ON Sverige), including its interest in Graninge AB (Graninge) and its interest in the Baltic Cable; and a

65.6 percent interest in E.ON Finland.

The on.top project also included the definition of mid-term performance targets for the Group. Management s principal goal in guiding strategic and investment decisions is to realize a significant improvement in E.ON s return on capital while growing earnings through 2006.

OTHER SIGNIFICANT EVENTS

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

In February 2005, E.ON Energie acquired 67.0 percent stakes in each of the two northeastern Bulgarian electricity distribution companies Elektrorazpredelenie Varna AD (Varna) and Elektrorazpredelenie Gorna Oryahovitza AD (Gorna Oryahovitza).

In May 2005, E.ON disposed of Viterra to Deutsche Annington GmbH (Deutsche Annington). The transaction received antitrust approval in early August 2005. Under U.S. GAAP, Viterra was accounted for as discontinued operations since its disposal.

In June 2005, E.ON Ruhrgas signed an agreement for the sale of Ruhrgas Industries to CVC Capital Partners, a European private equity firm. The transaction received antitrust approval and was closed in September 2005. Under U.S. GAAP, Ruhrgas Industries was accounted for as discontinued operations since June 2005.

In June 2005, E.ON Ruhrgas acquired a 51.0 percent stake in the Romanian gas supplier S.C. Distrigaz Nord S.A. (Distrigaz Nord).

In September 2005, Sydkraft was renamed E.ON Sverige.

In September 2005, E.ON Energie acquired a 24.6 percent stake in the Romanian electricity distribution company Electrica Moldova S.A. (Electrica Moldova) now renamed E.ON Moldova S.A. (E.ON Moldova) and simultaneously increased its stake in the company to 51.0 percent by subscribing to a capital increase.

In September 2005, Gazprom, BASF AG (BASF) and E.ON AG signed a basic agreement on the construction of the North European Gas Pipeline (NEGP) through the Baltic Sea from Vyborg on Russia s Baltic coast to Germany s Baltic coast. The parties to the agreement intend to set up the North European Gas Pipeline Company as a joint German-Russian venture, with Gazprom holding 51.0 percent and BASF s subsidiary Wintershall Aktiengesellschaft (Wintershall) and E.ON Ruhrgas each holding 24.5 percent.

In October 2005, E.ON sold a portion (1.6 TWh) of the generation capacity that E.ON Sverige had acquired as part of the Graninge acquisition to E.ON Sverige s minority shareholder, the Norwegian energy company Statkraft (Statkraft refers to Statkraft SF and its consolidated subsidiaries).

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In November 2005, E.ON Ruhrgas acquired 100 percent of the U.K. gas production company Caledonia Oil and Gas Ltd. (Caledonia).

In December 2005, LG&E Energy was renamed E.ON U.S.

In December 2005, E.ON AG and RAG signed a framework agreement on the sale of E.ON s remaining 42.9 percent stake in Degussa to RAG. The transaction is expected to be completed by July 1, 2006.

In February 2006, E.ON Nordic and Fortum Power and Heat Oy (Fortum) signed an agreement, whereby Fortum will acquire E.ON Nordic s 65.6 percent stake in E.ON Finland. The sale is subject to the approval of the Finnish competition authorities.

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

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

CAPITAL EXPENDITURES

E.ON s aggregate capital expenditures for property, plant and equipment were 2.9 billion in 2005 (2004: 2.5 billion, 2003: 2.5 billion). For a detailed description of these capital expenditures, as well as E.ON s expected capital expenditures for the period beginning in 2006, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

BUSINESS OVERVIEW

INTRODUCTION

E.ON is the second-largest industrial group in Germany, measured on the basis of market capitalization at year-end 2005. In 2005, the Group s core energy business was organized into the following separate market units: Central Europe, Pan-European Gas, U.K., Nordic and U.S. Midwest, as well as the Corporate Center. Outside its core energy business, E.ON holds a 42.9 percent interest in Degussa, which is not consolidated, but rather accounted for using the equity method.

Core Energy Business

Central Europe. E.ON Energie is the lead company of the Central Europe market unit. E.ON Energie is one of the largest non-state-owned European power companies in terms of electricity sales, with revenues of 24.3 billion (which included 1.0 billion of electricity taxes that were remitted to the tax authorities) in 2005. E.ON Energie s core business consists of the ownership and operation of power generation facilities and the transmission, distribution and sale of electric power, gas and heat in Germany and continental Europe. The Central Europe market unit owns interests in and operates power stations with a total installed capacity of approximately 36,400 megawatts (MW), of which Central Europe s attributable share is approximately 27,800 MW (not including mothballed, shutdown and reduced power plants). Through its own operations, as well as through distribution companies, in most of which it owns a majority interest, E.ON Energie also distributes electricity, heat and gas to regional and municipal utilities, commercial and industrial customers and residential customers. In 2005, E.ON Energie supplied approximately 18 percent of the electricity consumed by end users in Germany. The Central Europe market unit contributed 43.1 percent of E.ON s revenues and recorded adjusted EBIT of 3.9 billion in 2005.

Pan-European Gas. E.ON Ruhrgas is the lead company of the Pan-European Gas market unit. E.ON Ruhrgas is one of the leading non-state-owned gas companies in Europe and the largest gas business in Germany in terms of gas sales, with 690.2 billion kWh of gas sold in 2005. E.ON Ruhrgas principal business is the supply, transmission, storage and sale of natural gas. E.ON Ruhrgas imports gas from Russia, Norway, the Netherlands, the United Kingdom and Denmark, and also purchases gas from domestic sources. E.ON Ruhrgas sells this gas to regional and supraregional distributors, municipal utilities and industrial customers in Germany and increasingly

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also delivers gas to customers in other European countries. In addition, E.ON Ruhrgas is active in gas transmission within Germany via a network of approximately 11,000 kilometers (km) of gas pipelines and operates a number of underground storage facilities in Germany. E.ON Ruhrgas also holds numerous stakes in German and other European gas transportation and distribution companies, as well as a small shareholding in Gazprom, Russia s main natural gas exploration, production, transportation and marketing company. In 2005, the Pan-European Gas market unit recorded revenues of 17.9 billion (which included 3.1 billion in natural gas and electricity taxes that were remitted, directly or indirectly, to the tax authorities) and adjusted EBIT of 1.5 billion. The Pan-European Gas market unit contributed 31.8 percent of E.ON s revenues in 2005.

U.K. E.ON UK is the lead company of the U.K. market unit. E.ON UK is an integrated energy company with its principal operations focused in the United Kingdom. E.ON UK and its associated companies are actively involved in the ownership and operation of power generation facilities, as well as in the distribution of electricity and supply of electric power and gas and in energy trading. E.ON UK owns interests in and operates power stations with a total installed capacity of approximately 10,762 MW, of which its attributable share is approximately 10,547 MW. E.ON UK served approximately 8.6 million electricity and gas customer accounts at December 31, 2005 and its Central Networks business served 4.9 million customer connections. In 2005, E.ON UK recorded revenues of 10.2 billion or 18.0 percent of E.ON s revenues, and adjusted EBIT of 963 million.

Nordic. E.ON Nordic is the lead company of the Nordic market unit. It currently operates through the two integrated energy companies in which it holds majority stakes, E.ON Sverige and E.ON Finland. E.ON Nordic and its associated companies are actively involved in the ownership and operation of power generation facilities, as well as the distribution and supply of electric power, gas and heat, primarily in Sweden and Finland. Through E.ON Sverige and E.ON Finland, E.ON Nordic owns interests in power stations with a total installed capacity of approximately 14,982 MW, of which its attributable share is approximately 7,570 MW (not including mothballed and shutdown power plants). In February 2006, E.ON Nordic and Fortum signed an agreement, whereby Fortum will acquire E.ON Nordic s 65.6 percent stake in E.ON Finland. The sale is subject to the approval of the Finnish competition authorities. In 2005, E.ON Nordic recorded revenues of 3.5 billion (including 402 million of electricity and natural gas taxes that were remitted to the tax authorities) or 6.2 percent of E.ON s revenues, and adjusted EBIT of 806 million.

U.S. Midwest. E.ON U.S. is the lead company of the U.S. Midwest market unit. E.ON U.S. is a diversified energy services company with businesses in power generation, retail gas and electric utility services, as well as off-system sales. E.ON U.S. s power generation and retail electricity and gas services are located principally in Kentucky, with a small customer base in Virginia and Tennessee. E.ON U.S. owns interests in and operates power stations with a total installed capacity of approximately 8,300 MW, of which its attributable share is approximately 7,700 MW (not including mothballed and shutdown power plants). In 2005, the U.S. Midwest market unit recorded revenues of 2.0 billion or 3.6 percent of E.ON s revenues, and adjusted EBIT of 365 million.

Corporate Center. The Corporate Center consists of E.ON AG itself, equity interests managed directly by E.ON AG, including its remaining telecommunications interests, and consolidation effects at the Group level, including the elimination of intersegment sales.

Other Activities

Degussa. Degussa is one of the major specialty chemical companies in the world. As of February 2003, following the first step of the RAG/ Degussa transaction described in History and Development of the Company Ruhrgas Acquisition, E.ON held a 46.5 percent interest in Degussa and operated Degussa under joint control with RAG, which also held a 46.5 percent interest. E.ON has accounted for Degussa using the equity method since February 1, 2003. Effective June 1, 2004, E.ON sold a further 3.6 percent of Degussa stock to RAG. For all periods from February 1, 2003 until May 31, 2004, E.ON recorded 46.5 percent of Degussa s after-tax earnings in its financial earnings. From June 1, 2004, E.ON has recorded 42.9 percent of Degussa s after-tax earnings in its financial earnings. In December 2005, E.ON AG and RAG signed a framework agreement on the

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sale of E.ON s remaining 42.9 percent stake in Degussa to RAG. In 2005, Degussa contributed adjusted EBIT of 132 million.

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

As a result of E.ON s on.top strategic review launched in 2003, the core energy business has been reorganized into five new regional market units, plus the Corporate Center. Beginning in 2004, E.ON s financial reporting mirrors the new structure, with each of the five market units and the results of the enhanced Corporate Center (including consolidation effects) constituting a separate segment for financial reporting purposes. The results of E.ON s minority interest in Degussa continue to be presented outside of the core energy business as part of E.ON s Other Activities, which is reported as a separate segment. As part of the implementation of the new structure, E.ON completed intra-Group transfers of shareholdings in a number of its companies in December 2003, in 2004 and in 2005. None of these transfers had any impact on E.ON s financial results on a consolidated basis. To facilitate comparison, the table below includes reclassified revenues for 2003 according to the new market unit structure. For information about the transfer of shareholdings in connection with E.ON s on.top project, see History and Development of the Company On.top Project. For additional information on the presentation of segment information for 2005, 2004 and 2003, see Item 5. Operating and Financial Review and Prospects Business Segment Information.

The following table sets forth the revenues of E.ON by market unit for 2005, 2004 and 2003:

	2005		2004		2003	
	(in millions)	%	(in millions)	%	(in millions)	%
Central Europe(1)(2)	24,295	43.1	20,752	44.4	19,253	43.6
Pan-European Gas(2)(3)	17,914	31.8	13,227	28.3	11,919	27.0
U.K.	10,176	18.0	8,490	18.2	7,923	18.0
Nordic(4)	3,471	6.2	3,347	7.1	2,824	6.4
U.S. Midwest(2)	2,045	3.6	1,718	3.7	1,771	4.0
Corporate Center(2)(5)	(1,502)	(2.7)	(792)	(1.7)	(575)	(1.3)
Core Energy Business	*56,399*	*100.0*	*46,742*	*100.0*	*43,115*	*97.7*
Other Activities(2)(6)	*0*	*0*	*0*	*0*	*994*	2.3
Total Revenues(7)	56,399	100.0	46,742	100.0	44,109	100.0

(1) Includes electricity taxes of 1,049 million in 2005, 1,051 million in 2004 and 1,015 million in 2003.

(2) Excludes the sales of certain activities now accounted for as discontinued operations. For more details, see Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions Discontinued Operations and Note 4 of the Notes to Consolidated Financial Statements.

(3) Includes the sales of the former Ruhrgas activities from the date of consolidation on February 1, 2003. Sales include natural gas and electricity taxes of 3,110 million in 2005, 2,923 million in 2004 and 2,555 million in 2003.

(4) Sales include electricity and natural gas taxes of 402 million in 2005, 395 million in 2004 and 324 million in 2003.

(5) Includes primarily the parent company and effects from consolidation, as well as the results of its remaining telecommunications interests, as explained above.

(6) Includes sales of Degussa until January 2003, prior to its deconsolidation. For more details, see Other Activities Degussa, Item 5. Operating and Financial Review and Prospects Overview and Note 4 of the Notes to Consolidated Financial Statements.

(7) Excludes intercompany sales.

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Most of E.ON s operations are in Germany. German operations produced 65.0 percent of E.ON s revenues (measured by location of operation) in 2005 (2004: 64.2 percent; 2003: 64.6 percent). E.ON also has a significant presence outside Germany representing 35.0 percent of revenues by location of operation for 2005 (2004: 35.8 percent; 2003: 35.4 percent). In 2005, approximately 59.5 percent (2004: 61.2 percent; 2003: 61.5 percent) of E.ON s revenues were derived from customers in Germany and 40.5 percent (2004: 38.8 percent; 2003: 38.5 percent) from customers outside Germany. For more details about the segmentation of E.ON s revenues by location of operation and customers for the years 2005, 2004 and 2003, see Note 31 of the Notes to Consolidated Financial Statements. At December 31, 2005, E.ON had 79,947 employees, approximately 43 percent of whom were employed in Germany. For more information about employees, see Item 6. Directors, Senior Management and Employees Employees.

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

CENTRAL EUROPE

Overview

The Central Europe market unit is led by E.ON Energie. E.ON Energie, which is wholly owned by E.ON, is one of the largest non-state-owned European power companies in terms of electricity sales. E.ON Energie had revenues of 24.3 billion (which included 1.0 billion of electricity taxes that were remitted to the tax authorities), 20.7 billion of which in Germany, and adjusted EBIT of 3.9 billion in 2005. E.ON Energie, together with E.ON Ruhrgas and E.ON Nordic, is responsible for all of E.ON s energy activities in Germany and continental Europe and is one of the four interregional electric utilities in Germany that are interconnected in the western European power grid.

In connection with E.ON s acquisition of E.ON Ruhrgas, E.ON Energie was required to divest certain shareholdings. For more information about the required divestments, see Item 5. Operating and Financial Review and Prospects Acquisitions and Dispositions.

In order to further focus its energy business in Germany and in continental Europe, E.ON Energie entered into the following transactions in 2005 and the beginning of 2006:

In 2005, E.ON Energie increased its stake in the Hungarian gas distribution and supply company KÖGÁZ from 31.2 percent to 98.1 percent in several steps. In 2005, the company sold an aggregate of approximately 8.3 TWh of gas to 0.3 million customers.

In February 2005, E.ON Energie acquired 67.0 percent stakes in each of the two Bulgarian electricity distribution companies Varna and Gorna Oryahovitza. The companies operate in northeastern Bulgaria. In 2005, the companies sold an aggregate of approximately 4.9 TWh of electricity to 1.1 million customers.

In July 2005, E.ON Energie transferred its 51.0 percent interest (49.0 percent voting interest) in Gasversorgung Thüringen GmbH (GVT) and its 72.7 percent interest in Thüringer Energie AG (TEAG) to Thüringer Energie Beteiligungsgesellschaft mbH (TEB). Municipal shareholders also transferred interests in GVT totaling 43.9 percent to TEB. Consequently, GVT was merged into TEAG and the merged entity was renamed E.ON Thüringer Energie AG (ETE). Following this reorganization, E.ON Energie holds an 81.5 percent interest in TEB and TEB holds a 76.8 percent interest in ETE.

In July 2005, E.ON Energie acquired an additional 0.9 percent interest in Contigas Deutsche Energie AG (Contigas) through a public offer. In June 2005, the general meeting of Contigas passed a resolution authorizing E.ON Energie to use a squeeze-out procedure to acquire the remaining Contigas stock held by minority shareholders. Following the completion of the squeeze-out in November 2005, E.ON Energie acquired the remaining 0.2 percent and now owns 100 percent of Contigas.

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In September 2005, E.ON Energie acquired a 24.6 percent stake in the Romanian electricity distribution company Electrica Moldova now renamed E.ON Moldova and simultaneously increased its stake in the company to 51.0 percent by subscribing to a capital increase. In 2004, the company sold approximately 4.3 TWh of electricity to 1.3 million customers.

In September 2005, E.ON Benelux acquired 100.0 percent of the Dutch power and gas company NRE Energie b.v. (NRE). In 2004, the company supplied approximately 1.6 TWh of electricity and approximately 4.8 TWh of gas to approximately 0.3 million electricity and gas customers in the Netherlands.

In 2005, E.ON Energie decided to invest in new power plants in Germany in Irsching (530 MW natural gas) and Datteln (1,100 MW hard coal). Additionally, E.ON Energie plans to build a new Italian power plant at Livorno Ferraris (800 MW natural gas). For more information, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Expected Investment Activity.

In February 2006, E.ON Energie and RWE signed agreements to swap certain shareholdings in the Czech Republic and Hungary. These transactions are subject to regulatory and corporate approvals and are expected to be completed in 2006.

E.ON Energie s company structure reflects its operations in western and eastern Europe and, in addition, reflects the individual segments of its electricity business: generation, transmission, distribution and sale and trading. The following chart shows the major subsidiaries of the Central Europe market unit as of December 31, 2005, their respective fields of operation and the percentage of each held by E.ON Energie as of that date.

CENTRAL EUROPE MARKET UNIT

Holding Company
E.ON Energie AG

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

Western Europe

Conventional Power Plants
E.ON Kraftwerke GmbH (100%)

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

Nuclear Power Plants
E.ON Kernkraft GmbH (100%)

Power generation by nuclear power plants.

Hydroelectric Power Plants
E.ON Wasserkraft GmbH (100%)

Power generation by hydroelectric power plants.

E.ON Benelux Holding B.V. (100%)
Power generation by conventional power plants in the Netherlands.
District heating in the Netherlands.
Sales of power and gas in the Netherlands.

Transmission

E.ON Netz GmbH (100%)

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

Distribution, Sale and Trading of Electricity, Gas and Heat

E.ON Sales & Trading GmbH (100%)

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

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

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Distribution and sale of electricity, gas, heat and water to retail customers.
Energy support services.
Waste incineration.

Ruhr Energie GmbH (100%)

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

Eastern Europe

E.ON Hungária Energetikai ZRt. (100%)

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

E.ON Czech Holding AG (100%)

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

E.ON Moldova S.A. (51%)

Distribution and sale of electricity in Romania.

E.ON Bulgaria EAD (100%)

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

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

Distribution and sale of electricity in Slovakia.

Consulting and Support Services

E.ON Engineering GmbH (57.0%) (1)

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

E.ON IS GmbH (60.0%) (2)

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

E.ON Facility Management GmbH (100%)

Infrastructure services.

(1) The remaining 43.0 percent is held by E.ON Ruhrgas.

(2) The remaining 40.0 percent is held by E.ON AG and E.ON Ruhrgas.

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

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Operations

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

Generation:	the production of electricity at power stations;
Transmission:	the bulk transfer of electricity across an interregional power grid, which consists mainly of overhead transmission lines, substations and some underground cables (at this level there is a market for bulk trading of electricity, through which sales and purchases of electricity are made between generators, regional distributors, and other suppliers of electricity);
Distribution and Sale:	the transfer and sale of electricity from the interregional power grid and its delivery, across local distribution systems, to customers; and
Trading:	the buying and selling of electricity and related products for purposes of portfolio optimization, arbitrage and risk management.

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

The following table sets forth the sources of E.ON Energie s electric power in kWh in 2005 and 2004:

Sources of Power	**2005 million kWh**	**2004 million kWh**	**% Change**
Own production	129,063	131,278	-1.7
Purchased power	142,215	123,035	+15.6
from power stations in which E.ON Energie has an interest of 50 percent or less	*12,019*	*11,223*	*+7.1*
from other suppliers	*130,196*	*111,812*	*+16.4*
Total power procured(1)	271,278	254,313	+6.7
Power used for operating purposes, network losses and pump storage	(12,735)	(10,239)	+24.4
Total	258,543	244,074	+5.9

(1) Excluding physically-settled electricity trading activities at E.ON Sales & Trading GmbH (EST). EST s physically-settled electricity trading activities amounted to 113,666 million kWh and 110,914 million kWh in 2005 and 2004, respectively.

In 2005, E.ON Energie procured a total of 271.3 billion kWh of electricity, including 12.7 billion kWh used for operating purposes, network losses and pumped storage. E.ON Energie purchased a total of 12.0 billion kWh of power from power stations in which it has an interest of 50 percent or less. In addition, E.ON Energie purchased

130.2 billion kWh of electricity from other utilities, 23.5 billion kWh of which were from Vattenfall Europe, the eastern German interregional utility, for redistribution by eastern German regional distributors. In addition, E.ON Energie purchased power from local generators in Hungary, the Czech Republic, Bulgaria and Romania totaling 32.7 billion kWh. The increase in purchased power compared to 2004 primarily reflects the purchase of significantly higher volumes of renewable source electricity which is regulated under Germany s Renewable Energy Law as well as first-time consolidation effects (mainly in Bulgaria and Romania). Furthermore, short- and mid-term trading volumes increased. The increase in power used for operating purposes, network losses and pump storage is largely due to higher technical and non-technical network losses at the newly included subsidiaries in Bulgaria and Romania.

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Following the abolition of separate geographic operating areas for utilities under the Energy Law (as defined in Regulatory Environment) in 1998, E.ON Energie began to supply power nationwide and to broaden its activities in neighboring countries. E.ON Energie has thus significantly expanded beyond its traditional home markets, which include parts or all of the German states of Schleswig-Holstein, Lower Saxony, Hesse, North Rhine-Westphalia, Mecklenburg-Western Pomerania, Brandenburg, Saxony-Anhalt, Thuringia and Bavaria. E.ON Energie supplied approximately 18 percent of the electricity consumed by end users in Germany in 2005. Electricity accounted for 77.8 percent of E.ON Energie s 2005 sales (2004: 78.8 percent), gas revenues represented 15.3 percent (2004: 14.4 percent), district heating 1.9 percent (2004: 2.0 percent) and other activities 5.0 percent (2004: 4.8 percent).

The following table sets forth data on the sales of E.ON Energie s electric power in 2005 and 2004:

Sale of Power(1) to	Total 2005 million kWh	Total 2004 million kWh	% Change in Total
Non-consolidated interregional, regional and municipal utilities	138,425	130,862	+5.8
Industrial and commercial customers	77,175	72,077	+7.1
Residential and small commercial customers	42,943	41,135	+4.4
Total	258,543	244,074	+5.9

(1) Excluding physically-settled electricity trading activities at EST. EST s physically-settled electricity trading activities amounted to 113,666 million KWh and 110,914 million kWh in 2005 and 2004, respectively.

The increase in the total sale of power primarily reflects higher sales of renewable source electricity which is regulated under Germany s Renewable Energy Law as well as first time consolidation effects (mainly in Bulgaria and Romania). For further information, see Item 5. Operating and Financial Review and Prospects Results of Operations. E.ON Energie s total gas sales volume amounted to 112.3 billion kWh in 2005, a 9.1 percent increase from 102.9 billion kWh in 2004. The increase primarily reflects the first time consolidation of KÖGÁZ and DDGÁZ in Hungary and of NRE in the Netherlands. Additionally, the merger of TEAG and GVT resulted in higher sales volumes. Excluding the sales volumes from the newly included companies, gas sales decreased by 7.2 TWh. The decrease in sales volume was primarily weather-related (reflecting higher temperatures in winter 2005), as well as a result of increased competition in the business customer and the non-consolidated interregional, regional and municipal utilities segment.

Western Europe

Power Generation

General. In Germany, E.ON Energie owns interests in and operates electric power generation facilities with a total installed capacity of approximately 34,000 MW, its attributable share of which is approximately 25,600 MW (not including mothballed, shutdown or reduced power plants). The German power generation business is subdivided into three units according to fuels used: E.ON Kraftwerke GmbH owns and operates the power stations using fossil fuel energy sources, as well as waste incineration plants and renewable generation facilities, E.ON Kernkraft GmbH (E.ON Kernkraft) owns and operates the nuclear power stations and E.ON Wasserkraft GmbH owns and operates the hydroelectric power plants.

In the Netherlands, E.ON Energie operates, through its subsidiary E.ON Benelux, hard coal and natural gas power plants for the supply of electricity and heat to bulk customers and utilities. In 2005, it had a total installed generation capacity of approximately 1,870 MW.

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

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The following table sets forth E.ON Energie s major electric power generation facilities (including cogeneration plants) in Germany and the Netherlands, the total capacity and the capacity attributable to E.ON Energie for each facility as of December 31, 2005, and their start-up dates.

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

Power Plants	Total Capacity Net MW	Capacity Attributable to E.ON Energie		Start-up Date
		%(1)	MW	
Nuclear				
Brokdorf	1,370	80.0	1,096	1986
Brunsbüttel	771	33.3	257	1976
Emsland	1,329	12.5	166	1988
Grafenrheinfeld	1,275	100.0	1,275	1981
Grohnde	1,360	83.3	1,133	1984
Gundremmingen B	1,284	25.0	321	1984
Gundremmingen C	1,288	25.0	322	1984
Isar 1	878	100.0	878	1977
Isar 2	1,400	75.0	1,050	1988
Krümmel	1,260	50.0	630	1983
Unterweser	1,345	100.0	1,345	1978
Total	13,560		8,473	
Lignite				
Buschhaus	350	100.0	350	1985
Kassel	33	50.0	17	1988
Lippendorf S	891	50.0	446	1999
Schkopau	900	55.6	500	1995
Total	2,174		1,313	
Hard Coal				
Bexbach 1	714	8.3	59	1983
Buer (CHP)	70	100.0	70	1985
Datteln 1	95	100.0	95	1964
Datteln 2	95	100.0	95	1964
Datteln 3	113	100.0	113	1969
Farge	345	100.0	345	1969
GKW Weser/ Veltheim 2	93	67.0	62	1965
GKW Weser/ Veltheim 3	303	67.0	203	1970
Heyden	865	100.0	865	1987
Kiel	323	50.0	162	1970
Knepper C	345	100.0	345	1971
Maasvlakte 1 (NL)(2)	532	100.0	532	1988
Maasvlakte 2 (NL)(2)	520	100.0	520	1987
Mehrum C	690	50.0	345	1979

Rostock	508	50.4	256	1994
Scholven B	345	100.0	345	1968

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Power Plants	Total Capacity Net MW	Capacity Attributable to E.ON Energie		Start-up Date
		%(1)	MW	
Hard Coal (continued)				
Scholven C	345	100.0	345	1969
Scholven D	345	100.0	345	1970
Scholven E	345	100.0	345	1971
Scholven F	676	100.0	676	1979
Shamrock	132	100.0	132	1957
Staudinger 1	249	100.0	249	1965
Staudinger 3	293	100.0	293	1970
Staudinger 5	510	100.0	510	1992
Wilhelmshaven	747	100.0	747	1976
Zolling	449	100.0	449	1986
Total	10,047		8,503	
Natural Gas				
Burghausen	120	100.0	120	2001
Emden GT	52	100.0	52	1972
Erfurt	80	27.8	22	
Franken I/1	383	100.0	383	1973
Franken I/2	440	100.0	440	1976
Galileistraat (NL)	209	100.0	209	1988
Gendorf	40	50.0	20	2002
GKW Weser/ Veltheim 4 GT	400	74.0	296	1975
Grenzach-Wyhlen	40	69.9	28	2004
GT Ummeln	55	74.0	41	1973
Huntorf	290	100.0	290	1977
Irsching 3	415	100.0	415	1974
Jena-Süd	199	62.6	125	1996
Kirchlengern	180	62.9	113	1980
Kirchmöser	178	100.0	178	1994
Leiden (NL)	83	100.0	83	1986
Maasvlakte UCML (NL)	78	100.0	78	2004
Obernburg	100	50.0	50	1995
Robert Frank 4	487	100.0	487	1973
RoCa 3 (NL)(2)	220	100.0	220	1996
Staudinger 4	622	100.0	622	1977
The Hague (NL)	78	100.0	78	1982
Other (<40 MW installed capacity)	283	n/a	253	n/a
Total	5,032		4,603	

Fuel Oil

Audorf	87	100.0	87	1973
Hausham GT 1	25	100.0	25	1982
Hausham GT 2	25	100.0	25	1982

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Power Plants	Total Capacity Net MW	Capacity Attributable to E.ON Energie		Start-up Date
		%(1)	MW	
Fuel Oil (continued)				
Hausham GT 3	25	100.0	25	1982
Hausham GT 4	25	100.0	25	1982
Ingolstadt 3	386	100.0	386	1973
Ingolstadt 4	386	100.0	386	1974
Itzehoe	88	100.0	88	1972
Wilhelmshaven	56	100.0	56	1973
Zolling GT 1	25	100.0	25	1976
Zolling GT 2	25	100.0	25	1976
Total	1,153		1,153	
Hydroelectric				
Aufkirchen	27	100.0	27	1924
Bittenbrunn	20	100.0	20	1969
Bergheim	24	100.0	24	1970
Braunau-Simbach	100	50.0	50	1953
Egglfing	81	100.0	81	1944
Eitting	26	100.0	26	1925
Ering	73	100.0	73	1942
Erzhausen	220	100.0	220	1964
Feldkirchen	38	100.0	38	1970
Gars	25	100.0	25	1938
Geisling	25	100.0	25	1985
Happurg	160	100.0	160	1958
Hemfurth	20	100.0	20	1915
Jochenstein	132	50.0	66	1955
Kachlet	54	100.0	54	1927
Langenprozelten	164	100.0	164	1975
Neuötting	26	100.0	26	1951
Nußdorf	48	76.5	37	1982
Oberaudorf-Ebbs	60	50.0	30	1992
Passau-Ingling	86	50.0	43	1965
Pfrombach	22	100.0	22	1929
Reisach	105	100.0	105	1955
Rosenheim	35	100.0	35	1960
Roßhaupten	46	100.0	46	1954
Schärding-Neuhaus	96	50.0	48	1961
Stammham	23	100.0	23	1955
Straubing	22	100.0	22	1994
Tanzmühle	28	100.0	28	1959

Teufelsbruck	25	100.0	25	1938
Töging	85	100.0	85	1924
Vohburg	23	100.0	23	1992

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Power Plants	Total Capacity Net MW	Capacity Attributable to E.ON Energie % (1)	Capacity Attributable to E.ON Energie MW	Start-up Date
Hydroelectric (continued)				
Walchensee	124	100.0	124	1924
Waldeck 1	120	100.0	120	1931
Waldeck 2	440	100.0	440	1975
Wasserburg	24	100.0	24	1938
Other run-of-river, pump storage and storage	781	n/a	734	n/a
Total	3,408		3,113	
Others	537		333	
Total	**35,911**		**27.491**	
Mothballed/ Shutdown/ Reduced				
Arzberg 5(3)	104	100.0	104	1966
Arzberg 6(3)	252	100.0	252	1974
Arzberg 7(3)	121	100.0	121	1979
Aschaffenburg 21(3)	150	100.0	150	1963
Aschaffenburg 31(3)	143	100.0	143	1971
Emden 4(4)	433	100.0	433	1972
Franken II/1(3)	206	100.0	206	1966
Franken II/2(3)	206	100.0	206	1967
Irsching 1	151	100.0	151	1969
Irsching 2	312	100.0	312	1972
Offleben(3)	280	100.0	280	1988
Pleinting 1	292	100.0	292	1968
Pleinting 2	402	100.0	402	1976
Rauxel 2(3)	164	100.0	164	1967
Scholven G(3)	672	50.0	336	1974
Scholven H(3)	672	50.0	336	1975
Schwandorf B(3)	99	100.0	99	1959
Schwandorf C(3)	99	100.0	99	1961
Schwandorf D(3)	292	100.0	292	1972
Stade(3)	640	66.7	417	1972
Staudinger 2	249	100.0	249	1965
Westerholt 1(3)	138	100.0	138	1959
Westerholt 2(3)	138	100.0	138	1961
Total	6,215		5,320	

(1) Percentage of total capacity attributable to E.ON Energie.

(2) Power station operated by E.ON Benelux under long-term cross-border leasing arrangement.

(3) Dismantling in process or finished, respectively.

(4) Recommissioned in January 2006.
(CHP) Combined Heat and Power Generation.
(NL) Located in the Netherlands.

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

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

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

Operators of nuclear power plants are required under German law to establish sufficient financial provisions for future obligations that arise from the use of nuclear power. The three required provisions are for: (1) management of spent nuclear fuel rods, (2) disposal of contaminated operating waste and (3) the eventual decommissioning of nuclear plants. At year-end 2005, E.ON Energie had a total of approximately 13.0 billion provided for these purposes in respect of nuclear power plants included in its consolidated accounts, consisting of 4.2 billion for management of spent nuclear fuel rods, 0.4 billion for disposal of operational waste and 8.4 billion for decommissioning costs. These provisions are stated net of advance payments of 0.9 billion. In determining its pro rata share of these provisions, provisions attributed to minority interests included in E.ON Energie s consolidated accounts have been deducted and provisions for nuclear plants in which E.ON Energie has a minority interest are added. At year-end 2005, on such a pro rata basis, E.ON Energie s provisions for these purposes totaled 13.5 billion, as compared to 13.6 billion at year-end 2004.

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

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

In May 1995, PreussenElektra decided to shut down its nuclear power plant at Würgassen for economic reasons and, in October 1995, it applied for and received permission from the German authorities to decommission and dismantle the Würgassen plant in accordance with German nuclear energy legislation. E.ON Energie expects the decommissioning of Würgassen, which began in October 1995, to last until approximately 2015. In 2000, E.ON Energie also decided to shut down the nuclear power plant Stade. In July 2001, E.ON Kernkraft filed an application with the Lower Saxonian Ministry of Environment to decommission and dismantle Stade. E.ON Energie received the approval for decommissioning/dismantling in September 2005. Stade was shut

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down in November 2003, and E.ON Energie expects its decommissioning to last approximately 10 to 12 years. E.ON Energie has established a provision of 1.9 billion for the decommissioning of Würgassen and Stade, including the management of spent nuclear fuel rods and the dismantling of the plants.

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

Among other things, the amendment provides as follows:

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

Termination of Fuel Reprocessing: The transport of spent fuel elements for reprocessing was allowed until June 30, 2005. Following this deadline, the operators must store spent fuel in interim facilities on the premises of the nuclear plants. Such storage requires the approval and construction of interim storage facilities. The Company is currently constructing five interim on-site storage facilities, of which two are expected to go into operation in the first quarter of 2006, with the remaining three scheduled to be ready between November 2006 and February 2007. For the period from July 2005 until storage can begin in the interim storage facilities, the Company is storing the spent fuel elements at the plants in so-called in-plant fuel pools. The Company expects the capacity of these fuel pools to be sufficient to store the spent fuel elements until the storage facilities go into operation. E.ON has delivered all spent fuel elements under its reprocessing contracts with Cogema and BNGS.

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

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

In March 1999, the German parliament passed the Tax Relief Act 1999/2000/2002 (*Steuerentlastungsgesetz 1999/2000/2002*, the Tax Relief Act). The Tax Relief Act contains new rules for the tax treatment of nuclear provisions. Furthermore, the German tax authorities have adopted a more stringent interpretation of the previous law with respect to the years before 1999. The changes to the tax status of the provisions include the following:

The accrual period for decommissioning costs has been extended from 19 to 25 years. This requires E.ON Energie to release a portion of the provisions it had previously established for tax purposes based on the shorter accrual period.

Certain parts of the provisions concerning MOX fuel elements have to be reversed. The costs must be capitalized as incurred instead.

Those portions of the provisions that have been established in past years relating to the financing and operational costs for final storage of nuclear waste have been disallowed. The costs of these items will now be tax-deductible when they are actually expensed.

In accordance with the new general rule for long-term provisions, all types of provisions for nuclear power must now be discounted. The Tax Relief Act sets the discount rate at 5.5 percent. This also applies

to provisions that have previously been established, which must be released to the extent they do not reflect this discounting.

The Tax Relief Act provides that the tax payments resulting from the reversal of provisions necessitated by the extension of the accrual period, the disallowance of portions of the provisions related to costs of final storage of waste and the discounting of the provisions are spread over a period of ten years beginning in 1999.

In 2002, the Company concluded its general discussions with the tax authorities regarding the treatment of the years prior to 1999, and the tax calculations for these years have been agreed in principle. All of the resulting tax has already been paid and the Company has established a provision to cover the remaining amounts. The years from 1999 onwards are still under review.

None of the changes to the tax treatment of nuclear provisions described above cause any changes to the financial statements the Company prepares for other purposes. Due to the recognition of a related deferred tax asset generated by temporary differences between the balance sheet prepared for financial reporting purposes and the balance sheet for tax purposes, the changes in the tax status of the provisions for nuclear waste disposal had no material adverse effect on the Company s consolidated net income in 1999. However, the Tax Reduction Act *(Steuersenkungsgesetz)*, which was enacted in October 2000, included a lowering of the corporate income tax from 40 percent to 25 percent, which has resulted in a reduction of the deferred tax asset relating to the provisions.

Hard Coal. In 2005, approximately 40 percent of the hard coal used by E.ON Energie s German operations was mined in Germany. Traditionally, hard coal is mined in Germany under much more difficult conditions than in other countries. Therefore, German coal production costs are substantially above world market levels, and E.ON Energie strongly believes they will continue to remain high. Although electricity producers were in the past required to purchase German coal, they are now free to purchase coal from any source. To encourage the purchase of German coal, the German federal government has been paying direct subsidies to German producers enabling them to offer domestic coal at world market prices, although it is now in the process of reducing such subsidies. Due to high production costs and the reduction in subsidies, the volume of German coal production has shown a relatively steady decline in the past and is expected to continue to decline further. However, E.ON Energie expects that adequate supplies of imported coal for its operations will be available on the world coal market at acceptable prices. Hard coal is generally available from multiple sources, though prices are determined on international commodities markets and are therefore subject to fluctuations. E.ON Benelux also uses imported hard coal in its power plants.

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

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

Water. This domestic source of energy is primarily available in southern Germany due to the presence of mountains and rivers. The variable costs of production are extremely low in the case of run-of-river plants and

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consequently, these plants are used to cover base load requirements. Storage and pump storage facilities are used to meet peak demand and for back-up power purposes.

Waste Incineration. E.ON Energie also has a waste incineration business, led by BKB. In 2005, incinerated waste volumes totaled approximately 2.1 million tons. The power plants have a total capacity of 193 MW of electricity, of which 133 MW is attributable to E.ON Energie.

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

Although E.ON s power plants are maintained on a regular basis, there is a certain risk of failure for power plants of every fuel type (for example, in 2005 the breakdown of generators in the non-nuclear part of the Unterweser power plant and in the coal-fired Heyden power plant resulted in the plants being out of service for 12 and 8 weeks, respectively). In addition, the summer heat wave in Europe in 2003 reduced the availability of electric generating facilities dependent on using river water for cooling purposes. Depending on the associated generation capacity, the length of the outage and the cost of the required repair measures, the economic damage due to such failure can vary significantly. In order to meet contractual commitments, electricity which cannot be generated at these plants has to be bought from other generators or has to be generated from more expensive plants. Thus, power plant outages can negatively affect the market unit s financial and operating results.

Transmission

The German power transmission grid of E.ON Energie, which operates with voltages of 380, 220 and 110 kilovolts, has a system length of over 42,000 km and a coverage area of nearly 200,000 km^2. It is located in the German states of Schleswig-Holstein, Lower Saxony, Mecklenburg-Western Pomerania, Brandenburg, North Rhine-Westphalia, Saxony-Anhalt, Hesse, Thuringia and Bavaria, and reaches from the Scandinavian border to the Alps. The grid is interconnected with the western European power grid with links to the Netherlands, Austria, Denmark and Eastern Europe. The system is mainly operated by E.ON Netz GmbH (E.ON Netz). The network of E.ON Netz allows long-distance power transport at low transmission losses and covers more than 40 percent of the surface area of Germany. This system is operated from two main system control centers, one in Lehrte near Hanover and one in Karlsfeld near Munich, and from several regional control and service units at decentralized locations within the E.ON Netz grid area.

Access to E.ON Energie s power transmission grid is open to all potential users. The Company believes its usage fees and conditions comply with existing German regulations governing grid access. For further information, see Regulatory Environment Germany: Electricity.

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

Distribution and Sale

In Germany E.ON Energie supplies electricity, gas and heat, mainly through the regional electricity distribution companies in which it holds majority interests. In addition to the trading business described below, EST supplies electricity to these regional electricity distribution companies as well as to large municipal distributors and very large national and international industrial customers.

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

E.ON Energie s customers are interregional, regional and municipal utilities, traders, industrial and commercial customers and, only through regional distributors, residential and small commercial customers predominantly in those parts of Germany highlighted on the above map. E.ON Energie supplied approximately 18 percent of the electricity consumed by end users in Germany in 2005. In compliance with the EU Commission s conditions upon approving the VEBA-VIAG merger, E.ON Energie s majority-owned regional distributors E.ON EDIS and ETE in eastern Germany purchase power from E.ON Energie s competitor Vattenfall Europe. E.ON Energie s majority-owned distributor E.ON Avacon likewise purchases its power primarily from Vattenfall Europe for those of its customers situated in the eastern German state of Saxony-Anhalt.

The following table sets forth the sale of E.ON Energie s electric power (excluding that used in physically settling its trading activities) in Germany in 2005 and 2004:

Sale of Power to	Germany 2005 million kWh	Germany 2004 million kWh	% Change in Total
Non-consolidated interregional, regional and municipal utilities(1)	116,654	112,575	+3.6
Industrial and commercial customers(2)(3)	59,134	56,274	+5.1
Residential and small commercial customers	29,978	30,352	-1.2
Total(3)	205,766	199,201	+3.3

(1) The sale of power to non-consolidated interregional, regional and municipal utilities increased in 2005 compared with 2004, reflecting increased sales of electricity produced from renewable resources.

(2) The sale of power to industrial and commercial customers increased in 2005 compared with 2004, primarily due to additional customers acquired.

(3) The sale of power includes sales of EST in other European countries.

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In order to offer optimized services to major customers and to equalize supply and demand at all times with respect to the costs of procurement, E.ON Energie has integrated its trading and wholesale operations into EST. EST focuses on the national and international wholesale business for regional utilities, large municipal utilities and major industrial customers, and is also responsible for E.ON Energie s trading operations. The regional distribution companies manage the main part of E.ON Energie s retail business, which is the supply of power to municipal utilities, industrial and commercial customers, as well as residential and small commercial customers. The following chart sets forth the principal supply structure of E.ON Energie s electricity sales.

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

Gas. E.ON Energie s distribution subsidiaries supply natural gas to households, small businesses and industrial customers in many parts of Germany. E.ON Energie s gas sales volume in Germany in 2005 amounted to 100.5 billion kWh compared with 102.9 billion kWh in 2004. Due to the acquisition of NRE, E.ON Energie also had a gas sales volume of 1.7 billion kWh in the Netherlands in 2005.

Heat. E.ON Energie is one of the leading suppliers of district heating in Germany. It operates its own district heating networks and supplies several additional networks owned by other companies. E.ON Energie s regional distributors are also involved in district heat and steam delivery. E.ON Energie s total district heat deliveries in Western Europe in 2005 remained essentially stable at 13.0 billion kWh, of which 10.4 billion kWh were supplied in Germany. The remaining amount is mainly supplied through E.ON Benelux.

Water. Following the sale of its interest in Gelsenwasser AG (Gelsenwasser) in 2003, E.ON s remaining regional water business is conducted through certain of its distribution companies, particularly E.ON Hanse, E.ON Avacon AG and E.ON Westfalen Weser.

Customers. Through its subsidiaries and companies in which it has shareholdings, E.ON Energie serves approximately 9.4 million electricity customers in Germany. E.ON Energie s German operations also supply approximately 1.8 million customers with gas and more than 0.4 million customers with water.

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In the Netherlands, E.ON Benelux acquired the Dutch power and gas company NRE in 2005. In 2004, the company supplied approximately 1.6 TWh of electricity and approximately 4.8 TWh of gas to approximately 0.3 million electricity and gas customers in the Netherlands.

In Italy, the sales activities of E.ON Energie are operated by its subsidiary E.ON Italia. E.ON Italia focuses on industrial customers and local utilities. Its sales volume amounted to approximately 995 million kWh in 2005.

Trading

E.ON Energie has integrated its trading and wholesale operations into EST. An international team of traders buys and sells electricity on the spot and forward markets. E.ON Energie s trading operations offer customized and standard products that are traded on a bilateral basis, as well as trading in standard exchange-traded instruments. EST s trading focuses on Germany and continental Europe, including the following European power exchanges: European Energy Exchange in Leipzig, the Amsterdam Power Exchange in the Netherlands, Powernext in France, Energy Exchange Austria, the Italian Power Exchange and Operátor trhu s elektrinou (OTE) in the Czech Republic. EST also supplies cross border trading and risk management processes for optimizing international power procurement to E.ON Energie s operations in Eastern Europe and is the sole procurer for E.ON Energie s operations in Italy. As the central trading desk of the E.ON Energie group, EST began CO_2 emissions trading activities in 2005. For information on CO_2 emissions trading, see Regulatory Environment EU/ Germany: General Aspects (Electricity and Gas) Greenhouse Gas Emissions Trading. The volume of CO_2 emission certificates traded by EST amounted to 8.7 million tons in 2005.

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

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

The volume of EST s energy trading activities increased in 2005, reflecting higher price volatility in the power markets. See Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31, 2005 Compared with Year Ended December 31, 2004 Central Europe. The following table sets forth the total volume of EST s traded electric power in 2005 and 2004.

Trading of Power	2005 million kWh	2004 million kWh	% Change in Total
Power sold	164,109	146,755	+11.8
Power purchased	168,734	162,671	+3.7
Total	332,843	309,426	+7.6

Other

Consulting and Support Services. E.ON Engineering GmbH offers internal and external consulting, planning and construction services in the energy sector in fields such as chemical analytics and electrical, mechanical and civil engineering, with a focus on conventional and renewable power generation, cogeneration, use of biomass, pipeline construction, development of energy strategies and CO_2-emissions reduction. Building on their shareholdings in municipal and regional utilities, E.ON Energie and the regional distributors also establish partnerships and cooperative relationships with local authorities. E.ON Energie and the regional distributors operate their own electricity and gas

supply systems, and provide the local authorities with consulting, technical and managerial support to promote the efficient use of electricity and gas. E.ON Facility

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Management GmbH (E.ON Facility Management) provides technical, commercial and infrastructural facility management services, mainly for E.ON Energie group companies. In November 2005, E.ON Energie acquired an additional 49.0 percent stake in E.ON Facility Management, which is now wholly-owned, from HSG Technischer Service GmbH. E.ON IS GmbH (E.ON IS) is the provider for all information technology services needed in the E.ON Group. The company also offers information technology services for third parties. The E.ON Group acquired the remaining 25.2 percent shareholding as of January 1, 2005. Since then, E.ON IS has been consolidated in the Group, with E.ON Energie holding a 60.0 percent stake, E.ON AG holding a 26.0 percent stake and E.ON Ruhrgas holding the remaining 14.0 percent stake.

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

Eastern Europe

E.ON Energie has significant shareholdings in Hungary, the Czech Republic, Bulgaria, Romania and Slovakia, in which it has already built up a portfolio of activities. National holding companies such as E.ON Hungária Energetikai ZRt. (E.ON Hungária), E.ON Czech Holding AG and E.ON Bulgaria EAD coordinate E.ON Energie s activities.

In Hungary, E.ON Energie holds all of the shares (except for a golden share held by the Hungarian government) of the regional electricity distributors E.ON Dél-dunántúli Áramszolgáltató Rt., E.ON Észak-dunántúli Áramszolgáltató Rt. (ÉDÁSZ) and E.ON Tiszántúli Áramszolgáltató Rt. In 2005, these companies provided 2.4 million customers with approximately 14.4 TWh of electricity. In January 2003, E.ON Hungária founded E.ON Energiakereskedö Kft., an electricity and gas sales company, to serve the liberalized Hungarian electricity market. E.ON Energie also holds a 100.0 percent stake in the natural gas power generation company Debreceni Kombinált Ciklusú Erömü Kft. (95 MW). In the gas sector, E.ON Energie holds a 98.1 percent stake in the gas distribution and supply company KÖGÁZ, a 50.01 percent stake in the gas distributor DDGÁZ and a 16.3 percent stake in the gas company FÖGÁZ. KÖGÁZ and DDGÁZ have been fully consolidated since April 2005. In 2005, the two companies provided approximately 0.6 million customers with approximately 17.3 TWh of gas. In February 2006, E.ON Energie and RWE signed an agreement to swap certain of their respective shareholdings in Hungary and the Czech Republic, subject to antitrust and other regulatory approvals. Under the proposed swap, E.ON Energie would acquire almost all of the remaining shares of DDGÁZ and RWE would acquire E.ON Energie s interest in FÖGÁZ.

In the Czech Republic, E.ON Energie controls significant participations in the energy sector. As of January 1, 2005, E.ON Energie re-organized its former subsidiaries Jihomoravská energetika a.s. (JME) and Jihoceská energetika a.s (JCE) and fulfilled legal unbundling requirements by creating three new wholly-owned subsidiaries, E.ON Ceská republika, a.s., E.ON Distribuce, a.s. and E.ON Energie, a.s., and transferring the businesses of JME and JCE to these subsidiaries. On a combined basis, these companies provided approximately 1.4 million customers with approximately 12.2 TWh of electricity in 2005. In the gas sector, E.ON Energie owns minority shareholdings in the distributors JMP, Jihoceska plynárenska a.s. (JCP), PP, STP, SMP, ZCP and VCP. Under the proposed swap of shareholdings with RWE noted above, E.ON Energie would increase its interest in JCP to 59.8 percent and acquire additional shares in PP. RWE would acquire E.ON Energie s interests in STP, SMP, ZCP and VCP.

In February 2005, E.ON Energie acquired 67.0 percent stakes in each of the two northeastern Bulgarian electricity distribution companies Varna and Gorna Oryahovitza. The companies had combined sales of approximately 4.9 TWh and served approximately 1.1 million customers in 2005.

In September 2005, E.ON Energie acquired a 24.6 percent stake in the Romanian electricity distribution company Electrica Moldova now renamed E.ON Moldova and simultaneously increased its stake in the company to 51.0 percent by subscribing to a capital increase. In 2004, the company sold approximately 4.3 TWh of electricity to approximately 1.3 million customers.

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In 2002, E.ON Energie entered the Slovakian energy market by acquiring a 49.0 percent interest in the Slovakian electricity supplier Západoslovenská energetika a.s. (ZSE), which provided approximately 1.0 million customers with approximately 7.1 TWh of electricity in 2004.

In the Baltic region, following the re-organization of the Lithuanian energy industry, E.ON Energie now owns a 20.3 percent interest in Rytu Skirstomieji Tinklai (RST), the eastern Lithuanian electricity distribution company. E.ON Energie has an agreement with the Lithuanian government to sell its interest in RST to the new majority shareholder should RST be completely privatized.

In addition, as of December 31, 2005 E.ON Energie held a number of shareholdings in small generation assets, primarily in Hungary and the Czech Republic.

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

Competitive Environment

Since 1998, liberalization of the electricity markets in the EU has greatly altered competition in the German electricity market, which was formerly characterized by numerous strong competitors. Following liberalization, significant consolidation has taken place in the German market, resulting in three mergers of major interregional utilities in recent years: VEBA and VIAG forming E.ON, RWE and Vereinigte Elektrizitätswerke AG forming RWE (both in 2000) and Hamburgische Electricitäts-Werke AG/ Bewag Berliner Kraft und Licht Aktiengesellschaft/ VEAG/ Lausitzer Braunkohle Aktiengesellschaft forming Vattenfall Europe in 2002. In 2005, E.ON, RWE, Vattenfall Europe and the other remaining major interregional utility, EnBW, supplied approximately two thirds of the total electricity production in Germany.

The interregional utilities own the high-voltage transmission lines in their traditional supply areas and are active in all phases of the electricity business. In addition to the interregional utilities, there are about 900 electric utilities in Germany at the state, regional and municipal level, many of which are partly or wholly owned by state or municipal governments. These utilities may be involved in various combinations of the generation, transmission, distribution and supply and trading functions. The liberalization of the electricity market in Germany has also led to new market structures with new market participants. The market for electricity has become more liquid and more competitive, and currently has the highest number of participants in continental Europe. Approximately 200 new market participants have entered the German market since 1998, with more than half of them engaged in electricity trading. The volume of electricity trading rose in 2005 (602 TWh at the European Energy Exchange s Spot and Futures Market compared with 397 TWh in 2004). The European Energy Exchange has also become a benchmark for electricity prices in central Europe.

Liberalization of the electricity market in Germany caused wholesale and consequently end customer electricity prices to decrease in 1998, with significant declines in some market segments. These declines were largely due to aggressive price setting by new competitors and suppliers, as well as other factors such as significant power plant overcapacity in Germany and Europe and relatively high and increasing price transparency. The rate of price declines began to slow in the second half of 2000, and prices have increased since 2001 but have developed differently in each of the customer segments. According to the German Electricity Association, VDEW, in 2005 prices paid by household customers were about 9 percent higher than in the liberalization year 1998, while prices (including electricity tax) paid by industrial customers were still about 5 percent lower than in 1998. In 2005, wholesale electricity prices in Germany rose sharply due to rising CO_2 emission certificate prices and a dry and hot summer. Some industrial customers were affected by the high wholesale prices, but others had already procured a lower price in 2004 or earlier. For this reason, the wholesale price increase did not affect the industrial customer segment to the same degree as household customers.

In addition to the effect of higher wholesale market prices, a significant factor in the overall price recovery are new or increased costs faced by electricity companies since the beginning of liberalization. Among these new or increased costs are the electricity tax (introduced in 1998 and subject to annual increases through 2003), duties and additional costs attributable to compliance with new legislation, including the Renewable Energy Law and Co-Generation Protection Law, as well as higher costs incurred in procuring balancing power to cover

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fluctuations in the availability of electricity from renewable resources such as wind. As most distributors have tried to pass these increases through to their customers, electricity prices have risen more rapidly than the associated margins for generators in recent years. Taxes and duties accounted for approximately 40 percent of German electricity prices for household customers in 2005, compared with about 25 percent before deregulation in 1998. Similarly, electricity taxes and duties increased from 2 percent of German electricity prices for industrial customers in 1998 to 21 percent in 2005. In view of recent developments in the commodity and fuel markets, E.ON Energie expects electricity prices in Germany to further increase in 2006. E.ON Energie cannot exclude further price hikes for end customers in 2006, which in most cases have to be approved by the relevant authorities. However, these price changes for end customers depend on the wholesale market prices for electricity. For information about court proceedings on price increases affecting some of E.ON Energie s majority-owned regional distribution companies, see Item 3. Key Information Risk Factors External.

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

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

PAN-EUROPEAN GAS

Overview

E.ON Ruhrgas is the lead company of the Pan-European Gas market unit and is responsible for all of E.ON s non-retail gas activities in continental Europe. In terms of sales, E.ON Ruhrgas is one of the leading non-state-owned gas companies in Europe and the largest gas company in Germany. E.ON Ruhrgas principal business is the supply, transmission, storage and sale of natural gas. E.ON Ruhrgas also holds numerous stakes in German and other European gas transportation and distribution companies, as well as a small shareholding in Gazprom, Russia s main natural gas exploration, production, transportation and marketing company. In 2005, the Pan-European Gas market unit recorded revenues of 17.9 billion (which included 3.1 billion in natural gas and electricity taxes that were remitted, directly or indirectly, to the German tax authorities) and adjusted EBIT of 1.5 billion. 14.2 billion of the Pan-European Gas market unit s 2005 revenues were generated in Germany and 3.7 billion was generated abroad (measured by location of customer).

In 2005, E.ON Ruhrgas entered into the following significant transactions:

In November 2004, ERI signed an agreement for the acquisition of 75.0 percent minus one share each of the gas trading and gas storage businesses of the Hungarian oil and gas company MOL and its 50.0 percent interest in the gas import subsidiary Panrusgáz. In addition, MOL received a put option to sell to ERI up to 75.0 percent minus one share of its gas transmission business and put options to sell to ERI the remaining 25.0 percent plus one share in the MOL gas trading and gas storage businesses. As a condition of antitrust approval by the EU commission, MOL is obliged to sell the remaining 25.0 percent plus one share of the gas trading and storage businesses as well. As a result, ERI signed an agreement for the acquisition of the remaining 25.0 percent plus one share of each of the two companies. These transactions are expected to be completed at the end of March 2006.

In June 2005, after clearance was obtained from the relevant authorities, E.ON Ruhrgas acquired a 51.0 percent stake in the Romanian gas supplier Distrigaz Nord from the Romanian government. Distrigaz Nord is active in gas distribution and supply in northern Romania.

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In June 2005, E.ON Ruhrgas signed an agreement for the sale of Ruhrgas Industries to CVC Capital Partners.

In September 2005, E.ON Ruhrgas Norge AS (E.ON Ruhrgas Norge) acquired an additional 15.0 percent stake in the Njord oil and gas field from the British oil and gas company Paladin Resources plc. and now owns a 30.0 percent stake in this field.

In September 2005, Gazprom, BASF and E.ON signed a basic agreement on the construction of the NEGP.

In November 2005, E.ON Ruhrgas acquired Caledonia, a U.K. gas production company with interests in a total of 15 gas fields in the U.K. southern North Sea, from First Reserve, CSFB Private Equity Funds and others. Apart from its stakes in gas fields, Caledonia wholly owns Caledonia Energy Trading Limited (CETL) and has interests in two pipeline systems near the gas fields for transporting gas to the United Kingdom.

In the course of 2005, E.ON Ruhrgas UK Exploration and Production Limited (E.ON Ruhrgas UK) acquired a further 13.59 percent stake in Interconnector (U.K.) Limited (Interconnector) from BP plc. (BP) (4.0 percent), International Power plc (International Power) (3.38 percent) and Amerada Hess Corporation (Amerada Hess) (6.21 percent). E.ON Ruhrgas UK now holds a total interest of 23.59 percent in this company.

For information about additional transactions in the downstream business, see Downstream Shareholdings.

Operations

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

Supply:	The purchase of natural gas under long-term contracts with foreign and domestic producers, including the Russian gas company Gazprom, the world s largest gas producer in terms of volume, in which E.ON Ruhrgas holds a small shareholding. E.ON Ruhrgas also engages in gas exploration and production activities and, to supplement its supply as well as its sales business, in a limited amount of trading activities;
Transmission:	The transmission of gas within Germany via a network of approximately 11,000 km of pipelines in which E.ON Ruhrgas holds an interest;
Storage:	The storage of gas in a number of large underground natural gas storage facilities; and
Sales:	The sale of gas within Germany to regional and supraregional distributors, municipal utilities and industrial customers, as well as the delivery of gas to a number of customers in other European countries.

In addition to its natural gas supply, transmission, storage and sales businesses, E.ON Ruhrgas owns numerous shareholdings in integrated gas companies, gas distribution companies and municipal utilities through its subsidiaries ERI and Thüga. ERI holds primarily minority shareholdings in European integrated and regional gas distribution companies and in German regional gas distribution companies, while Thüga holds primarily minority shareholdings in about 100 regional and municipal electricity and gas utilities in Germany, as well as majority and minority shareholdings in a number of Italian gas distribution and sales companies and one Italian municipal utility.

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

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Shareholdings business unit reflects the results of ERI and Thüga. Other/ Consolidation includes consolidation effects.

The following table provides information about purchases and sales of natural gas and coke oven gas by E.ON Ruhrgas midstream operations for the years 2005 and 2004. The difference between gas supplies and gas sales in any given period is due to storage and metering differences and occurs routinely.

Purchases	**Total 2005 billion kWh**	**%**	**Total 2004 billion kWh**	**%**
Imports	580.0	84.5	537.4	83.2
German sources	106.1	15.5	108.6	16.8
Total	686.1	100.0	646.0	100.0
Sales				
Domestic distributors	323.7	46.9	328.7	51.2
Domestic municipal utilities	160.9	23.3	156.1	24.3
Domestic industrial customers	70.4	10.2	69.0	10.8
Sales abroad	135.2	19.6	87.6	13.7
Total	690.2	100.0	641.4	100.0

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

The increase in total sales volume in 2005 is mainly attributable to an increase in sales abroad, especially to customers in the United Kingdom (including E.ON UK); the sales increase was reflected in an increase in imports. For more information on E.ON Ruhrgas gas supply contract with E.ON UK, see History and Development of the Company Ruhrgas Acquisition and U.K. Energy Wholesale Energy Trading.

Supply

E.ON Ruhrgas purchases nearly all of its natural gas from producers in six countries: Russia, Norway, the Netherlands, Germany, the United Kingdom and Denmark. In 2005, E.ON Ruhrgas purchased a total of 686.1 billion kWh of gas, of which approximately 84.5 percent was imported and approximately 15.5 percent was purchased from German producers. E.ON Ruhrgas was the largest gas purchaser in Germany in 2005, acquiring more than half of the total volume of gas purchased for the German market. Of the 686.1 billion kWh of gas purchased in 2005, E.ON Ruhrgas bought approximately 28.2 percent from Russia and approximately 27.5 percent from Norway, its two largest suppliers. The following table provides information on the amount of gas purchased from each country and its percentage of the total volume of gas purchased by the midstream operations in the years 2005 and 2004:

Sources of Gas	**Total 2005 billion kWh**	**%**	**Total 2004 billion kWh**	**%**
Germany	106.1	15.5	108.6	16.8

Russia	193.5	28.2	201.3	31.2
Norway	188.4	27.5	169.6	26.3
The Netherlands	139.0	20.2	124.1	19.2
United Kingdom	34.1	5.0	22.8	3.5
Denmark	23.7	3.4	19.3	3.0
Others(1)	1.3	0.2	0.3	0.0
Total	686.1	100.0	646.0	100.0

(1) Italy and France.

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

As is typical in the gas industry, these purchases were made under long-term supply contracts that E.ON Ruhrgas has with one or more gas producers in each country. Purchases under such contracts provided for nearly all of the gas bought by E.ON Ruhrgas in 2005; the remaining amounts were purchased on international spot markets or pursuant to short-term contracts. E.ON Ruhrgas current long-term contracts with fixed terms (so-called supply -type contracts) have termination dates ranging from 2006 to 2029 (subject in certain cases to automatic extensions unless either party gives notice of termination), while so-called depletion -type contracts terminate upon the exhaustion of economic production from the relevant gas field. E.ON Ruhrgas believes that its existing contracts secure the supply of a total volume of approximately 10 trillion kWh of natural gas over the period to 2029. As is standard in the gas industry, the price E.ON Ruhrgas pays for gas under these contracts is calculated on the basis of complex formulas incorporating variables based upon current market prices for fuel oil, gas oil, coal and/or other competing fuels, with prices being automatically re-calculated periodically, usually monthly or quarterly. The contracts also generally provide for formal revisions and adjustments of the price or business terms to reflect changes in the market (in many cases expressly including changes in the retail market for natural gas and competing fuels), generally providing that such revisions may only be made once every few years unless the parties agree otherwise. Claims for revision are subject to binding arbitration in the event the parties cannot agree on the necessary adjustments. Certain contracts also provide E.ON Ruhrgas with the possibility of buying specified quantities of gas at prices linked to those on international spot markets. The contracts also require E.ON Ruhrgas to pay for specified minimum quantities of gas even if it does not take delivery of such quantities, a standard gas industry practice known as take or pay. Take-or-pay quantities are generally set at approximately 80 percent of the firm contract quantities. To date, E.ON Ruhrgas has been able to avoid the application of these take-or-pay clauses in nearly all cases. The contracts also include quality and availability provisions (together with related discounts for non-compliance), *force majeure* provisions and other industry standard terms. E.ON Ruhrgas also has short-term arrangements with some of its suppliers, which provided less than 3 percent of E.ON Ruhrgas gas supply in 2005. E.ON Ruhrgas generally takes delivery of the gas it imports at the point at which the relevant pipeline crosses the German border. For additional information on these contractual obligations, see Item 5. Operating and Financial Review and Prospects Contractual Obligations.

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

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

Russia. In 2005, E.ON Ruhrgas purchased 193.5 billion kWh of gas, or 28.2 percent of its total gas purchased, from Russia. Russia is the largest supplier of natural gas to E.ON Ruhrgas, while E.ON Ruhrgas is the second-largest purchaser of gas from Russia. As with most of its gas imports, E.ON Ruhrgas takes ownership of its Russian gas when it reaches the German border.

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

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Ruhrgas considers its shareholding in Gazprom to be an important element supporting its long-term supply relationship with Gazprom, which is the world s largest gas producer, having produced approximately 5.6 trillion kWh of gas in 2005. E.ON Ruhrgas expects the importance of Russian gas exports for Europe to increase as the indigenous production of important European supply countries decreases. Gazprom has indicated it will flexibly cover about one third of E.ON Ruhrgas gas requirements for the German market until 2030. E.ON Ruhrgas and Gazprom may enter into new gas supply contracts in the future which will provide a contractual basis for this arrangement. In July 2004, E.ON and Gazprom signed a Memorandum of Understanding for a deepened strategic cooperation between the parties, pursuant to which E.ON, Gazprom and BASF signed a basic agreement on the construction of the NEGP in September 2005. For details, see Transmission and Storage Pipelines.

In addition, E.ON Ruhrgas is a member of a consortium that holds a minority interest in Slovenský plynárenský priemysel a.s. (SPP), the operator of the gas transmission system in Slovakia through which most Russian gas bound for western Europe is transported.

Norway. In 2005, E.ON Ruhrgas purchased 188.4 billion kWh, or 27.5 percent of its total gas purchased, from Norwegian sources. E.ON Ruhrgas has supply contracts with a number of major Norwegian and international energy companies that hold concessions for the exploitation of Norwegian gas fields. Some of the contracts are of the depletion -type while others are supply -type contracts. E.ON Ruhrgas takes delivery of its Norwegian supplies mainly at the gas import points near Emden along the German North Sea coast.

The Netherlands. In 2005, E.ON Ruhrgas purchased 139.0 billion kWh, or 20.2 percent of its total gas purchased, pursuant to a single long-term supply contract with N.V. Nederlandse Gasunie. This contract provides E.ON Ruhrgas with a certain degree of flexibility in managing its supply portfolio. E.ON Ruhrgas believes such flexibility is particularly important in this case, as the Dutch gas fields are relatively close to the end consumers of E.ON Ruhrgas imports, making it more economically viable for E.ON Ruhrgas to react to changes in market demand by varying contract quantities. E.ON Ruhrgas takes delivery of Dutch gas at the German border.

Germany. In 2005, E.ON Ruhrgas purchased 106.1 billion kWh, or 15.5 percent of its total gas purchased, from domestic gas production companies. E.ON Ruhrgas has long-term supply contracts for German natural gas with ExxonMobil Gas Marketing Deutschland GmbH (formerly Mobil Erdgas-Erdöl GmbH), ExxonMobil Gas Marketing Deutschland GmbH & Co. KG (50 percent of former BEB), Shell Erdgas Marketing GmbH & Co. KG (50 percent of former BEB), Gaz de France Produktion Exploration Deutschland GmbH (formerly Preussag Energie GmbH) and RWE Dea AG. A number of the contracts provide E.ON Ruhrgas with significant additional flexibility by providing for the supply of minimum and maximum quantities of gas, rather than a single fixed amount. E.ON Ruhrgas expects the volume of gas it purchases from domestic sources to decline over the coming years due to the depletion of German gas fields.

United Kingdom. In 2005, E.ON Ruhrgas purchased 34.1 billion kWh, or 5.0 percent of its total gas purchased, from U.K. sources. These quantities were partly purchased from BP Gas Marketing Ltd under a long-term supply contract, partly purchased on the spot short-term market and partly received as equity gas through E.ON Ruhrgas subsidiary E.ON Ruhrgas UK, which has interests in U.K. gas fields and infrastructure. See Trading Exploration and Production below for more information on E.ON Ruhrgas UK.

In contrast to much of its other imported gas, which E.ON Ruhrgas generally takes ownership of at the German border, E.ON Ruhrgas takes delivery of its purchased U.K. gas supplies partly at Bacton and partly at Zeebrugge in Belgium. Gas from the U.K. gas fields is transported to Belgium through the undersea gas pipeline run by the project company Interconnector. During 2005, E.ON Ruhrgas UK acquired a further 13.59 percent stake in Interconnector and now holds a total interest of 23.59 percent. In order to transport the gas to Germany, E.ON Ruhrgas has long-term transportation contracts for the transmission of the gas through the Belgian pipeline system to the gas import point at Raeren near Aachen on the German-Belgian border.

Denmark. In 2005, E.ON Ruhrgas purchased 23.7 billion kWh, or 3.4 percent of its total gas purchased, from the Danish supplier DONG Naturgas A/ S (DONG), with which E.ON Ruhrgas has long-term supply contracts. E.ON Ruhrgas takes delivery of Danish gas at the German-Danish and Swedish-Danish border.

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Trading

In order to optimize and manage price risks of its long-term gas portfolio, E.ON Ruhrgas engages in gas, oil and coal trading. The gas trading activities are concentrated at the national balancing point in the United Kingdom, at the Zeebrugge hub in Belgium and at the Title Transfer Facility in the Netherlands, and are mainly handled via brokers participating in open markets. Financial, oil and coal trading activities are undertaken mainly for hedging purposes. Proprietary trading is marginal compared to asset-based trading.

E.ON Ruhrgas total traded gas volume for 2005 was 5.9 percent of total E.ON Ruhrgas sales, as compared with 4.9 percent in 2004, with the increase being attributable to increased hedging activities reflecting the expansion of the arbitrage business in the markets in the United Kingdom, Belgium and the Netherlands.

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

Exploration and Production

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

United Kingdom. In the United Kingdom, E.ON Ruhrgas operates through its subsidiary E.ON Ruhrgas UK, which holds mainly minority interests in a number of gas production fields, exploration blocks and pipelines in the British North Sea. In November 2005, E.ON Ruhrgas completed the acquisition of Caledonia, which owns interests in 15 gas fields and two pipeline systems (as well as a trading business). Caledonia was renamed E.ON Ruhrgas UK North Sea Limited (E.ON Ruhrgas North Sea) in November 2005.

In 2005, E.ON Ruhrgas UK produced 4.5 billion kWh (406 million cubic meters (m^3)) of gas, compared with 4.0 billion kWh (353 million m^3) of gas in 2004. In 2005, this gas came from the Elgin/ Franklin fields, in which E.ON Ruhrgas UK holds a 5.2 percent interest, and from the Scoter field, in which E.ON Ruhrgas UK holds a 12.0 percent interest and which had its first year of full production in 2005. In addition, E.ON Ruhrgas UK produced 2.5 million barrels of liquids (oil and condensate) in 2005, which were sold on the market. Start of production from the Elgin/ Franklin satellite fields Glenelg and West Franklin (in which E.ON Ruhrgas UK holds interests of 18.57 percent and 5.2 percent, respectively) has been deferred to 2006 and 2007, respectively. In the last two months of 2005, E.ON Ruhrgas North Sea produced an aggregate of 0.8 billion kWh of gas (73 million m^3) from the former Caledonia gas fields Johnston (interest 50.107 percent), Ravenspurn North (interest 28.75 percent), Caister (interest 40.0 percent) and Schooner (interest 4.83 percent).

Norway. E.ON Ruhrgas operates in Norway through its subsidiary E.ON Ruhrgas Norge. E.ON Ruhrgas Norge completed the acquisition of a further 15.0 percent stake in the Njord oil and gas field in the Norwegian Shelf area of the North Sea in September 2005 and now owns 30.0 percent of this field. Currently, gas from this field is being re-injected to increase the rate of oil recovery. E.ON Ruhrgas Norge obtained 2.3 million barrels of oil as a result of its stake in 2005 which were sold on the market. The field is currently expected to begin producing gas for sale in 2007.

Russia. In July 2004, E.ON and Gazprom signed a Memorandum of Understanding for a deepened strategic cooperation between the parties, including gas production in Russia.

Liquefied Natural Gas

LNG, which is liquefied in the gas producing country, transported by tanker and then converted back into gas at the receiving terminal, is an alternative to gas deliveries by pipeline. E.ON is currently conducting a feasibility study on the construction of an LNG unloading and regasification terminal in Wilhelmshaven which would be Germany s first such facility. E.ON Ruhrgas has a majority shareholding in Deutsche Flüssigerdgas Terminal Gesellschaft mbH, which owns property to build the terminal in Wilhelmshaven, which, if built, could handle upon completion as much as 5 billion m^3 of natural gas per year and would have the flexibility to handle another 5 billion m^3 if required. According to initial calculations, the investments required would total

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approximately 500 million. No decision to build the terminal has yet been made, though its construction would be in line with E.ON s strategy of expanding its sources of natural gas with the goal of enhancing the security of its supply.

Transmission and Storage

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

Project companies are entities E.ON Ruhrgas has set up with German or European gas companies for a special purpose, such as establishing a pipeline connection between two countries or building and operating underground gas storage facilities. The following table provides more information on the E.ON Ruhrgas share in each of its German project companies as of December 31, 2005:

Project Company	E.ON Ruhrgas Share %
DEUDAN (DEUDAN Deutsch/ Dänische Erdgastransport-Gesellschaft mbH & Co. KG)	25.0
EGL (Etzel Gas-Lager GmbH & Co. KG)	74.8
GHG (GHG-Gasspeicher Hannover Gesellschaft mbH)	13.2
MEGAL (MEGAL Mittel-Europäische-Gasleitungsgesellschaft mbH & Co. KG)	51.0
METG (Mittelrheinische Erdgastransportleitungsgesellschaft mbH)	100.0
NETG (Nordrheinische Erdgastransportleitungsgesellschaft mbH & Co. KG)	50.0
NETRA (NETRA GmbH Norddeutsche Erdgas Transversale & Co. KG)	40.6
TENP (Trans Europa Naturgas Pipeline Gesellschaft mbH & Co. KG)	51.0

The E.ON Ruhrgas underground storage facilities are operated by E.ON Ruhrgas as storage system operator. The E.ON Ruhrgas transmission system is operated by E.ON Ruhrgas Transport, a wholly-owned subsidiary of E.ON Ruhrgas, as transmission system operator. The underground storage facilities and the transmission system are monitored and maintained largely by E.ON Ruhrgas. The transmission system is used to transport the gas that E.ON Ruhrgas and third party customers receive from suppliers at gas import points on the German border or at other supply points within Germany to customers or to storage facilities for later use.

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

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

E.ON Ruhrgas Technical Infrastructure

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

Pipelines. As of the end of 2005, E.ON Ruhrgas owned gas pipelines totaling 6,449 km and co-owned gas pipelines totaling 1,550 km with other companies. In addition, German project companies in which E.ON Ruhrgas holds an interest owned gas pipelines totaling 3,274 km at the end of 2005.

The following table provides more information on E.ON Ruhrgas pipelines in Germany as of December 31, 2005:

Pipelines	Total km	Maintained by E.ON Ruhrgas km
Owned by E.ON Ruhrgas	6,449	6,177
Co-owned pipelines	1,550	604
DEUDAN (PC)	110	0
EGL (PC)	67	67
MEGAL (PC)	1,080	1,080
METG (PC)	425	425
NETG (PC)	285	144
NETRA (PC)	341	106
TENP (PC)	966	966
Companies in which E.ON Ruhrgas holds a stake through its subsidiaries ERI and Thüga		2,046
Owned by third parties		1,075
Total in Germany	11,273	12,690

(PC) project company

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E.ON Ruhrgas share in the use of any particular pipeline it does not wholly own is determined by contract and is not necessarily related to E.ON Ruhrgas interest in the pipeline. E.ON Ruhrgas pipeline network is comprised of pipeline sections of varying diameters originally built according to the estimated capacity needed for the relevant section of the system. Currently, the pipeline network comprises 2,021 km of pipelines with a diameter of less than or equal to 300 millimeters, 3,030 km of pipelines with a diameter of more than 300 and less than or equal to 600 millimeters, 2,917 km of pipelines with a diameter of more than 600 and less than or equal to 900 millimeters, and 3,305 km of pipelines with a diameter of more than 900 and less than or equal to 1,200 millimeters.

In 2005, E.ON Ruhrgas maintained 6,177 km of its own pipelines, 604 km of co-owned pipelines, 1,075 km of pipelines owned by third parties and 2,046 km of pipelines owned by companies in which E.ON Ruhrgas holds a stake through its subsidiaries ERI and Thüga, as well as 2,788 km of pipelines owned by project companies in which E.ON Ruhrgas holds an interest. In total, E.ON Ruhrgas maintained (including providing local monitoring) 12,690 km of pipelines in 2005. For information on pipeline monitoring and maintenance, see Monitoring and Maintenance below.

In addition to its German transmission system, E.ON Ruhrgas has a 23.59 percent interest in Interconnector, a U.K. project company that owns the Interconnector transmission system, comprising a 235 km undersea gas pipeline from the United Kingdom to Belgium, a transport compressor station at Bacton (four units with a total installed capacity of approximately 112 MW) and a compressor station at Zeebrugge (two units with a total installed capacity of approximately 70 MW).

In July 2004, E.ON Ruhrgas acquired a 20.0 percent interest in BBL Company V.O.F., a Dutch project company founded in July 2004, which is building a second undersea transmission system between continental Europe and the United Kingdom. Construction on this transmission system, which is expected to link Balgzand in the Netherlands to Bacton in the United Kingdom, began in December 2004.

E.ON Ruhrgas also owns a 3.0 percent interest in the Swiss project company Transitgas AG, which owns the Transitgas transmission system, running through Switzerland from Wallbach on the Swiss-German border and Rodersdorf on the French-Swiss border to Griespass on the Swiss-Italian border. The Transitgas system comprises pipelines totaling 293 km and one transport compressor station at Ruswil (four units with a total installed capacity of approximately 60 MW).

In September 2005, E.ON, Gazprom and BASF signed a basic agreement on the construction of the NEGP, which is currently planned to connect Vyborg on Russia s Baltic coast with Germany s Baltic coast, thereby providing an alternative undersea route for the supply of Russian natural gas to Germany, as compared with the current land routes through Ukraine and Poland. As a first step, the three joint venture partners have formed a Swiss company, in which Gazprom holds a 51.0 percent interest and E.ON Ruhrgas and BASF s subsidiary Wintershall each hold 24.5 percent stakes. Although work has started on connecting the current Russian gas infrastructure to the proposed landing site in Vyborg, no decision to build the pipeline has been taken and it is not expected that the pipeline could be completed before 2010 at the earliest. Gazprom is expected to decide to build the pipeline. E.ON Ruhrgas and Wintershall have only committed to join the feasibility study and have a right to step back and not join the construction depending on the result of the feasibility study. E.ON Ruhrgas initial investment in the joint-venture company was only CHF 245,000 (158,900). However, current estimates put E.ON Ruhrgas s share of the expected cost of the complete project, if built, at approximately 1 billion.

Compressor Stations. Compressor stations are used to produce the pressure necessary to transport gas through pipelines and to inject gas into underground storage facilities. E.ON Ruhrgas owns or co-owns 15 compressor stations, nine operating for gas transportation purposes (with a total installed capacity of 305 MW), and six for gas storage purposes (with a total installed capacity of 79 MW). German project companies in which E.ON Ruhrgas holds an interest own an additional 17 transport compressor stations with a total installed capacity of 537 MW and two storage compressor stations with a total installed capacity of 17 MW. In 2005, E.ON Ruhrgas provided monitoring and maintenance services under service contracts for the nine transport compressor stations leased out to E.ON Ruhrgas Transport and 13 transport compressor stations of the project companies. E.ON Ruhrgas also operated, monitored and maintained its six compressor stations operating for gas

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storage purposes. The current installed capacity of the compressor stations monitored and maintained by E.ON Ruhrgas totals 853 MW.

The following table provides more information about E.ON Ruhrgas and its project companies gas compressor stations in Germany as of December 31, 2005:

Owned by	Compressor Stations	Compressor Units	Total Installed Capacity MW	Compressor Units Monitored and Maintained by E.ON Ruhrgas	Installed Capacity of Compressor Units Monitored and Maintained by E.ON Ruhrgas MW
E.ON Ruhrgas (transportation and storage)	15	44	384	44	384
DEUDAN (PC) (transportation)	2	4	16	0	0
EGL (PC) (storage)	1	2	13	0	0
GHG Hannover (PC) (storage)	1	3	4	0	0
MEGAL (PC) (transportation)	5	17	179	17	179
METG (PC) (transportation)	2	9	99	9	99
NETG (PC) (transportation)	2	5	50	2	20
NETRA (PC) (transportation)	2	5	42	3	20
TENP (PC) (transportation)	4	15	151	15	151
Total in Germany	34	104	938	90	853

(PC) project company

Due to the complexity of the transmission system together with transmission rights and rights of beneficial use, as well as the number and complexity of factors influencing pipeline utilization, such as temperature, the volume of gas transported and the availability of compressor units, no meaningful data on the utilization of the transmission system is available. E.ON Ruhrgas had sufficient pipeline capacity in prior years and booked sufficient pipeline capacity in 2005. E.ON Ruhrgas believes that a shortage of pipeline capacity is not a material risk in the foreseeable future.

Storage. Underground gas storage facilities are generally used to balance gas supplies and heavily fluctuating demand patterns. For example, the gas sent out by E.ON Ruhrgas on a cold winter day is roughly four times as high as that on a hot summer day, while the flow of gas produced and purchased is much more constant. For this reason, E.ON Ruhrgas injects gas into storage facilities during warm weather periods and withdraws it in cold weather periods to cope with peak demand. E.ON Ruhrgas stores gas in large underground gas storage facilities, which are located in

porous rock formations (depleted gas fields or aquifer horizons) or in salt caverns. Underground gas storage facilities consist of an underground section (cavity or porous rock and wells) and an above-ground part, namely the storage compressor station. As of the end of 2005, E.ON Ruhrgas owned five storage facilities, co-owned another two storage facilities and leased capacity in two storage facilities in order to meet its gas storage requirements. In addition, E.ON Ruhrgas had storage capacity available through two project companies in which it is a shareholder. Through these owned, co-owned, leased and project company storage facilities, a working gas storage capacity of approximately 5.1 billion m^3 was available to E.ON Ruhrgas in 2005. Due to the number and complexity of factors influencing storage utilization, particularly temperature and the terms of supply and delivery contracts, E.ON Ruhrgas does not consider data on the utilization of gas storage capacity to be meaningful. E.ON Ruhrgas had sufficient storage capacity available both in 2005 and in prior years and does not consider a shortage of gas storage capacity to be a material risk in the foreseeable future. However, depending on a number of factors such as future gas sent out, E.ON Ruhrgas gas supply and delivery situation and further gas sales potential in the United Kingdom, E.ON Ruhrgas intends to increase working gas capacity by enlarging existing storage facilities, building new facilities and by leasing additional gas storage capacity in the future. For information about risks related to the reliability of gas supplies, see also Item 3. Key Information

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Risk factors. The following table provides more information about E.ON Ruhrgas underground gas storage facilities, all of which are situated in Germany, as of December 31, 2005:

Underground Storage Facilities	E.ON Ruhrgas Share in Working Capacity (million m^3)	E.ON Ruhrgas Share in Maximum Withdrawal Rate (thousand m^3/hour)	Owned by	E.ON Ruhrgas Share in Storage Facility or in the Project Company %	Operated by E.ON Ruhrgas
Bierwang(P)	1,300	1,200	E.ON Ruhrgas	100.0	Yes
Empelde(C)	18	39	GHG-Gasspeicher Hannover Gesellschaft mbH(PC)	13.2	
Epe(C)	1,657	2,450	E.ON Ruhrgas	100.0	Yes
Eschenfelden(P)	48	87	E.ON Ruhrgas/N-ERGIE AG	66.7	Yes
Etzel(C)	383	987	Etzel Gas-Lager GmbH & Co. KG(PC)	74.8	
Hähnlein(P)	80	100	E.ON Ruhrgas	100.0	Yes
Krummhörn(C)(1)	0	0	E.ON Ruhrgas	100.0	Yes
Sandhausen(P)	15	23	E.ON Ruhrgas/Gasversorgung Süddeutschland GmbH	50.0	Yes
Stockstadt(P)	135	135	E.ON Ruhrgas	100.0	Yes
Breitbrunn(P)	970(2)	520	RWE Dea AG/ExxonMobil Gasspeicher Deutschland GmbH(3)/ E.ON Ruhrgas (4)	Leased(3)	Yes(4)
Inzenham-West(P)	500	300	RWE Dea AG	Leased	
Total	5,106	5,841			

(C) salt cavern

(P) porous rock
(PC) project company
(1) Currently out of service for repairs/adjustments.

(2) 965 million m^3 was contractually guaranteed in 2004/05; 970 million m^3 is the current working gas capacity available to E.ON Ruhrgas.

(3) Underground section.

(4) Above ground part, particularly the storage compressor station.

Monitoring and Maintenance. In 2005, E.ON Ruhrgas carried out for itself and under service contracts for E.ON Ruhrgas Transport and some of the project companies E.ON Ruhrgas holds an interest in, monitoring and maintenance services for almost all of the E.ON Ruhrgas transmission system and its underground storage facilities.

Transmission system and underground storage monitoring operations are centered at E.ON Ruhrgas dispatching facility in Essen. Among other tasks, the center keeps the technical infrastructure under continual surveillance, handles all reports of disturbances in the system and arranges for the necessary response to any disturbance report. In 2005, E.ON Ruhrgas performed this kind of system monitoring for about 12,600 km of pipelines, 22 transport compressor stations, one storage compressor station and seven underground storage facilities. Management of operations, general maintenance (including local monitoring) and troubleshooting are handled by the E.ON Ruhrgas field stations and facilities located along the network. E.ON Ruhrgas also deploys mobile units from these stations and facilities to carry out maintenance and repair work. For certain sections of pipelines, primarily those where no field station or facility is located nearby, maintenance (including local monitoring) is performed by third parties under service contracts. E.ON Ruhrgas dispatching, monitoring and maintenance processes are regularly certified under International Standards Organization (ISO) 9001:2000

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(quality management), ISO 14001 (environmental management), OHSAS 18001, an Occupational Health and Safety Assessment Series for health and safety management systems (work safety management) and TSM, the Technical Safety Management rules of DVGW (The German Technical and Scientific Association for Gas and Water). DVGW is a self-regulatory body for the gas and water industries, its technical rules serving as a basis for ensuring safety and reliability of German gas and water supplies.

E.ON Ruhrgas Transport. On January 1, 2004, in fulfillment of one of the requirements of the ministerial approval authorizing E.ON s acquisition of Ruhrgas, E.ON Ruhrgas transferred its gas transmission business to a new subsidiary, E.ON Ruhrgas Transport. E.ON Ruhrgas Transport has sole responsibility for the gas transmission business, including technical responsibility for the transmission system, and functions independently of E.ON Ruhrgas sales business, which is a customer of E.ON Ruhrgas Transport. As the transmission system operator, E.ON Ruhrgas Transport operates and controls the E.ON Ruhrgas transmission system and handles all major functions needed for an independent gas transmission business: transmission management, transportation contracts (including access fees), shipper relations, planning, controlling and billing. E.ON Ruhrgas Transport obtains certain support services from E.ON Ruhrgas AG under service agreements. In connection with the Energy Law of 2005, the scope of support services was reduced as follows during 2005: (1) as from September 1, 2005, E.ON Ruhrgas Transport s employees handled all capacity planning and capacity allocation and (2) as from December 1, 2005, they handled the commercial transport operations.

On November 1, 2004, E.ON Ruhrgas Transport introduced an entry/exit system called ENTRIX for access to the E.ON Ruhrgas gas transmission system as a result of an agreement reached with the Competition Directorate-General of the European Commission (the Competition Directorate) with respect to a matter that had been pending before the Competition Directorate. ENTRIX enables customers to book entry and exit capacities for the transmission of gas separately, in different amounts and at different times. Booked capacities can be transferred at short notice and combined with capacities of other customers of E.ON Ruhrgas Transport. The fee structure is simple and applies to five zones into which the transmission system of E.ON Ruhrgas has been divided. The level of transmission fees is determined by reference to European markets and pipeline and transport competition in Germany. Customers also benefit from the introduction of local exit zones within which they can use capacities flexibly. According to the agreement reached with the Competition Directorate, E.ON Ruhrgas has to reduce the number of fee zones to four in 2006, unless the company is able to demonstrate that technical, qualitative, economic or other reasons make such reduction of zones impossible.

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

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

Sales

Germany. E.ON Ruhrgas was the largest distributor of natural gas in Germany in 2005, selling a total volume of 555 billion kWh of gas. E.ON Ruhrgas also sold 135.2 billion kWh of gas outside of Germany in 2005. The following map illustrates the sales area of E.ON Ruhrgas in Germany:

E.ON Ruhrgas sells gas to regional and supraregional distributors, municipal utilities and industrial customers. The following table sets forth information on the sale of gas by E.ON Ruhrgas sales business in Germany for the periods presented:

Sale of Gas to:	**Total 2005 billion kWh**	**%**	**Total 2004 billion kWh**	**%**
Distributors	323.7	58.3	328.7	59.3
Municipal utilities	160.9	29.0	156.1	28.2
Industrial customers	70.4	12.7	69.0	12.5
Total	555.0	100.0	553.8	100.0

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

E.ON Ruhrgas sales contracts vary depending on the type of customer. The majority of E.ON Ruhrgas customers are distributors and municipal utilities. Most of these contracts are long-term contracts. In many cases, especially concerning municipal utilities, E.ON Ruhrgas has offered rights to reduce the contractual amounts by October 1, 2006 or 2007 combined with an early termination by October 1, 2008 (see Competitive Environment). Price terms in all types of supply contracts are generally pegged to the price of competing fuels, primarily gas oil or heavy fuel oil, and provide for automatic quarterly price adjustments based on fluctuations in

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

Two requirements of the ministerial approval approving E.ON s acquisition of E.ON Ruhrgas related to gas sales contracts. The option of reducing the volume of gas that was granted to most distributors and municipal utilities for the remaining term of the relevant contract was in most cases not exercised for the gas years ending September 30, 2005 or 2006. Exercising this option will remain possible until these contracts end. The second requirement of the ministerial approval, obliging E.ON Ruhrgas to grant two larger regional distributor customers in which E.ON Ruhrgas previously held an interest the right to a staged termination of their contracts, has become obsolete as these companies have signed new contracts with E.ON Ruhrgas.

In 2005, gas prices in Germany continued to rise, due primarily to the rise in the price of oil. E.ON Ruhrgas has in certain cases responded to competitive pressure by re-negotiating the terms of sales contracts with major customers. See also Competitive Environment.

International. In 2005, E.ON Ruhrgas delivered 135.2 billion kWh of gas to customers in other European countries, or 19.6 percent of the total volume of gas sold by E.ON Ruhrgas, compared with 87.6 billion kWh or 13.7 percent in the period from January to December 2004. The destinations for E.ON Ruhrgas external sales are the United Kingdom, Switzerland, the Benelux countries, Austria, Hungary, Luxembourg, Italy, France, Denmark, Sweden, Poland and Liechtenstein. The 54.3 percent increase in international sales in 2005 was largely attributable to long-term supply contracts with E.ON UK (starting in October 2004) and E.ON Sverige (starting in October 2005). However, E.ON Ruhrgas sales to other international customers are increasingly made on the basis of short-term contracts. Limitations on available gas transportation capacity across the relevant borders may restrict E.ON Ruhrgas ability to expand its external sales business to certain countries. See also U.K. Energy Wholesale Energy Trading and Nordic Gas Distribution.

Downstream Shareholdings

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

ERI holds primarily minority shareholdings in European integrated and regional gas distribution companies and in German regional gas distribution companies, while Thüga holds primarily minority shareholdings in about 100 regional and municipal utilities in Germany. In addition, Thüga s main international shareholdings, most of which are held through its wholly owned Italian subsidiary Thüga Italia S.r.l. (Thüga Italia), are its majority shareholdings in five Italian gas distribution companies and one sales company, as well as two minority shareholdings in other Italian energy companies, including one municipal utility.

ERI: As of December 31, 2005, ERI s portfolio of shareholdings included primarily minority stakes in three domestic and 17 foreign companies. In 2005, ERI (including its fully consolidated shareholdings) contributed sales of 891.9 million (approximately 6.0 percent of E.ON Ruhrgas total sales, excluding natural gas and electricity taxes) and had sales volumes of 46.5 billion kWh in 2005 (2004: 30.1 billion kWh).

In March 2006, ERI expects to acquire shareholdings in certain businesses of the Hungarian gas company MOL. For details, see Overview.

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Germany. As of December 31, 2005, ERI held interests in the following regional gas distribution companies:

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

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

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

International. As of December 31, 2005, ERI held interests in the following operating companies in countries outside of Germany, primarily in central Europe and the Nordic region:

Shareholding	Share held by ERI %
Gasnor AS, Norway	14.00
Nova Naturgas AB, Sweden	29.59
Gasum Oy, Finland	20.00
AS Eesti Gaas, Estonia	33.66
JSC Latvijas Gaze, Latvia	47.23
AB Lietuvos Dujos, Lithuania	38.91
therminvest Sp.z o.o., Poland(1)	100.00
Inwestycyjna Spolka Energetyczna Sp.z o.o. (IRB), Poland	50.00
Szczencinska Energetyka Cieplna Sp.z o.o. (SECS), Poland(1)	32.13
EUROPGAS a.s., Czech Republic(2)	50.00
Colonia-Cluj-Napoca-Energie S.R.L. (CCNE), Romania	33.33
E.ON Ruhrgas Mittel- und Osteuropa GmbH(3)	100.00
Nafta a.s., Slovakia	40.27
S.C. Congaz S.A., Romania	28.59
Ekopur d.o.o., Slovenia(4)	100.00
SOTEG Société de Transport de Gaz S.A., Luxembourg	20.00
Holdigaz SA, Switzerland	2.21

(1) The shareholdings in these companies are expected to be transferred to E.DIS energia sp.z o.o. of the Central Europe market unit in 2006.

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

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

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

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

Thüga: Thüga holds primarily minority shareholdings in about 100 regional and municipal utilities in Germany. In addition, Thüga s main international shareholdings, most of which are held through its wholly owned Italian subsidiary Thüga Italia, are its majority shareholdings in five Italian gas distribution companies and one sales company, as well as two minority shareholdings in other Italian energy companies, including one

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municipal utility. Through its majority and minority shareholdings in Italian gas distribution and sales companies, Thüga supplied natural gas to approximately 750,000 end customers in Italy in 2005, primarily in the regions of Lombardy, Emilia Romagna, Veneto, Friuli Venezia-Giulia and Piedmont. With respect to its minority shareholdings, Thüga is an active shareholder, offering operational competence as well as other services. In 2005, Thüga contributed sales of 956.1 million (approximately 6.5 percent of E.ON Ruhrgas total sales, excluding natural gas and electricity taxes). Thüga increased its gas sales volumes by 7.7 percent to 22.5 billion kWh in 2005 from 20.9 billion kWh in 2004, primarily as a result of changes in the scope of consolidation of the Italian business.

As of December 31, 2005, E.ON Ruhrgas Thüga Holding GmbH held 81.1 percent of Thüga and E.ON Energie, through its subsidiary Contigas, held the remaining 18.9 percent.

Among other acquisitions in 2005, in July Thüga acquired an additional 21.2 percent of HEAG Südhessische Energie AG (HSE) from ERI.

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

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

International. As of December 31, 2005, Thüga held mainly the following shareholdings in privately owned gas distribution and sales companies as well as in one municipal utility in Italy:

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

Competitive Environment

Along with oil and lignite/hard coal, natural gas is one of the three primary sources of energy used in Germany. Gas is currently used for a little more than 20 percent of Germany s energy consumption and satisfies about a third of the energy demand of the German industrial and commercial/residential sectors. Competing sources of energy include

electricity and coal in all sectors, gas oil and district heating in the commercial/residential sector and gas oil and heavy fuel oil in the industrial sector. Natural gas is also used, but to a more limited extent, as an energy source for power stations. Since the 1970s, natural gas has made particular gains in

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the residential space heating market, where it is marketed as a modern and environmentally-friendly energy source for heating homes. At year-end 2005, approximately 48 percent of German homes were heated using gas, making gas the leading energy source for this market. In 2005, gas was chosen as the heating method for approximately 75 percent of new homes under construction.

The German gas market has always been characterized by competition. Approximately 15 independent companies are active in the regional and supraregional distribution of gas. Competition has increased since the early 1990s, when Wingas entered the gas transmission market by building its own pipeline infrastructure. Wingas pipeline network currently has a length of more than 2,000 km, compared with the E.ON Ruhrgas pipeline network length of over 11,000 km. The market entry of Wingas has led to increased price competition not only in areas close to the Wingas system, but all over Germany. Since 2000, when the first association agreement was signed, third party access has developed dynamically. Since July 2005, access to German gas networks has been governed by a new legal framework which is set forth in the Energy Law of 2005. For information on this new legal framework, see Regulatory Environment.

Within the German gas market, E.ON Ruhrgas competes with domestic and foreign gas companies, the gas subsidiaries of oil producers and pure trading companies. Major domestic competitors include RWE Energy, Shell and ExxonMobil as successors of the former BEB sales division, Verbundnetz Gas AG (VNG) and Wingas, while foreign competitors include Gaz de France, BP Energie, Econgas, Ecoswitch, Essent and Nuon. E.ON Ruhrgas currently enjoys a strong market position, supplying approximately 56 percent of all gas consumed in Germany in 2005. Nevertheless, E.ON Ruhrgas considers competition in the German gas market to be vigorous, with both new and established competitors vying for the business of E.ON Ruhrgas direct and indirect customers. E.ON Ruhrgas believes it was able to successfully compete in 2005 by remaining flexible in its contract and price negotiations and by offering attractive terms and services to its established and potential customers. Due to likely increasing competition in the transmission business in Germany, however, E.ON Ruhrgas Transport may not be able to renew some of its existing transportation contracts when they expire, or to gain new contracts. This may have the effect of leaving E.ON Ruhrgas Transport with excess transmission capacity.

Gas prices in gas supply contracts are mostly linked to the price of competing fuels, primarily gas oil or heavy fuel oil. The prices for end consumers fluctuate according to oil price developments as well, thereby maintaining competitive prices compared to oil products independent of oil price level. Gas prices in Germany are also affected by applicable taxes on fossil fuels. In Germany, customers in the commercial/residential sector pay gas prices that include at least 0.67 cent/kWh in duties and taxes, while industrial customers pay up to 0.47 cent/kWh in duties and taxes. In 2005, global energy prices rose significantly, though natural gas prices rose less steeply than oil prices. Like other gas companies, E.ON Ruhrgas adjusted its sales prices in 2005 to reflect the higher price levels. In addition, rising oil prices led to further gas price increases as of the beginning of 2006, and more increases are expected in 2006 due to the price linkage between oil and gas. Recently there have been massive consumer complaints on rising gas prices. For information on investigations of gas prices charged by some German utilities, including utilities in which E.ON Ruhrgas and E.ON Energie hold interests, see Item 3. Key Information Risk Factors.

In the context of the debate on long-term contracts, which the Federal Cartel Office (*Bundeskartellamt*) considers to be an obstacle to competition, E.ON Ruhrgas has offered those of its German distribution customers and municipal utilities that are supplied with more than 50 percent of their total gas requirements by E.ON Ruhrgas the termination of the existing contracts by October 1, 2008 in conjunction with a right to reduce their contractual amounts to 50 percent of their total gas purchases by either October 1, 2006 or October 1, 2007. Currently there is no indication as to how many customers will accept this offer. Sales contracts with distribution companies, where E.ON Ruhrgas supplies less than 50 percent of their total gas purchases, and with industrial customers are not affected. In connection with an agreement reached with the Competition Directorate-General of the European Commission, E.ON Ruhrgas also introduced an entry/exit system for third party access to its gas transmission system in November 2004. For details, see Transmission and Storage E.ON Ruhrgas Transport. In E.ON Ruhrgas opinion, these actions have had a considerable influence on the competitive environment in Germany. In addition, the Second Gas Directive and the Energy Law of 2005 are expected to further change competition in the gas industry. See Regulatory Environment. E.ON Ruhrgas cannot

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currently predict the form and extent of such changes, or whether these changes will have a negative effect on E.ON Ruhrgas ability to compete and results of operations. See also Item 3. Key Information Risk Factors.

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

U.K.

Overview

E.ON UK is one of the leading integrated electricity and gas companies in the United Kingdom. It was formed as one of the four successor companies to the former Central Electricity Generating Board as part of the privatization of the electricity industry in the United Kingdom in 1989. E.ON UK and its associated companies are actively involved in electricity generation, distribution, retail and trading. As of December 31, 2005, E.ON UK owned or through joint ventures had an attributable interest in 10,547 MW of generation capacity, including 577 MW of CHP plants and 233 MW of operational wind and hydroelectric generation capacity. E.ON UK served approximately 8.6 million electricity and gas customer accounts at December 31, 2005 and its Central Networks business served 4.9 million customer connections. The U.K. market unit recorded sales of 10.2 billion in 2005 and adjusted EBIT of 963 million.

Operations

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

E.ON UK operates significant wholesale and retail gas businesses and engages in gas trading. The company served approximately 8.6 million customer accounts at December 31, 2005, including approximately 5.6 million electricity customer accounts, 2.8 million gas customer accounts and 0.1 million industrial and commercial electricity and gas customer accounts. With effect from July 2006, 0.1 million fixed line telephone customer accounts previously serviced by Powergen are expected to be sold to Telstra, which already manages these accounts. E.ON UK s Central Networks distribution business served 4.9 million customer connections as of the end of 2005.

In the first half of 2005, E.ON UK acquired, in two tranches, 100 percent of the equity of Enfield Energy Centre Ltd. (Enfield) from NRG, El Paso and Indeck. Enfield operates a gas-fired power station near London. With an installed capacity of 392 MW, the power station can generate enough electricity for 300,000 homes. In July 2005, E.ON UK acquired Holford Gas Storage Limited (HGSL) from Scottish Power Energy Management Limited. HGSL was formed to develop one of the U.K. s largest underground gas storage facilities in Cheshire in northwest England, a project for which it has already received planning approval.

The U.K. market unit comprises the non-regulated business, including energy wholesale (generation and energy trading) and retail, the regulated distribution business, and other activities, such as certain non-distribution assets and the E.ON UK corporate center. In 2005, electricity accounted for approximately 68 percent of E.ON UK s sales, gas revenues accounted for approximately 32 percent and other activities accounted for less than 1 percent.

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The following table sets forth the sources and sales channels of electric power in E.ON UK s operations during each of 2005 and 2004:

Sources of Power	Total 2005 million kWh	Total 2004 million kWh	% Change
Own production(1)	37,255	34,916	+6.7
Purchased power from power stations in which E.ON UK has an interest of 50 percent or less	627	2,047	-69.4
Power purchased from other suppliers(2)	39,224	47,087	-16.7
Power used for operating purposes, network losses and pump storage	(2,114)	(1,976)	+7.0
Net power supplied(3)	74,992	82,074	-8.6
Sales of Power			
Mass market sales (residential customers and small and medium sized enterprises)	37,314	36,189	+3.1
Industrial and commercial sales(4)	22,301	26,528	-15.9
Market sales(2)	15,377	19,357	-20.6
Net power sold(3)	74,992	82,074	-8.6

(1) The increase in own production in 2005 was primarily attributable to the fact that the Killingholme power plant was returned to service and the Enfield power station was acquired in 2005.

(2) Power purchased from other suppliers and market sales decreased in 2005 compared with 2004 primarily due to lower sales to industrial and commercial customers and optimization decisions associated with E.ON UK s hedging strategy.

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

(4) During 2005, the industrial and commercial sales business continued to focus on securing profitable customers, which resulted in lower sales volumes in 2005 compared with 2004.

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

Sources of Gas	Total 2005 million kWh	Total 2004 million kWh	% Change

Long-term gas supply contracts	48,431	49,494	-2.1
Market purchases	134,041	126,400	+6.0
Total gas supplied(1)	182,472	175,894	+3.7

Sale and Use of Gas

Gas used for own generation	40,318	39,023	+3.3
Sales to industrial and commercial customers(2)	32,590	35,946	-9.3
Sales to retail mass market customers	67,671	66,221	+2.2
Market sales	41,893	34,704	+20.7
Total gas used and sold(1)	182,472	175,894	+3.7

(1) Excluding proprietary trading volumes. For information on proprietary trading volumes, see Energy Wholesale Energy Trading.

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(2) During 2005, the industrial and commercial sales business continued to focus on securing profitable customers, which resulted in lower sales volumes in 2005 compared with 2004.

Market Environment

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

Electricity. Demand for electricity in the United Kingdom has been relatively stable in recent years. In the near term, E.ON UK expects electricity demand in the United Kingdom to grow by an average of between 1 to 2 percent per annum under normal weather conditions.

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

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

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

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

However, since April 2003, increasing generation fuel costs, security of supply concerns and expected future environmental costs (including the introduction of CO_2 emission certificates) have combined to push up wholesale electricity prices for forward delivery substantially. Baseload prices for 2006 delivery increased from approximately GBP29 per MWh in January 2005 up to GBP52 per MWh in December 2005. Short-term electricity prices exhibited significant volatility during 2005 due mainly to volatile fuel input prices. In response to these increases in wholesale prices, U.K. suppliers, including E.ON UK, increased their retail electricity prices a number of times during 2005, as explained in more detail in Retail below.

Natural Gas. Wholesale gas prices in the United Kingdom increased in absolute terms and were more volatile during 2005, driven by higher oil prices and supply and demand imbalances in the United Kingdom and continental Europe. Annual prices for 2006 delivery increased from approximately 32 pence per therm in January 2005 to 62 pence per therm in December 2005. Although E.ON UK purchases gas on both U.K. and international trading markets, management partially mitigated these price increases by secured forward purchases to cover most of its requirements in 2005, switched fuel sources used by certain of its generating assets and increased retail prices. As noted above, E.ON UK and all of its main competitors either increased or announced increases in retail customer prices during 2005.

Competition. E.ON UK s exposure to wholesale electricity prices in the United Kingdom is partially hedged by the balance provided by its retail business. The retail energy market in the United Kingdom has consolidated over the last few years into six major competitors. Based on data from Datamonitor, Centrica, previously the monopoly gas supplier branded as British Gas, is currently the market leader in terms of size in

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both gas and electricity with approximately 17.8 million customer accounts. E.ON UK is the second largest energy retailer with approximately 8.6 million accounts, followed by Scottish and Southern Electricity with approximately 6.4 million accounts. The market is characterized by substantial levels of customers switching suppliers in any given year; approximately half of the customers in the United Kingdom have now switched either their gas or electricity supplier since market liberalization. However, churn levels, which measure the percentage of customers switching suppliers, have fallen since 2002 as the market has matured. E.ON UK reduced its annual churn rate from 15.4 percent in 2004 to 14.7 percent in 2005.

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

The U.K. s renewables obligation required electricity retailers to source an increasing amount of the electricity they supply to retail customers from renewable sources. Under the current regime, for the period from April 1, 2005 until March 31, 2006, the renewables obligation is equal to 5.5 percent, rising to a figure of 15.4 percent by 2015/2016, at which point it is to remain stable until 2026/27. The requirement applies to all retail sales over a twelve-month period beginning on April 1 of each year, and Renewables Obligation Certificates (ROCs) are issued to generators as evidence of qualified sourcing. ROCs are tradeable, and retailers who fail to present Ofgem with ROCs representing the full amount of their renewables obligation are required to make a balancing payment in the amount of any shortfall into a buy-out fund. Receipts from the buy-out fund are re-distributed to holders of ROCs.

The United Kingdom implemented the EU Emissions Trading Directive at the beginning of 2005. The scheme requires companies to have CO_2 emission certificates in an amount equal to the CO_2 emissions made by their fossil fuel-fired power plants with a thermal input of more than 20 MW. During 2005, the U.K. government made an initial allocation of certificates for the first phase of the scheme (2005 to 2007) to owners of generating facilities, with the total number of certificates being issued equal to less than 90 percent of emissions levels in recent years. As a result, E.ON UK had to buy 4.7 million tons of additional allowances in 2005.

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

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

Non-regulated Business

Energy Wholesale

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

Power Generation

E.ON UK focuses on maintaining a low cost, efficient and flexible electricity generation business in order to compete effectively in the wholesale electricity market. As of December 31, 2005, E.ON UK owned either wholly, or through joint ventures, power stations in the United Kingdom with an attributable registered generating capacity of 10,547 MW, including 577 MW of CHP plants and 50 MW of hydroelectric plant, while its

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attributable portfolio of operational wind capacity stood at 183 MW. The increase in E.ON UK s generation capacity during the year reflected the return to service of the Killingholme plant and the purchase of the Enfield plant, offset in part by the return of the Speke CHP plant to the former client at the end of the contract as described below. Despite the increase, E.ON UK s share of the generation market in Great Britain remained relatively stable in 2005, at approximately 10 percent.

E.ON UK generates electricity from a diverse portfolio of fuel sources. In 2005, approximately 56 percent of E.ON UK s electricity output was fuelled by coal and approximately 42 percent by gas, of which approximately eight percent was from CHP schemes, with the remaining two percent being generated from hydroelectric, wind and oil-fired plants. E.ON UK is continuing its effort to secure a balanced and diverse portfolio of fuel sources, giving it the flexibility to respond to market conditions and to minimize costs.

E.ON UK also regularly monitors the economic status of its plant in order to respond to changes in market conditions. This flexibility was demonstrated during 2005, when E.ON UK shut down two oil-fired units at Grain for the summer, and then returned these two units for winter use later in the year. Both CCGT modules at Killingholme were also returned to service at full capacity during 2005, the first time a CCGT plant had been returned to service after being mothballed in the U.K. Both actions were in response to increasing market prices which made the resumed operation of both plants economically attractive.

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The following table sets forth details about E.ON UK s electric power generation facilities in the United Kingdom, including their total capacity, the stake held by E.ON UK and the capacity attributable to E.ON UK for each facility as of December 31, 2005, as well as their start-up dates:

E.ON UK ELECTRIC POWER STATIONS

		E.ON UK s Share		
Power Plants	**Total Capacity Net MW**	**%**	**Attributable Capacity MW**	**Start-up Date**
Hard Coal				
Ironbridge U1(1)	485	100.0	485	1970
Ironbridge U2(1)	485	100.0	485	1970
Kingsnorth U1(1)	485	100.0	485	1970
Kingsnorth U2(1)	485	100.0	485	1971
Kingsnorth U3(1)	485	100.0	485	1972
Kingsnorth U4(1)	485	100.0	485	1973
Ratcliffe U1(1)(2)	500	100.0	500	1968
Ratcliffe U2(1)(2)	500	100.0	500	1969
Ratcliffe U3(1)(2)	500	100.0	500	1969
Ratcliffe U4(1)(2)	500	100.0	500	1970
Total	4,910		4,910	
Natural Gas				
Cottam Development Centre (CDC) Module	400	100.0	400	1999
Connahs Quay U1	345	100.0	345	1996
Connahs Quay U2	345	100.0	345	1996
Connahs Quay U3	345	100.0	345	1996
Connahs Quay U4	345	100.0	345	1996
Corby Module	401	50.0	200	1993
Enfield	392	100.0	392	2002
Killingholme Mod 1	450	100.0	450	1992
Killingholme Mod 2	450	100.0	450	1993
Total	3,473		3,272	
Oil				
Grain U1	650	100.0	650	1982
Grain U4	650	100.0	650	1984
Total	1,300		1,300	

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Power Plants	Total Capacity Net MW	E.ON UK s Share %	E.ON UK s Share Attributable Capacity MW	Start-up Date
Other (including hydroelectric and wind farms)				
Grain Aux GT1	28	100.0	28	1979
Grain Aux GT4	27	100.0	27	1980
Kingsnorth Aux GT1	17	100.0	17	1967
Kingsnorth Aux GT4	17	100.0	17	1968
Ratcliffe Aux GT2	17	100.0	17	1967
Ratcliffe Aux GT4	17	100.0	17	1968
Taylors Lane GT2	68	100.0	68	1981
Taylors Lane GT3	64	100.0	64	1979
Hydroelectric	50	100.0	50	1962
Wind farms	197	various	183	various
Total	502		488	
CHP schemes	577	100.0	577	various
Total Capacity	**10,762**		**10,547**	

(1) Biomass material co-fired during 2005.

(2) In June 2005, Ratcliffe-on-Soar power station successfully completed an 18-month trial to co-fire petcoke, a mixture of coal and gas. The trial was required by the U.K. Environmental Agency before permission could be given to move to commercial scale co-firing. A report on the trial has been submitted to the Environmental Agency, together with an application to move to commercial scale co-firing, and a decision is expected in 2006.

In addition, E.ON UK owns Edenderry Power Limited (Edenderry), which operates a 120 MW peat-fired plant in the Republic of Ireland. E.ON UK also owns a minority interest in a company that operates a gas-fired power plant in Turkey (see Midlands Electricity Non-Distribution Assets below).

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

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

During 2004, E.ON UK completed construction of a large offshore wind farm site with a capacity of approximately 60 MW at Scroby Sands off the coast of East Anglia. The Scroby Sands project builds on E.ON UK s success in commissioning the U.K. s first offshore wind farm at Blyth during 2001. Potential onshore and offshore projects with an aggregate capacity of approximately 1,100 MW are now in the development phase (compared with 770 MW in the development phase in 2004).

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

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

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

CHP. E.ON UK also operates large scale CHP schemes. CHP is an energy efficient technology which recovers heat from the power generation process and uses it for industrial processes such as steam generation, product drying, fermentation, sterilizing and heating. E.ON UK s total operational CHP electricity capacity at December 31, 2005 was 577 MW. Clients range across a number of sectors, including pharmaceuticals, chemicals, paper and oil refining. CHP capacity declined by 10 MW in 2005 due to the scheduled termination of the 10 year contract for the Speke CHP plant with Eli Lilly and Company Limited in November 2005. Under the terms of the contract, the asset was transferred back to the owner upon termination.

Energy Trading

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

Energy trading activities include:

- Purchasing of coal, gas and oil for power stations;
- Dispatching generation and selling the electrical output and ancillary services provided by E.ON UK s power stations;
- Purchasing gas and electricity as required for E.ON UK s retail portfolio;
- Managing the net position and risks of E.ON UK s generation and retail portfolio;
- Managing renewable obligations for the retail portfolio through long-term purchases and trading of ROCs;
- Purchasing and/or trading of CO_2 emission certificates and other environmental products, including Levy Exempt Certificates (issued in relation to the U.K. Climate Change Levy);
- Trading of weather derivatives, which assist in hedging volume variability in E.ON UK s retail business; and
- Achieving portfolio optimization and risk management.

E.ON UK also engages in a controlled amount of proprietary trading in gas, power, coal, oil and CO_2 emission certificates markets in order to take advantage of market opportunities and maintain the highest levels of market understanding required to support its optimization and risk management activities. The following table sets forth E.ON UK s electricity and gas proprietary trading volumes for 2005 and 2004:

Proprietary Trading Volumes	2005 Electricity billion kWh(1)	2004 Electricity billion kWh	2005 Gas billion kWh(1)	2004 Gas billion kWh
Energy bought	10.4	20.9	36.2	86.55
Energy sold	10.4	20.9	36.2	86.55
Gross volume	20.8	41.8	72.4	173.1

(1) The reduction in traded gas and electricity volumes in 2005 was primarily attributable to higher market prices, which reduced the volume of trading E.ON UK could conduct within the risk limits established by the Corporate Center.

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

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

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

Retail

E.ON UK sells electricity, gas and other energy-related products to residential, business and industrial customers throughout Great Britain. As of December 31, 2005, E.ON UK supplied approximately 8.6 million customer accounts, of which 7.9 million were residential customer accounts and 0.7 million were small and medium-sized business and industrial customer accounts. During the year, there was a net decrease in the total number of customer accounts of approximately 0.2 million as some customers switched suppliers in the wake of retail price increases described below. E.ON UK continues to focus on reducing the costs of its retail business, through efficiency improvements, more economical procurement of services and the utilization of lower cost sales channels.

Residential Customers. The residential business had approximately 7.9 million customer accounts as of December 31, 2005. Approximately 66 percent of E.ON UK s residential customer accounts are electricity customers and 34 percent are gas customers. Individual retail customers who buy more than one product (*i.e.*, electricity, gas or other energy-related products) are counted as having a separate account for each product, although they may choose to receive a single bill for all E.ON UK-provided services. In the residential customers sector, E.ON UK sold 28.4 TWh of electricity and 54.1 TWh of gas in 2005, as compared with 29.2 TWh of electricity and 51.5 TWh of gas in 2004.

E.ON UK targets residential customers through national marketing activities such as media advertising (including print, television and radio), targeted direct mail, public relations and online campaigns under its Powergen brand. E.ON UK also seeks to continue to exploit the high level of national awareness of its Powergen brand and has taken steps to enhance the strength of its brand, including the sponsorship of high profile, national sports competitions such as the Powergen Cups in Rugby Union and Rugby League. E.ON UK is also the main sponsor for Ipswich Town, a soccer team playing in the English Championship league.

In an environment of rising wholesale energy prices and increasing environmental costs, E.ON UK, like other suppliers, implemented a number of electricity and gas price increases affecting residential users in 2005 and the first quarter of 2006, though the precise level of increases varied by supplier. E.ON UK s increases in 2005 amounted to 7.2 percent for electricity and 11.9 percent for gas, while those in the first quarter of 2006 amounted to 18.4 percent for electricity and 24.4 percent for gas. At the same time, E.ON UK has also implemented a package of measures to limit the effects of rising wholesale costs on its most vulnerable customers, including free cavity wall insulation for customers aged 60 or over and offering free energy saving

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light bulbs to all its residential customers in 2005. These initiatives contribute to the requirements placed on suppliers in relation to the Energy Efficiency Obligations described in Regulatory Environment.

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

In June 2005, E.ON UK acquired 100 percent of Economy Power Ltd., which supplies 45,000 small and medium-sized business customers with electricity.

Other

E.ON UK brought together three separate businesses, metering, new connections and home installation, during November 2005 to form E.ON Energy Services, with the vision of providing E.ON UK customers with all the services they need to get connected to energy supplies, heat their homes and understand their energy use. E.ON Energy Services employs more than 2,300 people and manages over 2,000 contractors. Each year, E.ON Energy Services staff is expected to visit more than 12 million households and carry out work in 600,000 homes. The new energy services business was a part of both Central Networks and Retail during 2005. This business will be reported within the non-regulated segment beginning in 2006.

Regulated Business

Distribution

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

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

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

Distribution of Power to	Total 2005 million kWh	Total 2004 million kWh	% Change
Large non-domestic customers	26,129	26,610	-1.8
Domestic and small non-domestic customers	31,287	30,583	+2.3
Total	57,416	57,193	+0.4

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

network, as well as a five year performance target.

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Other

Midlands Electricity Non-Distribution Assets

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

NORDIC

Overview

E.ON Nordic s principal business is the generation, distribution, marketing, sale and trading of electricity, gas and heat, mainly in Sweden and Finland. In 2005, it operated through the two integrated energy companies in which it held majority stakes, E.ON Sverige (formerly Sydkraft), the second-largest Swedish utility (on the basis of electricity sales and production capacity), and E.ON Finland. E.ON Nordic and its associated companies are actively involved in the ownership and operation of power generation facilities. As of December 31, 2005, E.ON Nordic owned, through E.ON Sverige and E.ON Finland, interests in power stations with a total installed capacity of approximately 14,982 MW, of which its attributable share was approximately 7,570 MW (not including mothballed and shutdown power plants). On February 2, 2006, E.ON agreed to sell its entire interest in E.ON Finland to the Finnish utility Fortum. See E.ON Finland below.

In 2005, electricity accounted for approximately 70 percent of E.ON Nordic s sales, heat revenues accounted for approximately 15 percent, gas revenues accounted for approximately 7 percent and other activities accounted for approximately 8 percent. In 2005, E.ON Nordic had total sales of 3.5 billion (including 402 million of energy taxes) and adjusted EBIT of 806 million. E.ON Sverige accounted for 3.2 billion or approximately 92 percent of this sales total, while E.ON Finland accounted for the remaining 269 million or approximately 8 percent of E.ON Nordic s sales.

E.ON Sverige. E.ON Nordic is the largest shareholder in E.ON Sverige with a 55.3 percent equity and a 56.7 percent voting interest. Statkraft, the other shareholder in E.ON Sverige, has a put option allowing it to sell any or all of its 44.6 percent equity interest in E.ON Sverige to E.ON Energie at any time through December 15, 2007.

E.ON Sverige is active in the generation, distribution, marketing and sale of electricity. In 2005, it had a total installed generation capacity of 7,374 MW and generated 33,272 million kWh of electricity. E.ON Sverige generated about 50 percent of its electric power at nuclear power plants and about 46 percent at hydroelectric plants in 2005. The remaining 4 percent was generated using fuel oil, biomass, natural gas, wind power and waste. E.ON Sverige also supplies gas, is active in the heat and waste business and conducts electricity trading activities. In 2005, E.ON Sverige had sales of 3.2 billion. Electricity contributed approximately 71 percent, heat 14 percent, gas 8 percent and other 7 percent of 2005 sales. Other sales are mainly attributable to the waste business, as well as the company s other activities ElektroSandberg AB and E.ON Sverige Bredband AB. E.ON Sverige traded a total of approximately 73 TWh of electricity in 2005 (including both purchases and sales). E.ON Sverige is primarily active in Sweden. The company also operates to a minor degree in Finland, Denmark and Poland. In 2005, E.ON Sverige estimated that it supplied about 14 percent of the electricity consumed by end users in Sweden.

In 2003, E.ON Sverige acquired a majority stake in the Swedish utility Graninge. The stake was gradually increased to a 100 percent shareholding in the first half of 2004. As of the end of 2005, all of Graninge s Swedish activities had been fully integrated into E.ON Sverige s operations and are now carried out under the E.ON Sverige brand. This has resulted in cost savings net of integration costs in 2005. In September 2004, E.ON agreed further details regarding its agreement in principle with the Norwegian energy company Statkraft to sell a portion

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(1.6 TWh) of the generation capacity that E.ON Sverige had acquired as part of the Graninge acquisition to its minority shareholder Statkraft. This corresponds to approximately 5 percent of E.ON Sverige s annual electricity production, and approximately 50 percent of the capacity it acquired with the majority stake in Graninge. In July 2005, E.ON Sverige and Statkraft signed the corresponding agreement, whereby Statkraft would acquire a total of 24 hydroelectric power plants. In accordance with the agreement, Statkraft took ownership of the plants in October 2005.

On January 8 and 9, 2005, a severe storm hit Sweden and devastated large areas of forest in southern Sweden. This had a serious effect on the distribution grid, which in some areas was destroyed. Approximately 420,000 households in Sweden, including approximately 250,000 E.ON Sverige customers, were affected by power outages. Some customers, including E.ON Sverige customers, were left without electricity for several weeks. E.ON Sverige recorded related costs for rebuilding its distribution grid and compensating customers of approximately 140 million in 2005.

Sydkraft changed its legal name to E.ON Sverige on September 16, 2005. The Company believes that the rebranding to E.ON Sverige positively affects E.ON Nordic s retail operations and that rebranding allows for more efficient Group brand management.

E.ON Finland. E.ON Nordic also holds a majority shareholding in E.ON Finland (formerly Espoon Sähkö Oyj). In 2005, E.ON Nordic was the largest shareholder in E.ON Finland with a 65.6 percent stake. The city of Espoo, the former majority shareholder in E.ON Finland, retains a 34.2 percent stake and the remaining 0.2 percent of E.ON Finland, which is listed on the Helsinki Stock Exchange, is held by other shareholders. In September 2001, when E.ON Nordic acquired its shareholding in E.ON Finland, E.ON Nordic and the city of Espoo entered into a shareholders agreement, which contains restrictions regarding the transfer of shares in E.ON Finland. In April 2002, E.ON Nordic entered into a call option agreement, in which Fortum was granted a call option in relation to E.ON Nordic s entire shareholding in E.ON Finland; the call option was eligible for exercise in the first quarter of 2005, but any sale remained subject to certain legal restrictions pursuant to the shareholders agreement with the city of Espoo. In January 2005, E.ON Nordic received notice from Fortum that Fortum wished to exercise its call option. E.ON Nordic then notified Fortum that E.ON Nordic was not in a position to transfer its shares to Fortum due to statements of the city of Espoo based on the restrictions as contained in the shareholders agreement. In February 2005, Fortum filed a request for arbitration seeking to enforce its call option. On January 16, 2006, the city of Espoo decided to sell its shares in E.ON Finland to Fortum and to approve E.ON Nordic transferring its shares in E.ON Finland to Fortum. On February 2, 2006, E.ON Nordic and Fortum signed an agreement, whereby Fortum will acquire E.ON Nordic s entire 65.6 percent stake in E.ON Finland for a price of 37.12 per share, corresponding to a total of approximately 380 million. E.ON Nordic currently expects to record an estimated book gain of approximately 25 million on the sale, which is subject to the approval of the Finnish competition authorities. When the transaction is formally completed, the companies will simultaneously terminate the arbitration proceedings related to the transfer of E.ON Finland shares. In conjunction with the acquisition, E.ON and Fortum agreed that Fortum will pay an additional amount of 16 million to E.ON.

E.ON Finland is active in the generation, distribution, marketing and sale of electricity and heat, as well as the supply of gas in Finland, primarily in the Espoo region near Helsinki and in the Joensuu region. In 2005, it had a total installed generation capacity of 196 MW and generated 981 million kWh of electricity. E.ON Finland generated about 36 percent of its electric power at coal-fired power plants and about 35 percent at gas-fired plants in 2005. The remaining 29 percent was generated using biomass and hydroelectric plants. In 2005, E.ON Finland had sales of 269 million. Electricity contributed approximately 62 percent, heat 36 percent, and other 2 percent of 2005 sales. E.ON Finland also has an electricity trading business and traded a total of approximately 36 TWh of electricity in 2005 (including both purchases and sales).

In 2005, E.ON Finland estimated that it supplied about 7 percent of the electricity consumed by end users in Finland.

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Operations

In the Nordic region, electricity generated at power stations is delivered to consumers through an integrated transmission and distribution system. For information about the principal segments of the electricity industry, see Central Europe Operations. E.ON Nordic and its associated companies are actively involved in electricity generation, distribution, retail and trading.

The following table sets forth the sources and sales channels of electric power in E.ON Nordic s operations during each of 2005 and 2004:

Sources of Power	Total 2005 million kWh	Total 2004 million kWh	% Change
Own generation	34,253	33,110	+3.5
Purchased power from jointly owned power stations	10,398	11,030	-5.7
Power purchased from outside sources	5,921	7,376	-19.7
Total power procured(1)	50,572	51,516	-1.8
Power used for operating purposes, network losses and pump storage	(2,001)	(2,054)	-2.6
Total	48,571	49,462	-1.8
Sales of Power			
Residential customers	8,500	9,132	-6.9
Commercial customers	13,830	14,454	-4.3
Sales partners(2)/ Nordpool	26,241	25,876	+1.4
Total(1)	48,571	49,462	-1.8

(1) Excluding physically-settled electricity trading activities. Nordic s physically-settled electricity trading activities (including both purchases and sales) amounted to approximately 44 million kWh in each of 2005 and 2004.

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

In 2005, E.ON Nordic procured a total of 50,572 kWh of electricity, including 2,001 kWh used for operating purposes, network losses and pumped storage. E.ON Nordic purchased a total of 10,398 kWh of power from power stations in which it has an interest of 50 percent or less. In addition, E.ON Nordic purchased 5,921 kWh of electricity from other sources, mainly from the Nordpool power exchange. In 2005, own generation volumes increased by approximately 2.1 billion kWh in existing operations, primarily as a result of the higher levels of rainfall during the year. This was partially offset by a decline in nuclear power production of approximately 0.9 billion kWh due to the very high availability in 2004. Sales to residential and commercial customers decreased by approximately 1.3 billon kWh in 2005, mainly due to the January storm and continued strong competition. These negative effects were offset in part by the increase in hydroelectric production, which allowed E.ON Nordic to sell additional power on the Nordpool energy exchange. See Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended

December 31, 2005 Compared with Year Ended December 31, 2004 Nordic.

In 2005, E.ON Nordic supplied approximately 6 percent of the electricity consumed by end users in the Nordic countries.

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E.ON Nordic also operates wholesale and retail gas businesses in Sweden, Denmark and Finland. The following table sets forth the sources and sales channels of gas in E.ON Nordic s operations during each of 2005 and 2004:

Sources of Gas	Total 2005 million kWh	Total 2004 million kWh	% Change
Long-term gas supply contracts	9,310	9,252	+0.6
Market purchases	281	402	-30.1
Total gas supplied	9,591	9,654	-0.7
Sale and Use of Gas			
Gas used for own generation	2,624	2,539	+3.4
Sales to industrial and distribution customers	6,729	6,963	-3.4
Sales to residential customers	238	152	+56.6
Market sales	0	0	
Total gas used and sold	9,591	9,654	-0.7

E.ON Sverige purchases gas under long-term gas supply contracts with natural gas importers. Up to November 1, 2004, E.ON Sverige had a long-term contract with Nova Naturgas AB (Nova Naturgas) for the supply of natural gas. As of November 1, 2004, the contract was transferred to DONG, as a consequence of DONG s acquisition of the supply business of Nova Naturgas. The contract with DONG terminated at the end of September 2005, at which time E.ON Ruhrgas became the sole supplier of natural gas to E.ON Sverige pursuant to a long-term supply contract between the parties. The agreed framework for the E.ON Ruhrgas contract is essentially that of a take or pay arrangement, though it will provide E.ON Sverige with a certain amount of flexibility in relation to the purchase of additional quantities and the deferral of quantities not taken.

Market Environment

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

The first major step in Swedish market reform was taken in 1991, with the decision to separate transmission from generation. Svenska Kraftnät, established to manage the Swedish main transmission network, started operating in 1992. The networks were gradually opened to new participants, and legislation providing for competition became effective January 1, 1996. Finland instituted market competition beginning June 1, 1995. In 1997, Finland merged the grid operations of its two companies into a single national grid company, Fingrid.

Today, the key feature of the Swedish and Finnish electricity markets is that there is a strict separation between the natural monopoly and the competitive parts of the industry. Thus, transmission and distribution, which are seen as natural monopolies, are separated from generation, retail sales and trading. In order to make competition in generation and retail sales possible, third party access to transmission and distribution networks is guaranteed. The prices and quality of transmission and distribution services are subject to regulation by a sector-specific regulator in each country. Moreover, in each country a central transmission system operator is responsible for the stability of the

system. Thus, although there is a common spot market and free trade across the national borders, system control remains a national responsibility.

Following deregulation, the electricity trading market in Sweden, Finland, Norway and Denmark (the Nordic countries) is a liquid and transparent commodity market with trading taking place through the Nordic electricity exchange Nordpool. The market participants at Nordpool include power generators, distributors, industrial companies, other end users and portfolio managers. The electricity exchange markets consist of a spot market (delivery in the next 24-hour period), a financial market (contracts of up to four years for longer term

hedging) and clearing operations. The current volume of electricity traded at the Nordpool spot market exchange is equal to more than 40 percent of underlying consumption in the Nordic countries. As a result, pricing in the Nordic market has become increasingly efficient, with reduced transaction costs and high transparency. In addition, the exchange price is used as a reference price for a large part of bilateral trading contracts. The prices on the spot and forward markets are generally used as the basis for sales contracts with end customers.

The electricity supply system in the Nordic countries is highly dependent on the hydro power systems in Norway and Sweden. The inflow of water in the two countries is generally well correlated, *i.e.* low inflow in Norway usually coincides with a low inflow in Sweden. On a region-wide basis, this means that hydro power generation varies widely between dry and rainy years. In a normal year, total hydro power generation in the Nordic countries amounts to approximately 190-200 TWh. Hydro power has relatively low variable costs and is therefore the generation source that is the first to be put to use (base load). When the water level of hydro power reservoirs decreases, other sources of power generation have to be put into operation at increasing marginal cost. Although long-term precipitation is relatively stable in the region, wide variations occur in the short term both within individual years and between years. As a result, the price on the Nordpool electricity spot market can vary widely both within a given year and between years.

Since the introduction of the EU emissions trading scheme on January 1, 2005, CO_2 emission certificates have had a significant impact on electricity prices also in the Nordic countries. The price of certificates is correlated to fuel prices and to some degree to the hydrology in the Nordic countries as well as in the rest of the EU. In dry years, the demand for CO_2 emission certificates will potentially increase, while a decrease in demand can be expected in wet years. This can markedly increase the volatility of electricity prices.

In 2003, which was a dry year, the total volume of electrical energy generated by hydro power in the Nordic countries was 168 TWh. The system price, *i.e.* the traded price on Nordpool, reached levels of over 120 öre/kWh in the beginning of 2003 and did not drop below 30 öre/kWh until the end of March. Compared to this, prices in earlier years exceeded 30 öre/kWh only on a few occasions. During the summer of 2003, the price decreased to 20 öre/kWh, and then rose to levels between 25 and 30 öre/kWh during the autumn and winter.

In 2004, the total volume of electrical energy generated by hydro power was 183 TWh. In the beginning of 2004, electricity prices in Sweden remained at levels between 25 and 30 öre/kWh. Prices on the spot market as well as on the forward markets had a peak during summer and early autumn, with the spot price reaching levels of almost 40 öre/kWh. By the fourth quarter, more normal levels of rainfall during the course of the year allowed reservoir levels to recover and at year-end reservoirs were near normal levels. At year-end, electricity spot prices were quoted at levels of 22 öre/kWh.

In 2005, which was a wet year, the total volume of electrical energy generated by hydro power in the Nordic countries was 221 TWh. The year started with warm weather in January and February and after a cold March the rest of the year was a bit warmer than normal. The hydrological balance started at a level above normal and reached a peak of 16 TWh above normal in the beginning of the year. Reservoir levels decreased to normal at the end of the year. The introduction of the EU emissions trading scheme in January resulted in generally higher prices for electricity. The average electricity spot price in 2005 amounted to 27 öre/kWh.

Electricity consumption in the Nordic countries decreased during 2002 and 2003, before recovering in 2004. In 2001 there was a demand of 393 TWh, which fell in 2002 to 388 TWh and in 2003 to 380 TWh, with the decrease in demand being due to high electricity prices following the extremely dry autumn of 2002. In 2004 and 2005, electricity consumption recovered to around 390 TWh and 393 TWh, respectively.

In May 2003, the Swedish government introduced an electricity certificate system to support renewable electrical energy. This is a market-based support system in which the price of the electricity certificates is the result of the relationship between supply and demand on the electricity certificate market. The aim of the system is to increase the volume of electricity produced from renewable sources by 10 TWh by 2010 as compared with the 2002 level. Electricity certificates are granted by the Swedish government to generators of electricity from renewable sources. For every MWh of electricity produced from such sources the generator is given one certificate that it can sell in addition to the electricity generated. In order to create a demand for electricity certificates, it is mandatory for most electricity end users (including residential customers) to purchase a certain

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number of certificates in proportion to their consumption. This is known as the quota obligation. During 2004, the average quota obligation amounted to 8.1 percent of electricity consumed. In 2005, the average quota obligation amounted to 10.4 percent. The quota obligation is scheduled to gradually increase up to 16.9 percent in 2010. Any applicable end user who fails to meet this quota obligation must instead pay a quota obligation charge to the Swedish government. The electricity certificate scheme is currently under revision. In July 2005, the government proposed a number of amendments to the relevant law, including an increased level from 10 TWh renewable generation sources to 15 TWh by 2016, a prolongation of the overall support system until 2030 and the creation of a common certificate market with Norway. A new law proposal is expected in spring 2006 and parliament approval in mid-2006. E.ON Nordic believes that the proposed changes will positively affect its existing renewable energy generation sources and significantly reduce the uncertainty for future investments.

E.ON Nordic s main competitors in the Nordic generation market are the Swedish energy company Vattenfall AB (Vattenfall), the Finnish utility Fortum and the Norwegian energy company Statkraft. Vattenfall and Fortum are also the main competitors of E.ON Sverige in the Swedish retail market.

Natural Gas. The Swedish gas pipeline system is constructed along the western coast of Sweden, starting in Dragör, Denmark and ending in Gothenburg, Sweden. Gas represents 20 percent of the total energy supply in this region, while at the national level, it comprises somewhat less than 2 percent of Sweden s total energy supply. In 2005, gas consumption in Sweden amounted to approximately 10 TWh. The Swedish gas market is characterized by a small number of companies and a high degree of vertical integration. There are currently about ten competitors active in the Swedish market, with E.ON Sverige accounting for the distribution and sale of approximately half of all gas distributed and sold in Sweden in 2005. The major competitors in the end customer market are municipally owned companies with customers mainly in the geographic area of their municipality. The most important of those are Göteborgs Energi, Öresundskraft and Lunds Energi. In addition, the Danish gas company DONG competes in the Swedish gas market. See also Regulatory Environment.

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

In Sweden, most district heating companies are still owned by municipalities, although the current trend is for large energy groups to acquire municipal companies. E.ON Sverige is actively participating in this privatization process. District heating is not price-controlled. The price of competing alternatives serves, however, as a ceiling for the prices that district heating companies can charge. Similar to Sweden, Finland does not regulate district heating prices or revenues.

Power Generation

General. E.ON Nordic owns interests in electric power generation facilities in Sweden and Finland with a total installed capacity of approximately 14,982 MW, its attributable share of which is approximately 7,570 MW (not including mothballed, shutdown or reduced power plants).

E.ON Nordic generates electricity primarily at nuclear and hydroelectric power plants, with a small percentage generated at other types of power plants. In 2005, approximately 48 percent of E.ON Nordic s electric output was fuelled by nuclear, 45 percent by hydroelectric, and the remaining 7 percent by other fuels including oil, hard coal, biomass, natural gas, wind and waste.

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

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The following table sets forth E.ON Nordic s major electric power generation facilities (including cogeneration plants), the total capacity, the stake held by E.ON Sverige or E.ON Finland and the capacity attributable to E.ON Sverige or E.ON Finland for each facility as of December 31, 2005, and their start-up dates.

E.ON NORDIC ELECTRIC POWER STATIONS

		E.ON Sverige s/E.ON Finland s Share		
Power Plants	**Total Capacity Net MW**	**%**	**Attributable Capacity MW**	**Start-up Date**
Nuclear				
Forsmark 1(S)	1,018	9.3	95	1980
Forsmark 2(S)	951	9.3	88	1981
Forsmark 3(S)	1,190	10.8	129	1985
Oskarshamn I(S)	467	54.5	255	1972
Oskarshamn II(S)	602	54.5	328	1974
Oskarshamn III(S)	1,160	54.5	632	1985
Ringhals 1(S)	873	29.6	258	1976
Ringhals 2(S)	870	29.6	258	1975
Ringhals 3(S)	920	29.6	272	1981
Ringhals 4(S)	910	29.6	269	1983
Total	8,961		2,584	
Hydroelectric				
Balforsen(S)	88	100.0	88	1958
Bergeforsen(S)	160	44.0	70	1955
Bjurfors nedre(S)	78	100.0	78	1959
Blasjön(S)	60	50.0	30	1957
Degerforsen(S)	63	100.0	63	1965
Edensforsen(S)	67	96.5	65	1956
Edsele(S)	60	100.0	60	1965
Forsse(S)	52	100.0	52	1968
Gulsele(S)	64	65.0	42	1955
Hällby(S)	84	65.0	55	1970
Hammarforsen(S)	79	100.0	79	1928
Harrsele(S)	223	50.6	113	1957
Hjälta(S)	178	100.0	178	1949
Järnvägsforsen(S)	100	94.9	95	1975
Korselbränna(S)	130	100.0	130	1961
Moforsen(S)	135	100.0	135	1968
Olden (Langan)(S)	112	100.0	112	1974
Pengfors(S)	52	65.0	34	1954
Ramsele(S)	157	100.0	157	1958
Rätan(S)	60	100.0	60	1968
Sollefteaforsen(S)	61	50.0	31	Tba

Stensjön (Harkan)(S)	95	50.0	48	1968
Storfinnforsen(S)	112	100.0	112	1953

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Power Plants	Total Capacity Net MW	E.ON Sverige s/E.ON Finland s Share %	Attributable Capacity MW	Start-up Date
Hydroelectric (continued)				
Trangfors(S)	73	100.0	73	1975
Other (<50 MW installed capacity)	874	n/a	811	n/a
Total	3,217		2,771	
Fuel Oil				
Barsebäck GT(S)	84	100.0	84	1974
Bravalla(S)	240	100.0	240	1972
Halmstad G11(S)	78	100.0	78	1973
Halmstad G12(S)	172	100.0	172	1993
Karlshamn G1(S)	332	70.0	232	1971
Karlshamn G2(S)	332	70.0	232	1971
Karlshamn G3(S)	326	70.0	228	1973
Karskär G4(S)	125	50.0	63	1968
Öresundsverket GT(S)	126	100.0	126	1971
Oskarshamn GT(S)	80	54.5	44	1973
Other (<50 MW installed capacity)	100	n/a	64	n/a
Total	1,995		1,563	
Natural Gas				
Heleneholm G11, G12(S)(CHP)	130	100.0	130	1966+1970
Suomenoja GT(1)(FIN)	50	100.0	50	1989
Total	180		180	
Hard Coal				
Suomenoja(1)(FIN)	80	100.0	80	1977
Wind Power				
Sweden	19	n/a	19	n/a
Denmark	166	n/a	33	n/a
Total	185		52	
Other Power Plants				
Abyverket G1, G2, G3(S)(CHP)	151	100.0	151	1962-1974
Händelö (Norrköping)(S)(CHP)	100	100.0	100	1983
Joensuu Bio(1)(FIN)	65	100.0	65	1986
Karskär G3(S)	48	50.0	24	1968

Total	364	340	
Shutdown			
Barsebäck 1(S)(Nuclear)		25.8	1975
Barsebäck 2(S)(Nuclear)		25.8	1977
Total	**14,982**	**7,570**	

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(1) Power plant of E.ON Finland.
(FIN) Located in Finland.
(S) Located in Sweden.
(CHP) Combined Heat and Power Generation.

E.ON Nordic s total attributable capacity decreased by 401 MW compared with 2004 mostly due to the sale of hydroelectric power plants to Statkraft (see Overview E.ON Sverige above).

Following receipt of the necessary approvals, E.ON Sverige plans to build a new gas-fired CHP plant in the Swedish city of Malmö. In addition, efficiency improvements, which are aimed at increasing generation capacity, are planned for the nuclear reactors in Forsmark, Ringhals and Oskarshamn. The implementation of these efficiency measures has started in 2005. Pending receipt of thenecessary approvals, E.ON Sverige expects that all major efficiency improvements will have been carried out by 2010.

Nuclear Power. In Sweden, E.ON Sverige operates three nuclear power plants (Oskarshamn I III), which provided 50 percent of its total power output in 2005 (48 percent of E.ON Nordic s total power output in 2005). In addition, E.ON Sverige holds minority participations in all other Swedish nuclear power reactors. E.ON Sverige receives a share of the electrical power produced at these plants according to its respective shareholding. The purchase price for this electricity is determined on the basis of the production cost. E.ON Finland does not own an interest in or operate any nuclear power plants.

E.ON Sverige s nuclear power plants are required to meet applicable Swedish safety standards, which are described in Environmental Matters Nordic. In Sweden, nuclear waste is handled by Svensk Kärnbränslehantering AB (SKB), which is owned by the domestic nuclear power producers and controlled by various state institutions. Sweden s low and intermediate-level nuclear waste is deposited in the Repository for Radioactive Operational Waste, located at the Forsmark nuclear power plants. Spent nuclear fuel and other high-level nuclear waste are placed in temporary storage at the Central Interim Storage Facility for Spent Nuclear Fuel, situated near the Oskarshamn nuclear power plants. No long-term repository has yet been constructed for spent nuclear fuel, but SKB is planning to build a deep repository for the long-term storage of all spent nuclear fuel. E.ON Sverige expects that a decision will be taken on where the deep repository is to be built by 2010, with the first nuclear waste expected to be stored there by 2017.

In 1997, a law concerning the phase out of nuclear power was passed pursuant to which the government can decide to revoke a license to conduct nuclear operations, but must compensate the owner of the nuclear plants that are phased out. E.ON Sverige has one nuclear reactor, Barsebäck 1, which was closed under this law in 1999 and for which E.ON Sverige received compensation. Beginning in 2002, the Swedish government appointed a special negotiator whose task was to negotiate with the Swedish energy industry on behalf of the government, with the aim of reaching an agreement about a sustainable policy for the energy system.

In September 2004, these negotiations were unilaterally abandoned by the Swedish government. At the same time, the government has opted for the phase-out of the nuclear reactor block Barsebäck 2, which was subsequently shut down in May 2005. The effect of a possible phase-out of Barsebäck 2 on E.ON Sverige had already been taken into account in the agreement when Barsebäck 1 was shut down in 1999. Based on this, a final agreement concerning the compensation for the closure of Barsebäck 2 was entered into in November 2005 between E.ON Sverige, the Swedish government and the state-owned Swedish utility Vattenfall. The main component of the agreement is that E.ON Sverige gets an increased shareholding in the Swedish nuclear power generator Ringhals AB. This will give E.ON Sverige approximately the same production capacity as before the closure of Barsebäck 2.

Overall, there is deemed to be no effect on the balance sheet or profits of E.ON Sverige due to the pre-mature closure of Barsebäck 1 or 2. As of today, E.ON Sverige has no other nuclear power plants that have been explicitly targeted for early phase-out by the Swedish government. However, it is unclear if and to what extent E.ON Sverige will need to shut down other nuclear power plants in the future.

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In Sweden, the financing system for the handling of high-level nuclear waste as well as the dismantling of nuclear facilities is based on a fee charged per generated kWh of electricity. The exact amount is regularly calculated based on assumptions about the expected period of operation for each reactor by the Swedish Nuclear Power Inspectorate and ultimately determined by the Swedish government. Nuclear power operators include this fee in the price of electricity and transfer it to the national Nuclear Waste Fund. The purpose of this fund is to cover all expenses incurred for the safe handling and final disposal of spent nuclear fuel, as well as for dismantling nuclear facilities and disposing of decommissioning waste. Expenses for other low and intermediate-level operational nuclear waste have to be directly covered by the nuclear operators. For this purpose, E.ON Sverige has made provisions totaling 7.1 million as of December 31, 2005.

In Sweden, taxes are levied on the production of nuclear power based on the installed nuclear power capacity. This tax amounted to approximately 7,230 per MW of thermal power in 2005. In December 2005, the Swedish parliament approved an 85 percent increase in the nuclear tax effective as of January 2006. E.ON Sverige expects that the change will increase its related tax expense by 47 million in 2006.

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

Hydroelectric. In Sweden, E.ON Sverige operates 115 hydroelectric power plants, which provided 46 percent of its total power output in 2005 (45 percent of E.ON Nordic s total power output in 2005). In addition, E.ON Finland operates one minor hydroelectric plant. Due to the presence of mountains and rivers, hydroelectric plants are generally located in northern Sweden. Due to natural variances in annual water inflow to the hydro reservoirs, hydroelectric plants can be subject to reduced operations during periods of low precipitation. In periods of severe water shortages, such as occurred in late 2002 and early 2003 E.ON Sverige must purchase electricity which cannot be generated at these plants from the market in order to meet contractual commitments. Conversely, following periods of high precipitation E.ON Sverige is able to generate more electricity than it needs to meet its commitments, and is therefore able to sell excess electricity to its sales partners or on the market. Thus, variances in rainfall in the region can have a significant positive or negative effect on the Nordic market unit s financial and operating results. See also Item 3. Key Information Risk Factors.

Hydroelectric power plants in Sweden are subject to real estate taxes, which were increased in 2005. E.ON Sverige expects that its related tax expense will increase by 28 million in 2006 and rise further in 2007 due to a revaluation of the tax base.

Other Power Plants. Power plants fuelled by fuel oil, hard coal, biomass, natural gas, wind power and waste provided the remaining 7 percent of E.ON Nordic s total power output in 2005. Hard coal and wind power plants are usually used for electricity base load operations. Oil- and gas-fired plants are only used for peak load operations, when market prices cover the operational cost. The production planning of CHP plants is to a large degree dependent on temperature conditions. Fuel oil, natural gas, hard coal and biomass are generally available from multiple sources, though prices are determined on international commodities markets and are therefore subject to fluctuations. Waste is purchased under supply contracts with local providers.

Demand for power tends to be seasonal, rising in the winter months and typically resulting in additional electricity sales by E.ON Nordic in the first and fourth quarters. E.ON Nordic believes it has adequate sources of power to meet foreseeable increases in demand, whether seasonal or otherwise.

Although E.ON s power plants are maintained on a regular basis, there is a certain risk of failure for power plants of every fuel type. In September 2003, a blackout in parts of Sweden and Denmark was caused by a combination of a fault in the transmission grid and a failure at the power plant Oskarshamn (which is 54.5 percent owned by E.ON Sverige) that occurred when the plant was being returned to service following routine maintenance. The power plant restarted in November 2003 following a comprehensive investigation and analysis. No serious consequences arose from the shutdown. Depending on the associated generation capacity, the length of the outage and the cost of the required repair measures, the economic damage due to such failure can vary significantly. In order to meet contractual commitments, electricity which cannot be generated at these plants has to be bought from the market. Thus, as with water shortages, power plant outages can negatively affect the market unit s financial and operating results. No significant unplanned outage occurred in 2004 or 2005.

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Electricity Distribution

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

In Sweden, the high voltage electricity grid is managed by Svenska Kraftnät, a company owned by the Swedish government. Mid-voltage electricity is transmitted through a regional distribution network with a length of around 40,000 km, of which E.ON Sverige owns and manages 8,000 km, located in southern Sweden and around Sundsvall in the north of Sweden. The local distribution networks are managed by about 180 different grid companies, including E.ON Sverige. The length of the total local network for Sweden is about 550,000 km, of which E.ON Sverige owns 117,000 km. Balance control for the whole system is managed by Svenska Kraftnät.

In January 2005, a severe storm hit Sweden and devastated large areas of forest in southern Sweden. This had a serious effect on parts of E.ON Sverige s distribution grid, which in some areas was destroyed. For details, including the cost incurred by E.ON Sverige, see Overview. Following this storm, E.ON Sverige has launched a major reinvestment program in order to secure and increase the reliability of its local and regional distribution grids. The focus of reinvestment activity will be on cabling insulated overhead lines in the local networks and securing broader right of way corridors in the regional networks. E.ON Sverige expects that this will markedly reduce its exposure to weather-related damage in the future.

The electricity grid in Sweden is linked to the power transmission grids in Norway, Finland and Denmark. In addition, the Baltic Cable links the Swedish transmission grid to the grid of E.ON Energie in Germany. The Baltic Cable is one of the longest (250 km) direct current submarine cables in the world, with a designed capacity of 600 MW. E.ON Sverige owns one-third of the cable, with the remaining two-thirds owned by the Norwegian utility Statkraft.

In 2005, E.ON Sverige s distribution network served approximately one million customers, including approximately 590,000 customers in southern Sweden, 325,000 customers in the metropolitan areas of Stockholm/Örebro/ Norrköping and 85,000 customers in the Mid-Norrland region. The areas around the cities of Malmö (in southern Sweden), Stockholm, Örebro and Norrköping belong to the more densely populated areas of Sweden, but parts of southern Sweden and Norrland are more rural areas with a lower density.

E.ON Sverige also owns and operates local power distribution grids in Finland through Kainuun Energia Oyj (54,300 customers in western Finland), with a length of 12,470 km, and Karhu Voima Oyj (16 industrial customers in southwest Finland), with a length of 68 km.

The power distribution grid of E.ON Finland is located in the areas of Espoo and Joensuu. The grid has a system length of approximately 7,000 km. In 2005, E.ON Finland s distribution grid served approximately 162,000 customers.

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The following map shows E.ON Nordic s current distribution areas.

In Sweden and Finland, electricity customers have separate contracts with a retail supplier and an electricity distributor. For this reason, distribution customers of E.ON Sverige and E.ON Finland may choose other retail suppliers and E.ON Sverige and E.ON Finland may sell electricity to customers not covered by their own power transmission grids. For information on grid access, see Regulatory Environment Nordic.

Gas Distribution

The Swedish gas pipeline system is constructed along the western coast of Sweden, starting in Dragör, Denmark and ending in Gothenburg, Sweden. Gas represents 20 percent of total energy supply in the Nordic region, while at the national level, it comprises somewhat less than 2 percent of Sweden s total energy supply. The 320 km national gas transmission pipeline is owned by Nova Naturgas, a consortium in which E.ON Ruhrgas holds a 29.6 percent interest. E.ON Sverige owns, operates and maintains a regional high-pressure gas pipeline with a length of 202 km and a low-pressure gas distribution pipeline with a length of 1,700 km. In addition, E.ON Sverige has an underground gas storage facility in Getinge with a working capacity of 8.5 million m^3 and a maximum withdrawal rate of 40 thousand m^3/hour. In 2005, E.ON Sverige transported a total of 6.9 TWh of gas through its gas pipeline system.

The Swedish natural gas market is currently connected to the Danish natural gas market through one supply route. Sweden s strategic location between two of the largest producers, Russia and Norway, has led to the initiation of several studies and projects with the aim of increasing supplies to or via Sweden. E.ON Nordic is participating in the Baltic Gas Interconnector project promoting the construction of a pipeline between Germany, Sweden and Denmark. During 2004, E.ON Sverige was granted the Swedish concession for this project. The authorization processes in Germany and Denmark are ongoing.

Retail

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

Electricity. As of December 31, 2005, E.ON Sverige supplied electricity to approximately 850,000 electricity customer accounts in Sweden and to a minor degree in Denmark. Through its subsidiaries Kainuun Energia Oyj and Karhu Voima Oyj, E.ON Sverige supplied approximately 71,000 customers in Finland. Although

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the majority of E.ON Sverige s customer accounts are with residential customers, the majority of its sales are made to commercial customers. E.ON Sverige sold a total of 19.7 TWh of electricity in 2005, of which 7.0 TWh was delivered to residential customers and 12.7 TWh was delivered to commercial customers (including municipal distributors). E.ON Sverige s electricity customers are concentrated in the south of Sweden, the areas of Stockholm, Örebro and Norrköping, as well as in the Mid-Norrland region, although E.ON Sverige potentially serves customers throughout Sweden.

E.ON Finland s electricity sales operations cover all of Finland, although its customers are mainly located in the Espoo region. As of December 31, 2005, E.ON Finland supplied electricity to approximately 165,000 electricity customer accounts. In 2005, E.ON Finland sold electricity totaling 2.7 TWh, of which 1.5 TWh was sold to residential customers and 1.2 TWh was sold to commercial customers. E.ON Finland does not sell electricity to distributors.

Gas. In the Swedish gas market, E.ON Sverige supplied approximately 25,000 customers with gas in 2005. 6.1 TWh were delivered to large industrial and (mostly municipal) distribution customers, and 0.2 TWh were delivered to residential customers. E.ON Sverige also supplied a small amount of gas in Denmark in 2005.

E.ON Sverige also supplied 0.6 TWh of gas to eight industrial customers in Finland.

E.ON Finland sold 45 GWh of gas to 166 industrial customers in 2005. Overall, natural gas consumption in Finland is very limited in the residential customer sector. The main users of gas in Finland are power plants and the paper and pulp industry.

Heat & Waste. E.ON Sverige sells heating, including district heating, to approximately 18,000 customers in Sweden and Denmark. In 2005, sales of district heating in Sweden amounted to 6.2 TWh. In Denmark, 2005 sales amounted to 1.4 TWh. In addition, in 2005 E.ON Sverige sold a *de minimis* amount of heat in Poland. E.ON Finland s district heating operations are concentrated in the area of Espoo. E.ON Finland served a total of approximately 7,600 customers in 2005, delivering 2.5 TWh of heat.

E.ON Nordic is also active in the Swedish waste business, mainly through E.ON Sverige SAKAB AB (E.ON Sverige SAKAB). E.ON Sverige SAKAB s operations focus on recycling and destroying hazardous waste. In addition, E.ON Sverige SAKAB treats a small portion of household waste and industrial refuse for heat-recovery purposes. In 2005, E.ON Sverige s waste activities had combined sales of 52 million. Waste volumes handled amounted to approximately 453,000 tons.

Other Activities. E.ON Nordic provides distribution network and other services primarily in Sweden through E.ON Sverige s subsidiary ElektroSandberg AB. E.ON Sverige Bredband AB is active in the broadband communications business.

Trading

E.ON Nordic conducts its energy trading activities through E.ON Sverige and E.ON Finland. The focus is on electricity trading on the Nordpool exchange but does to a lesser extent include other commodities such as oil, natural gas, CO_2 emission certificates and propane.

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

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

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The following table sets forth the total volume of E.ON Nordic s traded electric power in 2005 and 2004.

Trading of Power	2005 million kWh	2004 million kWh	% Change
Power sold	53,503	56,758	-5.7
Power purchased	56,225	48,764	+15.3
Total	109,728	105,522	+4.0

The major part of realized trading volumes is usually contracted in the year prior to realization. Trading volumes increased compared to 2004, which was affected by the extremely high spot and forward prices in the beginning of 2003.

U.S. MIDWEST

Overview

E.ON U.S. is a diversified energy services company with businesses in power generation, retail gas and electric utility services, as well as asset-based energy marketing. Asset-based energy marketing involves the off-system sale of excess power generated by physical assets owned or controlled by E.ON U.S. and its affiliates pursuant to bilateral contracts with wholesale customers on negotiated terms. E.ON U.S. s power generation and retail electricity and gas services are located principally in Kentucky, with a small customer base in Virginia and Tennessee. As of December 31, 2005, E.ON U.S. owned or controlled aggregate generating capacity of approximately 7,700 MW, including E.ON U.S. s interest in independent power plants of 105 MW in North Carolina, which is the subject of a pending sale agreement. See Non-regulated Businesses. E.ON U.S. s 50 percent interest in a 550 MW Texas plant was sold in January 2005. In 2005, E.ON U.S. served more than one million customers. The U.S. Midwest market unit recorded sales of 2,045 million in 2005 and adjusted EBIT of 365 million.

Operations

In the areas of the United States in which E.ON U.S. operates, electricity generated at power stations is delivered to consumers through an integrated transmission and distribution system. For information about the principal segments of the electricity industry, see Central Europe Operations. In 2005, E.ON U.S. was actively involved in generation, transmission, distribution, retail and trading in the states in which it had utility operations.

E.ON U.S. divides its operations into regulated utility and non-regulated businesses. Utility operations are subject to state regulation that sets rates charged to retail customers.

In the regulated utility business, which accounted for approximately 96 percent of E.ON U.S. s revenues in 2005 (82 percent electricity, 18 percent gas), E.ON U.S. operates two wholly-owned utility subsidiaries: Louisville Gas and Electric Company (LG&E), an electricity and natural gas utility based in Louisville, Kentucky, which serves customers in Louisville and 17 surrounding counties, and Kentucky Utilities Company (KU), an electric utility based in Lexington, Kentucky, which serves customers in 77 Kentucky counties, five counties in Virginia and one county in Tennessee.

E.ON U.S. s non-regulated business, which accounted for approximately 4 percent of E.ON U.S. s sales in 2005, is primarily comprised of the operations of E.ON U.S. Capital Corp. (formerly LG&E Capital Corp.) (ECC) and LG&E Energy Marketing Inc. (LEM).

Market Environment

In the United States, the market environment for electricity companies varies from state to state, depending on the level of deregulation enacted in each jurisdiction.

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The electric power industry remains highly regulated at the retail level in much of the U.S., including Kentucky, although in some parts of the country, including Virginia, it has become more competitive as a result of price and supply deregulation and other regulatory changes. In approximately one-third of the United States, retail electricity customers can now choose their electricity supplier; however, some states have begun discussing re-regulation. To better support a competitive industry, federal regulators are transforming the manner in which the electric transmission grid is operated. Transmission owning entities are being strongly encouraged by federal regulators to transfer individual control over the operation of their transmission systems to regional transmission organizations (RTOs). These RTOs are intended to ensure non-discriminatory and open access to the nation s electric transmission system. Depending on the specifics of deregulation in the states in which they operate, U.S. electric utilities have adopted different strategies and structures, sometimes divesting one or more of the generation, transmission, distribution or supply components of their businesses.

E.ON U.S. s electric service territories are located in Kentucky, Virginia and Tennessee. At present, due to the absence of customer choice or competitive market requirements in Kentucky and Tennessee and the passage of legislation in Virginia exempting KU from the provisions of that state s liberalization measures, none of E.ON U.S. s retail utility operations are subject to customer choice or competitive market conditions. E.ON U.S. s customers are therefore generally required to purchase their electric service from E.ON U.S. s utility subsidiaries at prices approved by state governmental regulators.

E.ON U.S. s primary retail electric service territories are located in Kentucky, which accounted for approximately 62 percent of E.ON U.S. s total revenues in 2005. To date, neither the Kentucky General Assembly nor the Kentucky Public Service Commission (KPSC) have adopted or announced a plan or timetable for retail electric industry competition in Kentucky. However, the nature or timing of any new legislative or regulatory actions regarding industry restructuring or the introduction of competition and their impact on LG&E and KU cannot currently be predicted.

Although retail choice became available for many customers in Virginia in January 2002 pursuant to the Virginia Electric Restructuring Act (the Restructuring Act), KU remains exempt from the provisions of the Restructuring Act until such time as KU provides competitive electric service to retail customers in any other state. During 2005, KU s Virginia operations accounted for approximately 5 percent of KU s total revenues and approximately 2 percent of E.ON U.S. s total revenues. E.ON U.S. s very limited Tennessee operations accounted for less than 1 percent of total revenues in each of 2005 and 2004.

Over the past decade, E.ON U.S. has taken steps to keep its rates low while maintaining high levels of customer satisfaction, including a reduction in the number of employees; aggressive cost reduction activities; an increase in focus on commercial, industrial and residential customers; an increase in employee involvement and training; and continuous modifications of its organizational structure. E.ON U.S. also strives to control costs through competitive bidding and process improvements. The company s performance in national customer satisfaction surveys continues to be high.

Seasonal variations in U.S. demand for electricity reflect the summer cooling period as the time of peak load requirements, with a lesser peak during the winter heating period, the latter primarily in regions which do not have extensive gas distribution networks. The peak period of retail gas demand is the winter heating period.

Regulated Business

LG&E. LG&E is a regulated public utility that generates and distributes electricity to approximately 394,000 customers and supplies natural gas to approximately 321,000 customers in Louisville and adjacent areas of Kentucky. LG&E s service area covers approximately 700 square miles in 17 counties. LG&E s coal-fired electric generating plants, most of which are equipped with systems to reduce SO_2 emissions, produce a significant amount (97 percent) of LG&E s electricity; the remainder is generated by gas-fired combustion turbines (approximately 2 percent) and by a hydroelectric power plant. Underground natural gas storage fields assist LG&E in providing economical and reliable gas service to customers. As of December 31, 2005, LG&E owned steam and combustion turbine generating facilities with an attributable capacity of 3,105 MW and a 48 MW hydroelectric facility on the Ohio River.

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KU. KU is a regulated public utility engaged in producing, transmitting, distributing and selling electric energy. KU provides electric service to approximately 495,000 customers in 77 counties in central, southeastern and western Kentucky and approximately 30,000 customers in five counties in southwestern Virginia. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities and fewer than 10 customers in Tennessee. KU s coal-fired electric generating plants produce a significant amount (97 percent) of KU s electricity; the remainder is generated by gas- and oil-fired combustion turbines (approximately 3 percent) and a hydroelectric facility. As of December 31, 2005, KU owned steam and combustion turbine generating facilities with an attributable capacity of 4,433 MW and a 24 MW hydroelectric facility.

Power Generation

The following table sets forth details of LG&E s and KU s electric power generation facilities, including their total capacity, the stake held by E.ON U.S. and the capacity attributable to E.ON U.S. for each facility as of December 31, 2005, and their start-up dates.

LG&E S AND KU S ELECTRIC POWER STATIONS

		E.ON U.S. s Share		
Power Plants	**Total Capacity Net MW**	**%**	**Attributable Capacity MW**	**Start-up Date**
Hard Coal				
Cane Run 4(1)	155	100.0	155	1962
Cane Run 5(1)	168	100.0	168	1966
Cane Run 6(1)	240	100.0	240	1969
E.W. Brown 1(2)	101	100.0	101	1957
E.W. Brown 2(2)	167	100.0	167	1963
E.W. Brown 3(2)	429	100.0	429	1971
Ghent 1(2)	475	100.0	475	1974
Ghent 2(2)	484	100.0	484	1977
Ghent 3(2)	493	100.0	493	1981
Ghent 4(2)	493	100.0	493	1984
Green River 3(2)	68	100.0	68	1954
Green River 4(2)	95	100.0	95	1959
Mill Creek 1(1)	303	100.0	303	1972
Mill Creek 2(1)	301	100.0	301	1974
Mill Creek 3(1)	391	100.0	391	1978
Mill Creek 4(1)	477	100.0	477	1982
Trimble County(1)	511	75.0	383	1990
Tyrone 3(2)	71	100.0	71	1953
Total	5,422		5,294	
Natural Gas				
Cane Run 11(1)	14	100.0	14	1968
E.W. Brown 5(3)	117	100.0	117	2001
E.W. Brown 6(3)	154	100.0	154	1999
E.W. Brown 7(3)	154	100.0	154	1999
E.W. Brown 8(2)	106	100.0	106	1995

E.W. Brown 9(2)	106	100.0	106	1994

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Power Plants	Total Capacity Net MW	E.ON U.S. s Share %	E.ON U.S. s Share Attributable Capacity MW	Start-up Date
Natural Gas (continued)				
E.W. Brown 10(2)	106	100.0	106	1995
E.W. Brown 11(2)	106	100.0	106	1996
E.W. Brown IAC(3)	98	100.0	98	2000
Haefling 1(2)	12	100.0	12	1970
Haefling 2(2)	12	100.0	12	1970
Haefling 3(2)	12	100.0	12	1970
Paddy s Run 11(1)	12	100.0	12	1968
Paddy s Run 12(1)	23	100.0	23	1968
Paddy s Run 13(3)	158	100.0	158	2001
Trimble County 5(3)	160	100.0	160	2002
Trimble County 6(3)	160	100.0	160	2002
Trimble County 7(3)	160	100.0	160	2004
Trimble County 8(3)	160	100.0	160	2004
Trimble County 9(3)	160	100.0	160	2004
Trimble County 10(3)	160	100.0	160	2004
Waterside 7(1)	11	100.0	11	1964
Waterside 8(1)	11	100.0	11	1964
Zorn 1(1)	14	100.0	14	1969
Total	2,186		2,186	
Oil				
Tyrone Unit 1(2)	27	100.0	27	1947
Tyrone Unit 2(2)	31	100.0	31	1948
Total	58		58	
Hydroelectric				
Dix Dam(2)	24	100.0	24	1925
Ohio Falls(1)	48	100.0	48	1928
Total	72		72	
E.ON U.S. Regulated Business Total	**7,738**		**7,610**	
Shutdown				
Green River 1(2)	22	100.0	22	1950
Green River 2(2)	22	100.0	22	1950
Total	44		44	

(1) Power stations owned by LG&E.

(2) Power stations owned by KU.

(3) Power stations jointly owned by LG&E and KU.

Fuel. Coal-fired steam and combustion turbine generating units provided approximately 97 percent of LG&E s and KU s net kWh generation for 2005. The remainder of 2005 net generation was produced by natural gas- and oil-fueled combustion turbine peaking units (approximately 2 percent) and hydroelectric plants. E.ON

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U.S. has no nuclear generating units and coal will be the predominant fuel used by E.ON U.S. s subsidiaries for the foreseeable future. LG&E and KU have entered into coal supply agreements with various suppliers for coal deliveries for 2006 and beyond and normally augment their coal supply agreements with spot market purchases. The companies have coal inventory policies which they believe provide adequate protection under most contingencies. Reliability of coal deliveries can be affected from time to time by a number of factors, including fluctuations in demand, coal mine labor issues and other supplier or transporter operating or contractual difficulties.

Each of LG&E and KU expect to continue purchasing much of their coal, which has varying sulphur content ranges, from western Kentucky, southern Indiana and West Virginia, with additional KU purchases from eastern Kentucky, Wyoming and Colorado. In general, the delivered cost of coal has been rising since late 2000.

LG&E purchases natural gas transportation services from Texas Gas Transmission, LLC and Tennessee Gas Pipeline Company. LG&E also has a portfolio of gas supply arrangements with a number of suppliers in order to meet its firm sales obligations. These gas supply arrangements have various terms and include pricing provisions that are market-responsive. LG&E believes these firm supplies, in tandem with the pipeline transportation services, provide the reliability and flexibility necessary to serve LG&E s gas customers. LG&E operates five underground gas storage fields with a current working gas capacity of 15.1 billion cubic feet. Gas is purchased and injected into storage during the summer season and is then withdrawn to supplement pipeline supplies to meet the gas-system load requirements during the winter heating season. LG&E and KU primarily buy natural gas and oil fuel used for generation on the spot market.

LG&E and KU have limited exposure to market price volatility in prices of coal and natural gas, as long as cost pass-through mechanisms, including the fuel adjustment clause and gas supply clause, exist for retail customers. For a more detailed explanation of these mechanisms, see Regulatory Environment U.S. Midwest.

Asset-Based Energy Marketing. LG&E and KU conduct energy trading and risk management activities to maximize the value of power sales from physical assets they own, in addition to the wholesale sale of excess asset capacity. These off-system sales accounted for 4.4 TWh in 2005. Although the companies do not conduct proprietary or speculative trading, certain energy trading activities are accounted for on a mark-to-market basis in accordance with SFAS No. 133. Wholesale sales of excess asset capacity in the MISO day-ahead and real-time markets (as defined below) are treated as normal sales under SFAS No. 133 and are not marked-to-market.

Transmission

E.ON U.S. s utility subsidiaries LG&E and KU operate 4,930 miles of transmission line. They participate as transmission owning members of the Midwest Independent Transmission System Operator, Inc. (MISO), which commenced commercial operations in February 2002. The MISO implemented a day-ahead and real-time market (MISO Day 2), including a congestion management system, in April 2005. The Federal Energy Regulatory Commission (FERC) and the United States Courts of Appeals have generally affirmed the MISO s imposition of certain of its administrative, congestion management and other regional market-related costs on market participants and users of the system, including native load customers, resulting in increased costs for LG&E and KU. LG&E and KU continue to participate in proceedings before the FERC, the federal courts in Washington D.C. and the KPSC, challenging the imposition of various costs on native load customers and seeking authorizations to exit the MISO regime, as described below under Regulatory Environment U.S. Midwest.

For additional information about transmission developments, including additional proceedings, see Regulatory Environment U.S. Midwest.

At this time, LG&E and KU cannot predict the outcome or effects of the various KPSC and FERC proceedings described above, including whether such proceedings will have a material impact on their financial condition or results of operations. Further, the ultimate financial consequences for E.ON U.S. (primarily changes in transmission revenues and costs) associated with the April 2005 implementation of day-ahead and real-time market tariff charges are subject to varying assumptions and calculations and are therefore difficult to estimate.

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Distribution/ Retail

The electric retail activities of LG&E and KU are limited to their respective service territories in Kentucky, with a small KU service region in Virginia and service to less than 10 customers in Tennessee. In 2005, LG&E s total electric retail sales to residential, commercial and industrial customers were 11.0 billion kWh and its total aggregate electric sales, including off-system sales, were 16.1 billion kWh. In 2005, KU s total electric retail sales to residential, commercial and industrial customers were 16.5 billion kWh and its total aggregate electric sales were 21.6 billion kWh.

The following table sets forth LG&E s and KU s sale of electric power for the periods presented:

Sales of Electric Power to	Total 2005 million kWh	Total 2004 million kWh
Residential	10,864	10,084
Commercial and industrial customers	16,684	16,276
Municipals	2,014	1,959
Other retail	3,720	3,576
Off-system sales	4,434	4,199
Total	37,716	36,094

The gas retail activities of LG&E are limited to its service territory in Kentucky. In 2005, LG&E s total retail gas sales were 10.8 billion kWh (2004: 10.2 billion kWh) and its total aggregate gas sales (including gas transportation volumes and wholesale sales) were 14.6 billion kWh (2004: 14.7 billion kWh).

On June 30, 2004, the KPSC approved electric and gas base rate changes at LG&E and KU that increased these rates by an aggregate of approximately $100 million per year. The new rates became effective on July 1, 2004. For details, including pending regulatory challenges, see Regulatory Environment U.S. Midwest.

Non-regulated Businesses

ECC. ECC is the primary holding company for E.ON U.S. s non-regulated businesses discussed below. Its businesses include domestic power generation and wholesale sales, international operations, and pipeline services.

Argentine Gas Distribution Operations. ECC owns interests in Argentine gas distribution operations which provide natural gas to approximately two million customers in Argentina through three distributors (Gas Natural BAN S.A. (Ban), Distribuidora de Gas del Centro S.A. (Centro) and Distribuidora de Gas Cuyana S.A. (Cuyana)). ECC owns 19.6 percent of Ban, 45.9 percent of Centro, and 14.4 percent of Cuyana. These operations continue to be subject to economic and political risks typical of emerging markets.

LPI. LG&E Power Inc. (LPI), a wholly-owned subsidiary of ECC, and its affiliates own, operate and maintain interests in U.S. independent power generation facilities. LG&E Power Services LLC (LPS), an affiliate of LPI, operates four facilities in the United States under medium-term operating contracts with independent third parties. LPI also has a 50 percent ownership interest in a 209 MW coal-fired facility in North Carolina and operates that facility under a medium-term operating contract with a utility. Following management s decision in September 2003 to dispose of all of LPI s assets, LPI and ECC sold their interests in wind power generation facilities in Texas and Spain in 2004. In January 2005, LPI sold its 50 percent ownership interest in a 550 MW gas-fired power generation facility in Texas. LPI has also entered into a contract to sell its share of the facility in North Carolina, which sale process has been in litigation concerning third party consent or first refusal rights. Negotiations seeking to resolve the litigation and agreeing on a revised sale contract for the North Carolina facility, which would also include the sale of all of the assets of LPS, are progressing and it is possible that the transaction may be completed in the first half of 2006. However, no assurance can be given that the sale or the disposal of LPI s or LPS s remaining assets will be completed as planned.

LEM. Effective June 30, 1998, LEM discontinued its merchant energy trading and sales business. This business consisted primarily of a portfolio of energy marketing contracts entered into in 1996 and early 1997,

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including a long-term contract with Oglethorpe Power Corporation which terminated at the end of 2004, nationwide deal origination and some level of proprietary trading activities, which were not directly supported by E.ON U.S. s physical assets. E.ON U.S. s decision to discontinue these operations was primarily based on the impact that volatility and rising prices in the power market had on its portfolio of energy marketing contracts. As of December 31, 2005, E.ON U.S. has completed settlement of all commitments entered into during this period.

OTHER ACTIVITIES

Degussa

Overview

Degussa is one of the major specialty chemical companies in the world. In May 2002, E.ON reached a definitive agreement with RAG to sell a portion of E.ON s majority interest in Degussa to RAG and to acquire RAG s more than 18 percent interest in E.ON Ruhrgas in a two step transaction. In late January 2003, E.ON completed the first step of the RAG/ Degussa transaction by acquiring RAG s Ruhrgas stake and tendering 37.2 million of its shares in Degussa to RAG at the price of 38 per share, receiving total proceeds of 1.4 billion. Following this transaction and the completion of the tender offer to the other Degussa shareholders, RAG and E.ON each held a 46.5 percent interest in Degussa, with the remainder being held by the public. The shares of Degussa AG are listed on the Frankfurt Stock Exchange and are part of the MDAX, the performance index of 50 German mid-cap companies. In the second step, E.ON sold a further 3.6 percent of Degussa stock to RAG as of May 31, 2004. Effective June 1, 2004, E.ON owns 42.9 percent of Degussa. In December 2005, E.ON and RAG signed a framework agreement on the sale of E.ON s remaining 42.9 percent stake in Degussa to RAG at the price of 31.50 per share, which would result in total proceeds of 2.8 billion. The transaction, which is subject to the approval of the German federal government and the state of North-Rhine Westphalia, is expected to be completed by July 1, 2006. Until completion of this transaction, E.ON and RAG operate Degussa under joint control.

Since the first step of the RAG/ Degussa transaction was completed, E.ON accounts for Degussa using the equity method. For all periods from February 1, 2003 until May 31, 2004, E.ON recorded 46.5 percent of Degussa s after-tax earnings in its financial earnings. From June 1, 2004, E.ON records 42.9 percent of Degussa s after-tax earnings in its financial earnings. For 2005, Degussa contributed adjusted EBIT of 132 million.

Operations

Degussa s strategic management responsibilities lie with its board of management, while responsibility for management at the operational level rests with Degussa s decentralized business units, each of which is grouped into one of Degussa s core divisions. The following chart sets forth Degussa s divisions divided into business units:

DEGUSSA

Technology Specialists	**Construction Chemicals**	**Consumer Solutions**	**Specialty Materials**
Building Blocks	Admixture Systems Europe	Superabsorber	Coatings & Colorants
Exclusive Synthesis & Catalysts	Admixture Systems North America	Care & Surface Specialties	High Performance Polymers
C_4 -Chemistry	Admixture Systems Asia/Pacific	Feed Additives	Methacrylates
Aerosil & Silanes	Construction Systems Europe		Specialty Acrylics

Advanced Fillers & Pigments	Construction Systems Americas

In March 2006, Degussa announced that it had reached an agreement to sell the activities of its Construction Chemicals division to BASF. The transaction, which is subject to regulatory approvals, is expected to close before

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the end of the year. All other activities are grouped as non-core businesses or services/development units and are not shown in the table above.

DISCONTINUED OPERATIONS

In 2002 and 2001, the Company discontinued the operations of its former oil segment and of its former aluminum and silicon wafer segments, respectively. These former segments are accounted for as discontinued operations in accordance with U.S. GAAP. In addition, in 2003, E.ON discontinued and disposed of certain operations in the Central Europe and U.S. Midwest market units, as well as certain activities of Viterra in the Other Activities business segment. In 2005, E.ON discontinued and either disposed of certain operations or classified certain businesses as held for sale in the Pan-European Gas and U.S. Midwest market units, as well as Viterra in the Other Activities business segment. E.ON therefore also considers these businesses to be discontinued operations. Under U.S. GAAP, results of all such discontinued operations must be shown separately, net of taxes and minority interests, under Income (Loss) from discontinued operations, net in E.ON s Consolidated Statements of Income. For details, see Note 4 of the Notes to Consolidated Financial Statements.

Oil

In July 2001, E.ON and BP entered into an agreement pursuant to which BP agreed to acquire a 51.0 percent stake in VEBA Oel by way of a capital increase. VEBA Oel was then active in the oil and gas exploration and production, oil processing and marketing and petrochemicals businesses. The agreement also provided E.ON with a put option that allowed it to sell the remaining 49.0 percent interest in VEBA Oel to BP at any time from April 1, 2002 for 2.8 billion, subject to certain purchase price adjustments. In December 2001, the German Federal Cartel Office cleared the transaction. The capital increase took place in February 2002, giving BP majority control of VEBA Oel as of February 1, 2002. The aggregate consideration paid by BP for the capital increase was approximately 2.9 billion. In addition, 1.9 billion in shareholder loans from the E.ON Group to VEBA Oel were repaid. As of June 30, 2002, E.ON exercised the put option. E.ON has received 2.8 billion for its VEBA Oel shares plus the aforementioned repayment of the shareholder loans. In April 2003, E.ON and BP reached an agreement setting the final purchase price for VEBA Oel (without prejudice to the standard indemnities in the contract) at approximately 2.9 billion. The disposal of VEBA Oel resulted in a loss from discontinued operations net of income taxes of 37 million in 2003. E.ON recognized a loss on disposal of 35 million in 2003 related to the final purchase price settlement and a gain of 1.4 billion in 2002. In 2004, E.ON recognized a loss of 19 million resulting from claims under standard contractual indemnities. These effects were recorded under Income (Loss) from discontinued operations, net in the income statement for the relevant period.

Aluminum

In March 2002, E.ON sold VAW (then one of Europe s major aluminum companies) to the Norwegian company Norsk Hydro ASA for the aggregate price of 3.1 billion, including financial liabilities and pension provisions totaling 1.2 billion. E.ON realized a gain on disposal of 893 million, which does not include the reversal of VAW s negative goodwill of 191 million, as this amount was required to be recognized as income due to a change in accounting principles upon adoption of SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142), on January 1, 2002. In 2005, E.ON recognized a gain of 10 million before income taxes resulting from the release of a related provision. This effect was recorded under Income (Loss) from discontinued operations, net in the Consolidated Statements of Income.

Silicon Wafers

On September 30, 2001, E.ON agreed to sell its 71.8 percent interest in MEMC (then a worldwide manufacturer of silicon wafers for the semiconductor device industry) to Texas Pacific Group, a San Francisco-based financial investor, for a symbolic price, which included the assumption of shareholder loans made by E.ON. The transaction was completed on November 13, 2001. In September 2003, the purchase price was adjusted, as provided for in the purchase agreement, because MEMC had substantially improved its earnings

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performance in 2002. This purchase price adjustment resulted in income from discontinued operations net of income taxes and minority interests for E.ON of 14 million.

Other Activities

In June 2003, Viterra disposed of Viterra Energy Services AG (Viterra Energy Services), which then provided heat and water submetering services for administrators and owners of residential and commercial property, to CVC Capital Partners. In March 2003, Viterra sold its Viterra Contracting GmbH (Viterra Contracting) subsidiary, which then provided heat contracting services to apartment buildings, to Mabanaft GmbH (Mabanaft). The aggregate consideration for both transactions totaled 961 million, including approximately 112 million of assumed liabilities, with Viterra realizing a gain of 641 million. The portion of 2003 results included in Income (Loss) from discontinued operations, net in E.ON s Consolidated Statements of Income amounted to 681 million. For the portion of 2003 prior to their disposition, Viterra Energy Services and Viterra Contracting had combined revenues of 202 million. In 2004, the release of previously recorded provisions resulted in income in the amount of 10 million, which is recorded in the same line item.

On May 17, 2005, E.ON sold Viterra (then one of Germany s largest private owners of residential property) to Deutsche Annington. The purchase price for 100 percent of Viterra s equity was approximately 4 billion. The transaction closed in August 2005. The company was classified as a discontinued operation in May 2005 and deconsolidated as of July 31, 2005. The portion of Viterra s 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON s Consolidated Statements of Income amounted to 2.6 billion and 294 million, respectively. In 2005, Viterra had revenues of 453 million. E.ON recorded a gain on disposal of 2.4 billion.

Other

As a legal condition for E.ON s acquisition of Ruhrgas, E.ON Energie was required to dispose of its 80.5 percent shareholding in Gelsenwasser, which then provided drinking water, industrial water, natural gas and other utility services in Germany. In September 2003, a joint venture company owned by the municipal utilities of the German cities of Dortmund and Bochum purchased the Gelsenwasser interest for 835 million. The portion of Gelsenwasser s 2003 results included in Income (Loss) from discontinued operations, net in E.ON s Consolidated Statements of Income amounted to 479 million. In 2003, Gelsenwasser had revenues of 295 million. E.ON realized a gain on disposal of 418 million.

As a part of the regulatory approval of the former Powergen s acquisition of LG&E Energy (now E.ON U.S.), the SEC had required that LG&E Energy sell CRC-Evans International Inc. (CRC-Evans), then a provider of specialized equipment and services used in the construction and rehabilitation of gas and oil transmission pipelines. Effective October 31, 2003, LG&E Energy sold CRC-Evans to an affiliate of Natural Gas Partners for 37 million. The portion of CRC-Evans results included in Income (Loss) from discontinued operations, net in E.ON s Consolidated Statements of Income amounted to approximately 1 million in each of 2005 and 2003. E.ON realized no gain or loss on the disposal. In 2003, CRC-Evans had revenues of 73 million.

On June 15, 2005, E.ON Ruhrgas signed an agreement regarding the sale of Ruhrgas Industries (then an industrial business, which focused on metering and industrial furnaces) to CVC Capital Partners. The purchase price for 100 percent of Ruhrgas Industries equity was approximately 1.2 billion, with the purchaser s assumption of Ruhrgas Industries debt and provisions bringing the total value of the transaction to approximately 1.5 billion. The transaction received antitrust approval in July and early September and closed on September 12, 2005. The company was classified as a discontinued operation in June 2005 and deconsolidated as of August 31, 2005. The portion of Ruhrgas Industries 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON s Consolidated Statements of Income amounted to 628 million and 29 million, respectively. In 2005, Ruhrgas Industries had revenues of 847 million. E.ON recorded a gain on disposal of 0.6 billion.

In November 2005, E.ON U.S. entered into a letter of intent with Big Rivers Electric Corporation (BREC), a power generation cooperative in western Kentucky, regarding a proposed transaction to terminate the lease and operational agreements for nine coal-fired and one oil-fired electricity generation units in western

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Kentucky among the parties, which were held through its wholly-owned subsidiary Western Kentucky Energy Corp. and affiliates (WKE). The parties are in the process of negotiating definitive agreements regarding the transaction, the closing of which would be subject to review and approval of various regulatory agencies and other interested parties. Subject to such contingencies, the parties are working on completing the proposed termination transaction by the end of 2006. WKE was classified as a discontinued operation at the end of December 2005. The portion of WKE s 2005 and 2004 results included in Income (Loss) from discontinued operations, net in E.ON s Consolidated Statements of Income amounted to a loss of 162 million and 2 million, respectively.

For further information, see Note 4 of the Notes to Consolidated Financial Statements.

REGULATORY ENVIRONMENT

EU/ GERMANY: GENERAL ASPECTS (ELECTRICITY AND GAS)

Overview

In order to promote competition in the EU energy market, the EU adopted electricity and gas directives (Directive 96/92/ EC Concerning Common Rules for the Internal Market in Electricity, or the First Electricity Directive and Directive 98/30/ EC Concerning Common Rules for the Internal Market in Natural Gas, or the First Gas Directive).

The First Electricity Directive was adopted in December 1996 and was intended to open access to the internal electricity markets of EU member states. Germany implemented the First Electricity Directive by enacting an Energy Law (*Energiewirtschaftsgesetz,* or the Energy Law) that entered into force on April 29, 1998. The Energy Law of 1998 modified the old Energy Law, the German legal framework governing utilities that sets forth the general obligations required of electricity and gas companies and defines which segments of the industry are subject to regulation.

The First Gas Directive was adopted in 1998 and was intended to open access to the internal gas markets of EU member states. The Energy Law of 1998 already included elements of the First Gas Directive, while an amendment to the Energy Law, which came into effect on May 24, 2003, completed the implementation of the First Gas Directive into German law.

In June 2003, the EU Energy Council amended the First Electricity Directive and replaced it with a new electricity directive (Directive 2003/54/ EC Concerning Common Rules for the Internal Market in Electricity, or the Second Electricity Directive), and also adopted a second gas directive (Directive 2003/55/ EC Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 98/30/ EC, or the Second Gas Directive), which replaced the First Gas Directive. Germany implemented these directives by enacting the new Energy Law of 2005 (*Zweites Gesetz zur Neuregelung des Energiewirtschaftsrechts*, or the Energy Law of 2005), which came into force on July 13, 2005. Corresponding network access and network charges ordinances for electricity and gas came into force on July 29, 2005.

The following paragraphs outline relevant aspects of the First Electricity and Gas Directives, the Energy Law, the Second Electricity and Gas Directives, and amendments of the Energy Law, as well as other EU proposed and adopted directives and regulations that affect the German energy industry.

E.ON s operations outside of Germany are subject to the different national and local regulations in the relevant countries.

The First Electricity and Gas Directives

The First Electricity Directive established common rules for the internal EU electricity market. Under the First Electricity Directive, the EU electricity market was expected to be opened gradually to competition. Member states could choose to have either a so-called single-buyer system or a system permitting negotiated or regulated third party access to electricity networks (nTPA or rTPA). Member states that elected the nTPA system were required to publish frameworks for network charges. The Directive also required integrated utilities

to keep separate accounts for their transmission and distribution activities, as well as for other activities not relating to transmission and distribution, in their internal accounting.

The First Gas Directive provided for a gradual opening of EU member states natural gas markets to competition. It allowed each member state to opt for nTPA or rTPA systems, similar to the provisions of the First Electricity Directive. Under the First Gas Directive, natural gas companies were allowed to apply for a temporary derogation from the rules for third party access in case of serious economic and financial difficulties created by existing take-or-pay commitments. The First Gas Directive also required integrated utilities to keep separate accounts for their transmission and distribution activities, as well as for other activities not relating to transmission and distribution, in their internal accounting.

The German Energy Law

Germany s Energy Law of 1998 implemented the First Electricity Directive. The Energy Law abolished exclusive supply contracts, thereby introducing competition in the supply of electricity to all consumers, and provided (in addition to the so-called single-buyer system) for non-discriminatory nTPA for all utilities. The German market was opened for all customers in one step, going far beyond the requirements of the First Electricity Directive and also beyond the steps taken by Germany s neighboring countries. Specifically, in assessing a request for energy transmission, the Energy Law requires a transmission company to take into account the extent to which such transmission displaces electricity generated from CHP plants, renewable energy sources and, in eastern Germany, lignite-based power plants, and the extent to which it impedes the commercial operation of such power plants. Furthermore, the Energy Law introduced a provision for third party access into the Law Against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, or GWB). In 1998, the first electricity association agreement provided the main basis for an nTPA network access system for electricity in Germany. See Germany: Electricity Electricity Network Access below.

The Energy Law of 1998 also included prior to the adoption of the First Gas Directive certain parts of the First Gas Directive. The Energy Law of 1998 enhanced competition in gas supply to consumers and provided for non-discriminatory nTPA for all utilities. The German gas market was opened for all customers in one step in the year 1998, in this respect going far beyond the requirements of the First Gas Directive and also beyond the steps taken by Germany s neighboring countries. In 2000, the first gas association agreement provided the main basis for an nTPA network access system for gas in Germany. Technical access rules for household and small commercial customers were introduced in September 2002.

The Second Electricity and Gas Directives

Completion of the Internal Electricity Market/ The Second Electricity Directive. On June 26, 2003, the EU Energy Council adopted the Second Electricity Directive, which replaced the First Electricity Directive. The Second Electricity Directive requires full market opening to competition in each member state by July 1, 2004 for commercial customers and by July 1, 2007 for household customers. The Directive also sets forth general rules for the organization of the EU electricity market, such as the option of the member states to impose certain public service obligations, customer protection measures and provisions for monitoring the security of the EU s electricity supply. The previous framework of negotiated third party access in Germany is no longer allowed under the Second Electricity Directive. Instead, the Directive requires that at least a methodology for calculating network charges be fixed by law or approved by an independent regulatory body which is required to be established. In addition, the Second Electricity Directive contains provisions requiring the organizational and legal unbundling of transmission and distribution system operators, as well as mandatory electricity labeling for fuel mix, emissions and waste data.

The following paragraphs provide more detail on the independent regulatory authority, legal unbundling, electricity labeling and certain of the public service requirements.

The Second Electricity Directive (as well as the Second Gas Directive, see below) requires the establishment of a regulatory body that is independent of the interests of the electricity and gas industries. According to the Directive, the independent regulator shall be responsible for ensuring non-discriminatory network access, monitoring effective competition and ensuring the efficient functioning of the market. Further, the regulator shall

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be responsible for fixing or approving the terms and conditions for connection and access to national transmission and distribution networks (or at least the methodologies to calculate such terms), including transmission and distribution charges, and for the provision of balancing services, and shall also have the authority to require transmission and distribution system operators, if necessary, to modify their terms and conditions in order to ensure that they are proportionate and applied in a non-discriminatory manner.

In addition, the Second Electricity Directive requires that each transmission and distribution system operator be independent, at least in terms of legal form, organization and decision-making, from other activities not relating to transmission or distribution (legal unbundling). This requirement does not imply or result in the requirement to separate the ownership of assets of the transmission network from the vertically integrated undertaking. The Second Electricity Directive enables member states to postpone the implementation of provisions for legal unbundling of distribution system operations until July 1, 2007 at the latest. Derogations from legal unbundling may also be granted to distribution companies serving less than 100,000 connected customers or small isolated networks. Member states can request an exemption from legal unbundling if they can prove that total and non-discriminatory access to the distribution networks can be achieved by other means.

The Second Electricity Directive requires electricity suppliers to specify in or with bills, as well as in promotional materials for end user customers, the following information:

The contribution of each energy source to the overall fuel mix of the supplier over the preceding year; and

A reference to where information is publicly available on the environmental impact of the supplier s activities, including the amount of CO_2 and radioactive waste produced.

Finally, the Second Electricity Directive requires that household customers and where member states deem it appropriate small companies must be provided with universal service, *i.e.*, the right to be supplied with electricity of a specified quality at reasonable prices.

Completion of the Internal Gas Market/ The Second Gas Directive. On June 26, 2003, the EU also adopted the Second Gas Directive, which replaced the First Gas Directive. Similar to the Second Electricity Directive, the Second Gas Directive requires full opening of each member state s gas market to competition by July 1, 2004 for all non-household customers and by July 1, 2007 for all customers. The Directive also sets forth similar general rules for the organization of the EU gas market. The previous framework of negotiated third party gas network access in Germany is no longer allowed under the Second Gas Directive. Instead, as in the Second Electricity Directive, the Second Gas Directive requires that at least a methodology for calculating network charges be fixed by law or approved by an independent regulatory authority which is required to be established. The Directive also requires integrated gas companies to legally unbundle their transmission and distribution system operators from other operations.

The Second Electricity and Gas Directives were required to be implemented by each member state by July 1, 2004.

Revisions of the German Energy Law

Prior to the adoption of the Second Gas Directive, the German government amended the Energy Law in May 2003. The amended Energy Law *(Erstes Gesetz zur Änderung des Gesetzes zur Neuregelung des Energiewirtschaftsrechts)* fully completed the implementation of the First Gas Directive into national law. Apart from provisions to facilitate the opening of the gas market, a new section determined the legal basis for non-discriminatory access to gas networks. In addition, the amended Energy Law formally recognized the relevant electricity and gas association agreements (*Verbändevereinbarung Strom II+* and *Verbändevereinbarung Gas II*) as good commercial practice until December 31, 2003. Furthermore, this amendment modified the provisions of the GWB concerning the suspensive effect of appeals made against decisions of the Federal Cartel Office, so that decisions issued pursuant to the third party access provision of the GWB became immediately applicable.

In order to implement the Second Electricity and Gas Directives, the German legislature passed the Energy Law of 2005 *(Zweites Gesetz zur Neuregelung des Energiewirtschaftsrechts)*, which came into force on July 13,

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2005. Corresponding network access and network charge ordinances for electricity and gas came into force on July 29, 2005.

Under this new legal framework, the German legislature has authorized the Federal Network Agency (*Bundesnetzagentur*, or the BNetzA, previously called the Regulatory Authority of Telecommunications and Post) to act as the independent regulatory body required by the Second Electricity and Gas Directives, initially with ex-ante supervisory powers. The BNetzA is responsible for fixing or approving and controlling the terms and conditions for connection and access to national transmission and distribution networks, including transmission and distribution charges. The BNetzA (and the state-level regulators) also have the authority to require transmission and distribution system operators, if necessary, to modify their conduct in order to ensure that they act in a non-discriminatory manner.

The following paragraphs provide more detail on the most significant elements of the Energy Law of 2005 for German utilities:

Network access and network charge regulation: The new law contains two phases of regulation. In the starting phase of regulation, the BNetzA and the state level regulators set allowed capital costs for utilities ex-ante using a cost-based rate-of-return model. The allowed capital costs for existing investments are derived from a regulated asset base that is partly valued at current cost. For new investments, the allowed capital costs are derived from a regulated asset base valued at historic cost. Network operators must calculate network charges using this cost-based model and submit the charges to the BNetzA for approval ex-ante. See Germany: Electricity Electricity Network Charges and Germany: Gas Gas Network Charges below. In a second phase of regulation, which is currently expected to be implemented in 2007, the BNetzA is obliged to develop and implement a new incentive-based regulation system which will replace the current cost-based model. At this time, E.ON is unable to predict the form of such incentive regulation, or its effects on the Company and on the German energy industry generally.

The Energy Law of 2005 contains an exemption from cost calculations for gas transmission networks if actual or potential pipeline competition can be proved. The law also provides for the development of a special entry/exit system for gas network access, whereby network operators have to offer entry and exit capacities for the transmission of gas separately to system users in order to ensure that system users only need one contract for entry capacities and one contract for exit capacities. All network operators are obliged to develop an entry/exit model by February 1, 2006, with implementation required by October 1, 2006.

Unbundling of network operators: The Energy Law of 2005 requires legal as well as operational (organizational), information and accounting unbundling of each transmission and distribution system operator from the other activities of the utilities. Network operators serving less than 100,000 connected customers are exempt from the legal and operational unbundling obligations.

The Company s German transmission system operations already comply with the legal unbundling requirements contained in the Energy Law of 2005. With respect to its distribution system operations, the Company expects to comply with the legal unbundling requirement by the required deadline of July 1, 2007. The Company s German transmission and distribution system operations already comply with the operational (organizational), information and accounting unbundling requirements contained in the Energy Law of 2005.

The exact interpretation of some of the new regulatory rules is still pending. Therefore, the Company cannot predict all consequences of the new legal framework for its operations or the effect of the new law on its future earnings and financial condition.

European Regulation on Cross-Border Trading

The Second Electricity Directive was accompanied by a new EU regulation on cross-border electricity trading (Regulation (EC) No. 1228/2003 on Conditions for Access to the Network for Cross-Border Exchanges in Electricity, or the Regulation on Cross-Border Electricity Trading). This regulation required the establishment of a committee of national experts chaired by the EU Commission. The committee will adopt guidelines on inter-transmission system operator compensation for electricity transit flows, on the harmonization of national

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transmission charges and on network congestion management. The applicable guidelines have already been drafted and are expected to enter into force in 2006.

At the EU level, a provisional charge system for cross-border electricity trading came into effect in March 2002. The system provides a fund mechanism to cover costs resulting from cross-border trades. Until 2003, money for the fund was raised from two sources: a charge on exports and socialized costs charged to all electricity customers. As of January 1, 2004, a modified cross-border charge system has taken effect. Instead of charging export fees for international electricity flows, transmission system operators must now pay into a fund according to their net physical import and export flows. As before, the distribution of the funds depends on transit volume, so as a large transit country Germany continues to be a net receiver of funds. This transitional charge system will remain in effect until the guidelines outlined in the EU s Regulation on Cross-Border Electricity Trading are applicable, *i.e.* at least for part of 2006.

Greenhouse Gas Emissions Trading

In order to reach the greenhouse gas emissions reduction targets set by the Kyoto Protocol to the United Nations Framework Convention on Climate Change (the Kyoto Protocol), the EU adopted a directive on emissions trading (Directive 2003/87/ EC Establishing a Scheme for Greenhouse Gas Emission Allowance Trading Within the Community, or the Emissions Trading Directive) on October 13, 2003. The Emissions Trading Directive establishes a greenhouse gas emissions allowance trading scheme for member states which started in 2005. The trading scheme is currently limited to the trading of CO_2 emission certificates. The first obligatory commitment period under the Kyoto Protocol will follow from 2008 to 2012. Under the emissions allowance trading scheme, operators of identified types of industrial installations within the EU (including fossil fuel-fired combustion installations and gas turbines with a thermal input exceeding 20 MW) are obliged to acquire one or more CO_2 emission certificates that entitle the installation to emit a specified quantity of CO_2. If an installation exceeds the level of emissions covered by its certificates (which were initially allocated free of charge), it is obliged to buy additional certificates on the market. If it fails to do so, it must pay a penalty fee of 40 per ton of CO_2 emitted and the missing certificates additionally have to be bought on the market. If the emissions of an installation fall below the level of allocated emission certificates, the certificates can be sold on the market. Discussions have recently started on the allocation of allowances for the second phase of the emissions trading scheme, which is scheduled to run from 2008 to 2012.

Most EU member states have already transposed the Emissions Trading Directive into national law. In Germany, in July 2004 the German Parliament passed the so-called Greenhouse Gas Emissions Trade Act (*Treibhausgas-Emissionshandelsgesetz* or TEHG) and in August 2004 the Allocation Act 2007 (*Zuteilungsgesetz 2007* or ZuG 2007), which consists of methods of permit allocation and application procedures, came into force. Most of E.ON Energie s gas-, oil- and coal-powered generating facilities are covered by the new legislation. In addition, E.ON Ruhrgas operates several compressor stations with a thermal capacity exceeding 20 MW which are covered by the legislation. Pursuant to ZuG 2007, E.ON Energie and E.ON Ruhrgas applied for the necessary CO_2 emission certificates by year-end 2004. The results of the allocation of CO_2 emission certificates for E.ON Energie s covered facilities by the competent authority (*Deutsche Emissionshandelsstelle* or DEHSt) are generally acceptable to E.ON. However, E.ON Energie has filed lawsuits against the DEHSt with respect to the allocation of CO_2 emission certificates at certain installations. Currently, the number of certificates granted to E.ON Energie s covered facilities nearly covers its emissions, with a slight shortfall. The actual shortfall at any time, however, depends on a number of influence parameters, *e.g.,* availability of plants, weather conditions, electricity demand, electricity exports and fuel prices. E.ON considers the results of the allocation of CO_2 emission certificates for E.ON Ruhrgas covered facilities to be generally acceptable.

Outside Germany, CO_2 emission certificates have also been allocated in Sweden, Finland and the Netherlands. In the United Kingdom, an initial allocation of certificates has been made, although the U.K. government is considering an appeal of its CO_2 emissions allocation to try to claim additional allowances. Although the Company is generally satisfied with the allocations, E.ON Benelux has filed an objection for a single installation.

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The implementation of the Emissions Trading Directive took effect in 2005. Since the CO_2 emissions trading market is still a developing market, the Company cannot currently predict how the trading of CO_2 emission certificates will develop or what long-term impact, if any, the new regime may have on the Company s financial condition and results of operations. Currently, the Company does not generally expect the emissions trading scheme to have a significant negative impact on its operations. However, in 2005, companies of both the U.K. and Central Europe market units had to purchase additional CO_2 emission certificates on the market, with a resultant increase in operating costs. For more information, see Item 5. Operating and Financial Review and Prospects Results of Operations Year Ended December 31, 2005 Compared with Year Ended December 31, 2004. By the end of 2005, CO_2 emissions trading was possible between 15 member states of the European Union. For more information about the Company s trading operations, see Business Overview Central Europe Trading, U.K. Energy Wholesale E Trading and Nordic Trading.

Energy Infrastructure and Security of Supply

In December 2003, the European Commission proposed a legislative package on energy infrastructure and security of supply. In January 2006, the EU adopted Directive 2005/89/ EC Concerning Measures to Safeguard Security of Electricity Supply and Infrastructure Investment (the Security of Supply Directive) , which requires EU member states to ensure a high level of security of electricity supply by taking necessary measures to facilitate a stable investment climate. The Security of Supply Directive stipulates that transmission system operators set minimum operational rules and obligations for network security, which then may require approval by the relevant authority. Member states must also prepare, in close cooperation with the transmission system operators, a system adequacy report according to EU reporting requirements. Member states must transpose the Security of Supply Directive into national law by February 24, 2008.

In addition, in November 2005 the EU adopted a regulation on conditions for access to gas transmission networks, which covers access to all gas transmission networks in the EU and addresses a number of issues such as access charges (which must reflect the actual costs incurred), third party access services, capacity allocation mechanisms, congestion management, transparency requirements, balancing and imbalance charges, secondary markets (introducing a use-it-or-lose-it principle), and information and confidentiality provisions. The regulation also requires the establishment of a committee of national experts chaired by the EU Commission, which will have the authority to revise the rules annexed to the regulation. The regulation will apply from July 1, 2006, except for provisions concerning amendment of the rules in the regulation annex, which will apply as of January 1, 2007.

The European Commission has also proposed a directive on energy end-use efficiency and energy services. The text of the directive, which has already been agreed upon and is expected to be adopted during 2006, foresees indicative targets for member states to reduce overall end energy consumption by nine percent over a nine year period, which would be achieved by boosting energy efficiency measures in the EU.

Security of Energy Supply (Gas)

On April 26, 2004, the EU adopted a directive establishing measures to safeguard the security of the EU s gas supply (Directive 2004/67/ EC Concerning Measures to Safeguard Security of Natural Gas Supply, or the Gas Supply Directive). The Gas Supply Directive establishes a common framework within which member states must define general, transparent and non-discriminatory security of supply policies compatible with the requirements of a competitive internal gas market, and focuses on measures to be taken if severe difficulties arise in the supply of natural gas. The key elements of the Gas Supply Directive are:

Member states must adopt adequate minimum security of supply standards, and

A three step procedure will take effect in the event of a major supply disruption for a significant period of time. Under the three step procedure, the gas industry should take measures as a first response to such a disruption, followed by national measures taken by member states. In the event of inadequate measures at the national level, the Gas Coordination Group, consisting of representatives of member states, the gas industry and relevant consumers under the chairmanship of the European Commission, would then decide on necessary measures.

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The Gas Supply Directive is required to be implemented by each member state by May 19, 2006. This directive has been implemented into German law through the Energy Law of 2005.

Markets in Financial Instruments Directive

The Markets in Financial Instruments Directive (MiFID), which substantially revises the existing Investment Services Directive, was adopted by the EU in April 2004. The original implementation deadline has been postponed and member states are now required to implement MiFID by May 1, 2006. This new legislation is then scheduled to apply to the relevant companies by November 1, 2007.

MiFID establishes high level organizational and conduct of business standards that apply to all investment firms, including the application of EU capital adequacy standards. The extension of regulation to include commodity derivatives and investment advice are two notable features of the directive which potentially affect energy firms which are active in the trading business. There are, however, a number of exemptions which could apply to energy firms, depending on how MiFID is eventually implemented in the member states. The Company cannot currently predict how the implementation of MiFID may affect its operations.

GERMANY: ELECTRICITY

The Electricity Feed-in Law and the Renewable Energy Law

Under the amended German *Stromeinspeisungsgesetz* (law governing renewable electricity fed into the power network, or Electricity Feed-In Law), which came into effect in 1991, all regional utilities with standard rate customers were required to pay for energy produced from renewable resources, including wind-generated electricity, fed into the network. The price paid by the regional utility to the generator of renewable energy, determined by the average electricity price to the end user nationwide, typically exceeded the regional utilities procurement costs, thereby forcing regional utilities to pay part of the costs of renewable sources of energy. Regional utilities in whose supply area the feeding plants are located had to bear these costs.

As this led to distortions in competition, the German Parliament passed another change in the Electricity Feed-in Law, which came into effect April 1, 2000. Important aspects of the changed law, which is called the Renewable Energy Law, include:

Fixed charges for renewable energies: Charges for renewable energies are fixed. For wind turbines coming online in 2006, the charge is fixed at 8.36 cent/kWh. This charge is limited in time, with a general term of five years that may be extended up to 20 years depending upon the actual production volume of the installation. After five years, the charge is reduced to 5.28 cent/kWh if 150 percent or more of a reference production, which is the potential production of the installed wind turbine operating with a constant wind speed of five meters per second over five years, has been produced. In addition, the fixed charge is reduced by two percent for new wind turbines every year. For wind turbines coming online in 2007, this means a reduction to 8.19 cent/kWh and 5.17 cent/kWh respectively.

National burden sharing: The Renewable Energy Law assumes that the subsidy obligation would be passed on in full to the supplying companies. At the transmission company level, there is an equalization process covering the whole country. Each transmission company first determines how much electricity it takes up under the Renewable Energy Law and how much electricity in total flows in its region to end users. An equalization will then be effected among all transmission companies so that all transmission companies take on and subsidize proportionally equivalent amounts of renewable electricity under the statute. The transmission company will then pass these quantities of electricity and the corresponding costs on to the suppliers delivering electricity to end users in its region in proportion to their respective sales.

The Renewable Energy Law abolished regional differences in electricity costs for consumers and the related competitive disadvantages for E.ON Energie. However, the growing production of energy from wind turbines has led to growing costs for balancing power, network extensions and back-up power for power stations that have to be kept in reserve. This became a growing burden for E.ON Energie, since almost half of Germany s wind

turbines are situated in the network control area of E.ON Energie AG, an area that meets approximately 30 percent of German electricity demand.

In August 2004, an amendment of the Renewable Energy Law came into force which partially addressed this burden by introducing an obligation for the transmission system operators to share the effort of balancing power by equally distributing the feed-in of electricity from wind power according to the electricity consumption in the area of each transmission system operator. As a result of this burden sharing mechanism, E.ON Energie is able to pass a certain amount of balancing costs on to other network operators. Other costs caused by renewable energy (network extension and back-up power) are, however, currently not part of the national burden sharing mechanism. E.ON Energie believes that the charges for renewable energies are still too high and that competition which would bring down the cost of renewable energy generation has not developed.

In two court rulings dated December 22, 2003, the German Federal Court of Justice found that contractual provisions used by E.ON s competitor RWE to impose taxes and levies upon the customer (so-called *Steuer- und Abgabeklauseln*) also apply to the additional burdens placed on electric power companies by the Renewable Energy Law, despite the fact that those burdens are neither taxes nor levies in a legal sense. Although E.ON was not a party to the proceedings that resulted in these rulings, it believes these rulings could be a legal base for all German electric power companies to pass the costs imposed by the Renewable Energy Law on to their customers.

Co-Generation Protection Law

In order to protect existing CHP plants and give incentives to improve them, the German Parliament passed a new Co-Generation Protection Law *(Kraft-Wärme-Kopplung-Gesetz)* on March 1, 2002, which came into effect on April 1, 2002 and replaced the former Co-Generation Protection Law of May 2000. The new law, which will expire at the end of 2010, requires local network operators to pay CHP plants the following bonus payments for electricity that is produced in combination with heat and fed into the public network:

CHP plants that were commissioned before 1990 received 1.53 cent/kWh in 2002 and 2003 and 1.38 cent/kWh in 2004 and 2005, and will receive 0.97 cent/kWh in 2006;

CHP plants that were commissioned after 1990 received 1.53 cent/kWh in 2002 and 2003 and 1.38 cent/kWh in 2004 and 2005, and will receive 1.23 cent/kWh in 2006 and 2007, 0.82 cent/kWh in 2008, and 0.56 cent/kWh in 2009;

CHP plants that are modernized received 1.74 cent/kWh in 2002, 2003 and 2004 and 1.69 cent/kWh in 2005, and will receive 1.69 cent/kWh in 2006, 1.64 cent/kWh in 2007 and 2008, and 1.59 cent/kWh in 2009 and 2010; and

Small CHP plants with an installed capacity of less than two MW received 2.56 cent/kWh in 2002 and 2003 and 2.4 cent/kWh in 2004 and 2005, and will receive 2.25 cent/kWh in 2006 and 2007, 2.1 cent/kWh in 2008 and 2009, and 1.94 cent/kWh in 2010.

The local network operators are in turn allowed to pass on the costs of the bonus payments to the network operators, which may pass on the costs of the bonus system to their customers. A nationwide equalization process among the utilities was implemented in order to ensure the equal distribution of the costs of the bonus system across utilities. In 2005, every consumer had to pay an additional approximately 0.336 cent/kWh (including VAT). Industrial customers with an electricity consumption of more than 10,000 MWh and electricity costs higher than 15 percent of their total turnover had to pay only 0.05 ct/kWh for that portion of their electricity consumption exceeding 10,000 MWh per year. For those customers whose electricity costs are higher than 4 percent of their total turnover, this fee for electricity consumption exceeding 100,000 kWh per year is limited to 0.025 cent/kWh. In 2004, the government together with the utilities started a monitoring process to evaluate the extent to which CO_2 emissions have been reduced as a result of this law and whether the current bonus payments are adequate. The results of this monitoring process have not yet been published.

The European Union has passed a co-generation directive in order to promote the use of co-generation and thereby increase energy efficiency and reduce CO_2 emissions. The directive corresponds largely to the German national CHP

legislation and will not require a change in current German law.

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Electricity Network Access

The First Electricity Directive was implemented in Germany with a framework for negotiated third party access to high-, medium- and low-voltage networks agreed by the associations of all German utilities and of industrial customers (*Verbändevereinbarung,* amended as *Verbändevereinbarung II* and *Verbändevereinbarung II+*). *Verbändevereinbarung II+* was valid until December 2003 and subsequently utilities still acted according to its rules until the Energy Law of 2005 came into force. As of July 13, 2005, electricity network access is regulated according to the Energy Law of 2005, as described in Revisions of the German Energy Law above.

Electricity Network Charges

As described in Revisions of the German Energy Law above, the regulation of electricity network charges started in July 2005, with network charges calculated according to a cost-based rate-of-return model. To obtain approval for network charges to be used in 2006, network operators had to submit the calculated charges to the BNetzA by the end of October 2005. Network operators may apply the currently valid network charges until BNetzA approves the new charges.

Electricity Rate Regulation

Prices at which local and regional distributors sell electricity to standard-rate and smaller industrial customers are currently regulated by the economics ministries of each of the German states (as provided in the Federal Electricity Charge Regulation (*Bundestarifordnung Elektrizität,* or BTO Elt)). The rates are set at a level to assure an adequate return on investment on the basis of the costs and earnings of the electricity company. However, these governmentally-set ceiling rates do not completely represent the actual market situation, with numerous rates offered which are designed to meet different customers special needs. The average price charged by utilities for an average standard-rate customer in Germany with an assumed annual consumption of 3,500 kWh was, according to the VDEW, 18.66 cent per kWh in 2005 (all taxes included), while E.ON Energie charged an average of 18.84 cent per kWh. The average price quoted by the German Association for Energy Consumption (VEA) for industrial customers was 9.06 cent per kWh, while the average price per kWh charged by E.ON Energie was 9.42 cent per kWh, as quoted by VEA as of July 1, 2005 (net of tax). Pursuant to the Energy Law of 2005, electricity rate regulation will be abandoned on July 1, 2007.

Prices for sales of electricity by E.ON Energie to regional electricity companies, municipal utilities and large industrial customers are not regulated by the BTO Elt; however, they are governed by the GWB, which requires that no patently unreasonable rates are set.

GERMANY: GAS

Gas Network Access

Until the Energy Law of 2005 took effect, E.ON Ruhrgas used the framework for third party gas network access contained in an agreement between E.ON Ruhrgas and the Competition Directorate-General of the European Commission with respect to a matter that had been pending before the Competition Directorate. The agreement contained, among other commitments by E.ON Ruhrgas with respect to its transmission business such as greater transparency and improved congestion management, an agreement to use an entry/exit system for gas network access. The agreed entry/exit system was introduced by E.ON Ruhrgas Transport on November 1, 2004. For more information, see Business Overview Pan-European Gas Transmission and Storage. As of July 13, 2005, gas network access is regulated according to the Energy Law of 2005, as described in Revisions of the German Energy Law above. Under the Energy Law of 2005, gas network operators have to offer an entry/exit system. In order to comply with this requirement, E.ON Ruhrgas Transport has adjusted its entry/exit system with the introduction of the new ENTRIX 2 system on February 1, 2006.

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Gas Network Charges

As described in Revisions of the German Energy Law above, the regulation of gas network charges started in July 2005, with network charges calculated according to a cost-based rate-of-return model. To obtain approval for network charges to be used in 2006, network operators had to submit the calculated charges to the BNetzA by the end of January 2006. Network operators may apply the currently valid network charges until BNetzA approves the new charges.

The Energy Law of 2005 provides an exemption from cost calculations for gas transmission networks if actual or potential pipeline competition can be proved. E.ON Ruhrgas Transport sent an application for such an exemption to the BNetzA in January 2006.

Gas Rates

Gas and heat rates are not regulated in Germany, but the GWB does apply.

For information about proceedings regarding gas price calculations, *e.g.* against E.ON Hanse, see Item 3. Key Information Risk Factors External.

U.K.

Liberalization of the electricity and gas industries in the United Kingdom largely pre-dated the requirements of the First and Second Electricity and Gas Directives described under EU/ Germany: General Aspects (Electricity and Gas) above, but the U.K. regulatory regime is basically consistent with the terms of such directives. E.ON UK is also subject to U.K. and EU legislation on competition.

The gas and electricity markets in England, Wales and Scotland are regulated by a single energy regulator, the Gas and Electricity Markets Authority (the Authority), established in November 2000. The Authority is assisted by Ofgem, which is governed by the Authority. The principal objective of the Authority is to protect the interests of consumers of gas and electricity, wherever appropriate, by the promotion of effective competition in the electricity and gas industries. The Authority may grant licenses authorizing the generation, transmission, distribution or supply of electricity and the transportation, shipping or supply of gas. The Energy Act 2004 also gives the Authority power to license the operation of gas and electricity interconnectors. Any such license will incorporate by reference as appropriate the standard conditions determined for that type of license, which may be modified by the Authority. The license may also include other conditions that the Authority considers appropriate. License conditions may be modified in accordance with their terms or under the provisions of the Electricity Act 1989 (as amended) or Gas Act 1986 (as amended), as appropriate. The Authority has power to impose financial penalties on licensees and/or make enforcement orders for breach of license conditions and other relevant requirements.

The Authority also has within its designated areas of responsibility many of the powers of the Office of Fair Trading to apply and enforce the prohibitions in the Competition Act 1998 in relation to anti-competitive agreements or abuse of market dominance, including imposing financial penalties for breach. Since May 1, 2004, following reform of the EC competition law regime, the Authority also has the power to apply Articles 81 and 82 of the EC Treaty, which deal with control of anti-competitive agreements and abuse of market dominance. Within its designated areas, the Authority also exercises concurrently with the Office of Fair Trading certain functions under the Enterprise Act 2002 relating to the power to make market investigation references to the Competition Commission.

Electricity

Unless covered by a license exemption, all electricity generators operating a power station in England, Wales or Scotland are required to have a generation license. The principal generation license within the E.ON U.K. business is held by E.ON UK. Although generation licenses do not contain direct price controls, they contain conditions which regulate various aspects of generators economic behavior.

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The distribution licenses held by Central Networks East and Central Networks West (the two companies operating under the brand Central Networks) authorize the licensee to distribute electricity for the purpose of giving a supply to any premises in Great Britain. They provide for a distribution services area, equating to the former authorized area of the former public electricity suppliers in the East Midlands and West Midlands areas, respectively, in which the licensee has certain specific distribution services obligations. Under the Electricity Act 1989 (as amended), an electricity distributor has a duty, except in certain circumstances, to make a connection between its distribution system and any premises for the purpose of enabling electricity to be conveyed to or from the premises and to make a connection between its distribution system and any distribution system of another authorized distributor, for the purpose of enabling electricity to be conveyed to or from that other system.

The distribution licenses place price controls on distribution. The current distribution price controls are in effect for a five year period ending March 2010, and are expected to provide for overall stable prices for the distribution of electricity over that period. The price controls are intended to provide companies with sufficient revenues to allow them to finance their operating costs and capital investment. In addition to caps on revenue, the price controls also include targets for overall quality of network performance based upon the average number and duration of supply outages experienced by consumers. Companies can be either rewarded or penalized for exceeding or failing these targets.

The supply license held by Powergen Retail Limited authorizes the licensee to supply electricity to any premises in Great Britain. It provides for a supply services area, equating to the former authorized area of Powergen Energy plc, as the former public electricity supplier in the East Midlands, in which the licensee has certain specific supply services obligations. The supply license used to place price controls on supply; however, these price controls lapsed after March 31, 2002. Following the end of the price controls, Ofgem relies on monitoring competition and, where necessary, using its powers under the Competition Act 1998 to tackle abuse. In addition, Ofgem is pursuing a range of measures under its Social Action Plan to help vulnerable and low income customers. It is also continuing to work with the industry to improve the process for customers when they switch suppliers.

A separate supply license is held by E.ON UK, trading as E.ON Energy, which does not extend to supply to domestic premises. E.ON UK also continues to hold a second-tier supply license for Northern Ireland (to which the Utilities Act 2000 generally does not extend).

Following the acquisition of the U.K. retail energy business of the TXU Group in October 2002, E.ON UK also holds a number of additional electricity and gas supply licenses through certain of the companies that were acquired as part of that deal. Customers supplied under these licenses have been migrated to the supply licenses held by Powergen Retail Limited and E.ON UK.

In June 2005, E.ON UK acquired the electricity supply company of Economy Power. Former customers of Economy Power are currently supplied under a separate electricity supply license but are being migrated to the supply licenses held by Powergen Retail Limited and E.ON UK.

Under section 33BC of the Gas Act 1986, section 41A of the Electricity Act 1989 and section 103 of the Utilities Act 2000, electricity and gas suppliers are subject to a statutory obligation (known as the Energy Efficiency Commitment (EEC)) which requires them to achieve targets for installing energy efficiency measures in the household sector. The current obligation (known as the Electricity and Gas (Energy Efficiency Obligations) Order 2004) covers the period from April 1, 2005 to March 31, 2008. A range of energy efficiency measures qualify for the obligation, with E.ON UK anticipating that about 60 percent of its expenditures will be on home insulation. The U.K. government estimates that the cost to suppliers of this requirement will be about GBP9 per year for each of their gas and electricity customers, although the actual cost will depend on the cost to suppliers of contracting for energy efficiency measures, which is to some extent uncertain.

Gas

Licenses to ship gas and to supply gas are held by a number of companies in the U.K. market unit.

E.ON UK operates gas pipelines that are subject to the Pipelines Act 1962 (as amended), including pipelines at Killingholme, Cottam, Connah s Quay, Enfield and Winnington. This legislation gives third parties rights to

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apply to the Secretary of State for a direction requiring the pipeline owner to make spare capacity available to the third party.

NORDIC

Sweden

Electricity. The main legislation applicable to the electricity industry in Sweden is the Swedish Electricity Act *(Ellag (1997:857)*, or the Electricity Act) that came into force on January 1, 1998.

The Electricity Act promotes competition by creating opportunity for customers to enter into agreements with the supplier of the customer s choice. In order to further ensure competition in sales of electricity, the Electricity Act also requires functional unbundling of the generation/sales and the transmission and distribution businesses, as well as legal unbundling of these businesses so that transmission and distribution operations are carried out by a separate legal entity. As a consequence, electricity customers in Sweden have separate contracts with a retail supplier and an electricity distributor. In Sweden, retail prices are not regulated.

Transmission and distribution of electricity are considered to be natural monopolies and are subject to regulation. The Energy Markets Inspectorate (EMI), which is part of the Swedish Energy Agency, grants licenses to erect power lines and carry on distribution operations. As the regulator for the Swedish electricity and gas markets, EMI has the authority to supervise the monopoly transmission and distribution businesses in order to protect the interests of the customers. EMI also oversees third party access to the networks. It monitors network charges and other terms for the transmission and distribution of electricity and is responsible for setting certain standards with respect to transmission and distribution. In Sweden, the high-voltage transmission grid is owned and operated by Svenska Kraftnät, the state-owned national grid company. The mid- and low-voltage distribution networks are owned and operated by a large number of both privately and publicly owned companies. A tariff, consisting of an annual connection fee and an hourly transmission charge, applies for access to the national transmission as well as the regional and local distribution networks. Market participants pay for the right to feed in or take out electricity at just one point, which gives the participant access to the entire grid system and enables it to trade with any of the other market participants in the Nordic grid system. EMI also monitors quality of supply data for statistical reasons.

Changes in the Electricity Act regarding distribution regulation came into force in July 2002. The amendments provide that network charges have to be reasonable compared to the distribution companies performance. The concept of performance has initially been defined by EMI, which annually constructs a fictitious network for each utility in order to calculate the resources needed in the network business. The resulting value of the network is then compared to the utility s actual revenues in order to assess the reasonableness of the network charges. For this purpose EMI has created a regulation model called the Network Performance Assessment Model (NPAM). At present, the model is used for assessing the performance of the local networks only, but EMI intends to include the regional networks in the near future.

NPAM was used for the first time to evaluate network charges for 2003. Swedish electricity distribution companies reported the required information to EMI, which examined the operation of the companies. EMI decided in December 2004 to prolong its inspection of a number of Swedish electricity distribution companies. Within E.ON Sverige, 14 distribution areas were initially subject to the additional inspection, with inspection satisfactorily concluded for 13 of these areas. For the remaining area, EMI has decided that E.ON Sverige must reduce the network charges for 2003 by SEK19.7 million, by repaying customers a portion of the network charges. E.ON Sverige has appealed the decision to the relevant administrative court. With respect to 2004 network charges, EMI decided in October 2005 to prolong its inspection of 4 distribution areas within E.ON Sverige. EMI has not issued a final decision regarding 2004 network charges.

In July 2005, several sections of the Electricity Act were amended in order to comply with the Second Electricity Directive. Among other changes, the amendments require more detailed regulation concerning the calculation of network charges; more information on the invoice and in advertising about the composition of energy sources used in producing the delivered electricity; that distribution companies procure the electricity required to cover their net losses in an open, non-discriminatory and market-oriented manner; and that

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distribution companies establish a supervision plan which states what kind of actions will be taken in order to prevent discriminatory behavior towards other operators in the market.

As a result of the severe storm that hit Sweden in January 2005, the Swedish government passed new legislation concerning electricity distribution in December 2005. Under the new law *(SFS 2005: 1110)*, which was incorporated into the Electricity Act and which came into force on January 1, 2006, a customer shall be compensated for power outages that last more than 12 hours by at least 12.5 percent and up to 300 percent of the customer s annual network charges. With effect from January 1, 2011, the maximum allowable period of time for a power outage will be 24 hours.

Gas. In order to comply with the requirements of the Second Gas Directive, a new Swedish Natural Gas Act (*Naturgaslag (2005:403)* or the Natural Gas Act) was implemented on July 1, 2005. From this date, all non-household customers may choose their gas supplier. Household customers will be eligible as of July 1, 2007. In addition, the Natural Gas Act stipulates legal and functional unbundling of the transmission, distribution, storage and regasification (LNG) businesses from the supply business and requires separate accounting for the transmission, distribution, storage and regasification (LNG) businesses. The law also requires non-discriminatory third party access to the gas networks based on published charges for eligible customers. Further, distribution and transmission companies must also establish a supervision plan which states what kind of actions will be taken in order to prevent discriminatory behavior towards other operators in the market. As in the former Natural Gas Act, the new Natural Gas Act contains rules regarding the granting of licenses to build and use natural gas pipelines and natural gas storage, as well as new rules regarding the granting of licenses for LNG facilities.

The Natural Gas Act also requires EMI to pre-approve the criteria used by network operators to establish network charges valid from 2006. EMI approved the model (the criteria for network charges) used by E.ON Sverige in November 2005. In addition, the Natural Gas Act requires that the revenues from network charges be reasonable compared to costs for capital and operations, and stipulates that the reasonableness of network charges remains subject to examination by EMI ex-post. EMI is currently developing a model for assessing the revenues from network charges. The first examination will take place in 2007 regarding revenues for 2006. If EMI finds that revenues from network charges are not reasonable, it can obligate the operator to reduce network charges.

Renewable Energy and Electricity Certificates. The Swedish electricity certificate system has been in operation since May 2003. The objective of the current system, which is based on the Swedish Act on Electricity Certificates *(SCS 2003:313)*, is to increase the volume of electricity produced from renewable energy sources by 10 TWh by 2010 as compared with the 2002 level.

During 2004 EMI gave the Ministry of Sustainable Development recommendations on the electricity certificate system based on an analysis of the system. EMI recommended that the electricity certificate system be made permanent and that long-term quota levels be set if necessary investments in renewable energy are to take place. Due in part to this analysis, the Swedish government delivered proposals on an amendment of the Act on Electricity Certificates to the Swedish Parliament during 2005. The amendment proposals and Parliament approval are expected during 2006. For more information about the current system and proposed changes, see Business Overview Nordic Market Environment.

Finland

The main legislation applicable to the Finnish electricity industry is the Electricity Market Act (*Sähkömarkkinalaki (386/1995)*, or the Electricity Market Act), which came into effect in June 1995. The Electricity Market Act pre-dated the requirements of the First Electricity Directive, but is basically consistent with the terms of that directive. The purpose of the Electricity Market Act is to ensure preconditions for an efficiently functioning electricity market so as to secure the sufficient supply of high-standard electricity at reasonable prices. The Electricity Market Act contains regulations for distribution and transmission companies with regard to electricity network licenses, general obligations and pricing principles for network operation, systems responsibility, balance responsibility and balance determination, construction of electricity networks, retail sale of electricity and unbundling of operations. Under the Electricity Market Act, generation, retail and electricity trading are subject to competition, while transmission and distribution remain regulated natural monopolies. The

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Finnish government amended the Electricity Market Act at the end of 2004 because the legislation did not meet all the requirements of the Second Electricity Directive, in particular the requirement for legal unbundling.

The Finnish energy regulator, the Energy Market Authority (EMA), is an expert body subordinate to the Finnish Ministry of Trade and Industry. Its operation started in June 1995, at the same time as the Electricity Market Act took effect.

Electricity and natural gas network operation in a specific geographical area is subject to license, with only one license allowed per specific geographical area. The EMA grants network licenses to utilities engaged in distribution operations. Moreover, the EMA also grants permits for constructing high voltage power lines.

The pricing of network services, such as connection, distribution and metering, must be public, reasonable, non-discriminatory and regionally impartial. The EMA supervises and monitors the pricing of transmission and distribution services of the regional network operators and the national grid. Moreover, the EMA also intervenes in the terms and prices of network services that are considered to restrict competition. The EMA can forbid a network operator from applying a pricing system that does not meet requirements and can obligate the company to correct its pricing within three months. The EMA itself cannot impose any penalty on network operators.

In order to comply with all of the requirements of the Second Electricity Directive, the Finnish government has revised the regulations on pricing supervision with effect from January 1, 2005. The revised act *(Laki sähkömarkkinalain muuttamisesta No. 1172)* also requires the legal unbundling of distribution operators that have a network capacity over 200 GWh and functional unbundling for operators serving over 100,000 customers. The new regulation provides for evaluation of the reasonableness of distribution pricing based on the network operator s rate of return, combined with efficiency requirements. The reasonableness of distribution pricing is evaluated ex-post. In cases where the EMA determines that over-charging has occurred, network operators must return the excess profits to customers. The first regulatory period covers the years 2005-2007, with a four year period to follow. The EMA has set allowed annual profits for this period; the allowed income level is lower than in 2004. Distribution operators are not satisfied with the level of allowed income, and over 80 percent of the operators, including E.ON Finland, have appealed to The Market Court to change the EMA s Regulatory Decision setting the earnings basis and level of regulated income. E.ON Finland expects a final resolution of this matter in 2006.

U.S. MIDWEST

Retail Electric Rate Regulation

The KPSC has regulatory jurisdiction over the rates and service of LG&E and KU and over the issuance of certain of their securities. The Virginia State Corporation Commission also has parallel regulatory jurisdiction with respect to certain of KU s operations. The KPSC and Virginia State Corporation Commission, respectively, regulate the retail rates and services of LG&E or KU and, via periodic public rate cases and other proceedings, establish tariffs governing the rates LG&E and KU may charge customers. Because KU owns and operates a small amount of electric utility property in Tennessee and serves less than 10 customers there, KU is also subject to the jurisdiction of the Tennessee Regulatory Authority.

LG&E and KU are each a public utility as defined in the Federal Power Act. Each is subject to the jurisdiction of the Department of Energy and the FERC with respect to the matters covered in the Federal Power Act, including the wholesale sale of electric energy in interstate commerce. In addition, the FERC and certain states share jurisdiction over the issuance by public utilities of short-term securities.

On December 29, 2003, LG&E and KU filed general rate case applications with the KPSC seeking increases in regulated tariffs. LG&E s last electric rate case was in 1990 and its last gas rate case was in 2000; KU s last rate case was in 1983. LG&E requested an increase in its annual electric rates of an aggregate of $63.8 million or 11.3 percent and an increase in its annual gas rates of an aggregate of $19.1 million or 5.4 percent. KU requested an increase of an aggregate of $58.3 million or 8.5 percent. On June 30, 2004, the KPSC issued an order approving increases in the base electric and gas rates of LG&E and the base electric rates of KU. In the KPSC s order, LG&E was granted increases in annual base electric rates of approximately $43.4 million or 7.7 percent and in annual base gas rates of approximately $11.9 million or 3.4 percent. KU was granted an increase in annual

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base electric rates of approximately $46.1 million or 6.8 percent. The rate increases took effect on July 1, 2004. The Attorney General of Kentucky (Kentucky Attorney General) appealed these rate increases and opened an investigation into the communications between the companies and the KPSC which led to them. The KPSC granted a rehearing on a single issue appealed by the Kentucky Attorney General and also opened an investigation into the communications involved in the rate cases. In December 2005, the KPSC issued an order noting completion of its inquiry, including review of the Kentucky Attorney General s investigative report. The order concluded no improper communications occurred during the rate proceedings. The order further established a procedural schedule through the first quarter of 2006 for considering the sole issue for which rehearing was granted, concerning state tax rates used in calculating the granted rate increases. The resolution of this income tax issue is expected to fall within the range of earnings provided by the KPSC in its original order approving the rate increases. Upon resolution of this income tax issue on appeal at the KPSC, the initial rate increase order could then be subject to further appeal through the courts. Additional proceedings before the KPSC, and possibly Kentucky courts, regarding the rate increases are expected to continue during 2006. It is uncertain when such matters will be concluded or whether they will ultimately have an effect on the rate increase. Pending the results of such matters, LG&E and KU are charging customers the approved higher rates.

The electric rates of LG&E and KU in Kentucky contain fuel adjustment clauses whereby increases and decreases in the cost of fuel for electric generation are reflected in the rates charged to all retail electric customers. The KPSC requires public hearings at six-month intervals to examine past fuel adjustments, and at two-year intervals to review past operations of the fuel clause and transfer the then-current fuel adjustment charge or credit to the base charges. At present, the KPSC also requires that electric utilities, including LG&E and KU, publicly file certain documents relating to fuel procurement and the purchase of power and energy from other utilities.

Through December 31, 2003, the electric rates LG&E and KU charged in Kentucky were subject to an earnings sharing mechanism (ESM). The ESM was originally put in place for three years beginning January 1, 2000. The KPSC s order approving new base rates effective July 1, 2004 terminated the ESM for all periods after 2003, but allowed for recovery of amounts requested through 2003. Under the ESM settlement, LG&E and KU were able to collect from customers approximately $13.0 million and $16.2 million, respectively, of ESM revenue earned in calendar year 2003, beginning in April 2004. No additional ESM amounts remain to be charged or recovered at this time.

In 1992, the Kentucky General Assembly enacted a statute which provides an alternative procedure to increasing base rates by allowing utilities to recover the costs of environmental compliance by means of a surcharge rather than by opening a general rate case. Pursuant to this statute, LG&E s and KU s electric rates in Kentucky contain an environmental cost recovery surcharge which recovers costs incurred by LG&E or KU that are required to comply with the U.S. Clean Air Act Amendments of 1990 (the Clean Air Act) and other environmental regulations. The magnitude of the surcharge fluctuates with the amount of approved environmental compliance costs incurred during each rate period. At six-month intervals, the KPSC reviews the operation of each utility s environmental surcharge, and, after review, may disallow any surcharge amounts found not to be just and reasonable. In addition, every two years the KPSC reviews and evaluates the past operation of the surcharge, and, after review, may disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found to be just and reasonable into the utility s existing base rates.

Retail Gas Rate Regulation

LG&E s gas rates in Kentucky contain a gas supply charge, whereby increases or decreases in the cost of gas supply are reflected in LG&E s rates, subject to approval of the KPSC. The gas supply charge procedure prescribed by order of the KPSC provides for quarterly rate adjustments to reflect the expected cost of gas supply in that quarter. In addition, the gas supply charge contains a mechanism whereby any over- or under-recoveries of gas supply cost from prior quarters will be refunded to or recovered from customers through the adjustment factor.

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Transmission Developments

A number of regional or industry-wide FERC proceedings regarding transmission market structure changes are in varying stages of development. In the ordinary course of business, LG&E and KU, either directly or via industry groups, participate in many of these proceedings. In April 2005, the MISO implemented day-ahead and real-time markets (MISO Day 2), including a congestion management system, which are part of the FERC-required Transmission and Energy Markets Tariff (TEMT). MISO membership and operations, including the MISO Day 2 markets, have resulted in substantial changes, including increased costs, for LG&E and KU. In 2003, the KPSC initiated a proceeding examining the benefits and costs of LG&E s and KU s membership in MISO. In this KPSC proceeding, LG&E and KU requested an order directing their ultimate exit from MISO, if approved by the FERC and under other appropriate circumstances. In November 2005, in a separate proceeding, LG&E and KU filed applications with the KPSC for approval of certain proposed transmission and reliability arrangements effective upon any exit from MISO. Orders in the KPSC proceedings may occur during the first half of 2006. In October 2005, LG&E and KU submitted applications with the FERC seeking its authority to exit MISO and to transfer certain transmission functions to a reliability coordinator and an independent transmission organization. Various entities, including MISO and certain wholesale customers of LG&E and KU, filed interventions and protests with the FERC. LG&E and KU subsequently reached settlement agreements with the Kentucky wholesale customers addressing their post-exit concerns and such customers withdrew their protests. LG&E and KU have requested an order in early 2006 in the FERC proceeding, but no assurance can be given as to the ultimate timing of such an order.

At this time, LG&E and KU cannot predict the outcome or effects of the various proceedings described above, including whether such will have a material impact on the financial condition or results of operations of the companies. Financial consequences (changes in transmission revenues and costs) associated with the initial implementation of MISO Day 2 and TEMT markets since April 2005 remain difficult to fully quantify. One component, MISO-related administrative costs incurred by LG&E and KU, was approximately $12 million during 2005. Changes in revenues and costs related to broader shifts in energy market practices and economics are not currently estimable. Should LG&E or KU exit MISO, current MISO rules may also impose an aggregate exit fee of up to $41 million depending on the timing and circumstances of actual withdrawal. While LG&E and KU believe legal and regulatory precedent should permit most or many of the MISO-related costs to be recovered in their rates charged to customers, they can give no assurance that state or federal regulators will ultimately agree with such position with respect to all costs, components or timing of recovery.

Energy Policy Act of 2005 and Repeal of PUHCA

The Energy Policy Act of 2005 (EPAct 2005) was enacted on August 8, 2005. Among other matters, the comprehensive legislation contains provisions mandating improved electric reliability standards and performance; providing certain economic and other incentives relating to transmission, pollution control and renewable generation assets; increasing funding for clean coal generation incentives; repealing PUHCA; and establishing a new Public Utility Holding Company Act of 2005 (PUHCA 2005). PUHCA 2005 reduces or eliminates many prior federal regulatory constraints applicable to public utility holding companies in such areas as mergers and acquisitions, non-energy-related investments, financial and capital structures, utility system integration, affiliate services, and reporting and record-keeping requirements.

The FERC was directed by the EPAct 2005 to adopt rules to address many areas previously regulated by other agencies under other statutes, including PUHCA. The FERC is in various stages of rulemaking on these issues and E.ON U.S. is monitoring these rulemaking activities and actively participating in applicable proceedings. In general, where FERC rules have been finalized, such rules similarly liberalize federal regulation or oversight in these areas. E.ON U.S. is still evaluating the potential impact of EPAct 2005 and PUHCA 2005 and the associated rulemakings and cannot predict what impact the legislation and such rulemakings will have on its operations or financial position.

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Other Regulations

Integrated resource planning regulations in Kentucky require LG&E, KU and other major utilities to make triennial filings with the KPSC of historical and forecasted information relating to forecasted load, capacity margins and demand-side management techniques. The two utilities filed such integrated resource plans in April 2005 and the Kentucky Attorney General and representatives of an industrial customer group were granted intervenor status as is customary in these types of proceedings before the KPSC. Proceedings will continue in 2006, although no procedural schedule has been established.

Pursuant to Kentucky law, the KPSC has established the service boundaries for LG&E, KU and other utility companies, other than municipal corporations, within which each such supplier has the exclusive right to render retail electric service.

ENVIRONMENTAL MATTERS

GENERAL

E.ON is subject to numerous national and local environmental laws and regulations concerning its operations, products and other activities in the various jurisdictions in which it operates. Although E.ON believes that its domestic and international production facilities and operations are currently in material compliance with the laws and regulations with respect to environmental matters, such laws and regulations could require E.ON to take future action to remediate the effects on the environment of prior disposal or release of substances or waste. Such laws and regulations could apply to various sites, including power plants, pipelines and gas storage facilities, chemicals plants, waste disposal sites and chemicals warehouses. Such laws and regulations could also require E.ON to install additional controls for certain of its emission sources or undertake changes in its operations in future years. For greater detail on the application of environmental laws and regulations to E.ON s operations, see below. E.ON has established and continues to establish accruals for environmental liabilities where it is probable that a liability will be incurred and the amount of liability can be reasonably estimated. The provisions made are considered to be sufficient for known requirements. E.ON adjusts accruals as new remediation commitments are made and as information becomes available which changes estimates previously made.

The extent and cost of future environmental restoration and remediation programs are inherently difficult to estimate. They depend on the magnitude of any possible contamination, the timing and extent of corrective actions required and E.ON s share of liability relative to that of other responsible parties.

Any failure to comply with present or future environmental laws or regulations could result in the imposition of fines, suspension of operations or production or alteration of production processes. Such laws or regulations could also require acquisition of expensive remediation equipment or other expenditures to comply with environmental regulation.

GERMANY: ELECTRICITY

Air Pollution. All of E.ON Energie s plants are subject to EU and/or national regulations, and are equipped where necessary with pollution removal devices. The most important pollution law applicable to E.ON Energie s German plants is the German Federal Pollution Control Act (*Bundesimmissionsschutzgesetz,* or BImSchG) and its implementing ordinances. One of such ordinances, the Ordinance on Large Combustion Plants (*Verordnung über Großfeuerungsanlagen,* or 13. BImSchV), sets stringent emission limits for power stations for all known air pollutants, such as sulphur oxides (SO_x), NO_x and dust. The relevant emissions of E.ON Energie s power plants are continuously measured and reported. Due to the extensive installation of scrubbers, catalysts, electrostatic precipitators and other pollution control devices, E.ON Energie s power plants comply with all current requirements. In order to implement the EU environmental guideline 2001/80/ EU, the German government amended 13. BImSchV in 2004 to introduce lower emission limits. Because of the reduction in emission limits, especially for particulate emissions, some of E.ON Energie s power plants require retrofitting of their instrumentation and/or electrostatic precipitators in order to comply with the amended ordinance. E.ON

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Energie expects to implement most of these retrofits between 2008 and 2011. The total cost of compliance is currently expected to be approximately 10 million, primarily for efficiency improvements in some electrostatic precipitators.

Emission trading for carbon dioxide started in the EU on January 1, 2005. For details on the Emissions Trading Directive, applicable German legislation and effects on E.ON Energie, see Regulatory Environment.

Nuclear Energy. Details of E.ON Energie s nuclear power operations in Germany and those of its 21 percent minority investee BKW in Switzerland can be found under Business Overview Central Europe Power Generation and Other Minority Shareholdings above. E.ON Energie does not own interests in or operate any nuclear power facilities in any other country. German safety standards for nuclear power stations are among the most stringent in the world. German nuclear power regulations are found in the AtG and a number of national regulations, guidelines and technical rules. The German regulatory framework regarding nuclear power regulations is also governed by international agreements, including the Euratom Agreement, dated March 23, 1957 (*Euratomvertrag*), the Paris Liability Agreement, dated July 29, 1960 *(Pariser Haftungsübereinkommen)*, and the Non-Proliferation Treaty, dated July 1, 1968 *(Nichtverbreitungsvertrag)*.

Under the AtG, the import, export, transportation or storage of nuclear materials *(Kernbrennstoff)* requires the approval and supervision of regulatory authorities. The building, operating, owning or materially altering by any entity of any plants or installations that produce, fission or otherwise process or reprocess nuclear materials (Nuclear Plants) also requires approvals of, and is supervised by, regulatory authorities. Approvals can be subject to limitations or conditions, including conditions subsequent, and may also be subsequently revoked if they are not complied with or one of their preconditions has ceased to exist. The regulatory authorities may also give orders to obtain information from, enter and inspect any Nuclear Plants.

According to the AtG, radioactive wastes and dismantled radioactive parts must either be recycled or permanently disposed of by any entity handling or otherwise using nuclear power. The AtG follows the so-called polluter pays principle, which requires such entity to pay for the recycling or permanent disposal of nuclear waste.

Liability. In case of environmental damages, the owner of a German facility is subject to liability provisions that guarantee comprehensive compensation to all injured parties. Because of achievements in pollution control, the issue of environmental damage due to air pollutants from electric utilities has not recently been a subject of public debate in Germany. In general, subjects such as acid rain, as well as high concentrations of ground level ozone have been linked to accumulated deposits from many emission sources or, in the case of the ozone, predominantly from traffic emissions. There has been some relaxation in the evidence required under the German Environmental Liability Law *(Umwelthaftungsgesetz)* to establish and quantify environmental claims. If claims were to arise in relation to environmental damages and plaintiffs were successful in overcoming problems of proof and other issues, such claims could result in costs to E.ON Energie that might be material. So far as E.ON Energie is aware, no material environmental claims have been made against it and, under current circumstances, E.ON Energie does not believe that there is a significant risk of material liability in respect of any potential claims.

In case of a nuclear accident in Germany, the owner of the reactor, the factory or the nuclear materials storage facility (the Proprietor) is subject to liability provisions that guarantee comprehensive compensation to all injured parties. Under German nuclear power regulations, the Proprietor is strictly liable, and the geographical scope of its liability is not limited to Germany or the contractual territory of the Paris Liability Agreement. The Proprietor is in principle subject to unlimited liability. The AtG and the Regulation regarding the Provision for Coverage pursuant to the AtG (*Atomrechtliche Deckungsvorsorge-Verordnung,* or AtDeckV) require every Proprietor to provide liability coverage by either insurance or financial security. The amount of coverage required is reevaluated every five years. In February 2002, the AtG was amended and the required liability coverage was increased from 256 million to 2.5 billion. E.ON Energie has insurance covering the first 256 million of damages. To provide liability coverage for the additional amounts required by the AtG amendment, the German nuclear power plant operators entered into a solidarity agreement to cover the increase, which provides that the costs of liability exceeding the operator s own resources and those of its parent company in the event of a nuclear

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accident will be covered by a pool, with the nuclear facility operators having a mutual responsibility to cover each other s damages. For details, see Note 25 of the Notes to Consolidated Financial Statements. For this reason, the AtG amendment has resulted in only a slight cost increase for liability coverage.

GERMANY: GAS

Air Pollution. The construction and operation of E.ON Ruhrgas gas pipeline system is subject to EU and national law, rules and regulations. The most important pollution law applicable to E.ON Ruhrgas gas transport and storage facilities is the BImSchG and its implementing ordinances. E.ON Ruhrgas facilities comply with all of the current requirements. One of such ordinances, 13. BImSchV, was amended in 2004 to require reduced emission limits also for existing gas turbines for air pollutants such as NO_x and carbon monoxide (by 2015). For more information, see

Germany: Electricity. E.ON Ruhrgas uses gas turbines to drive compressors for gas transportation and storage. If the turbines do not comply with the new emission limits, E.ON Ruhrgas will have to take measures to retrofit the non-complying turbines. E.ON Ruhrgas cannot currently quantify the measures that will be required by the amendment of 13. BImSchV. Any other amendments to or new environmental legislation that creates new or more stringent environmental standards could also affect the future operation of E.ON Ruhrgas facilities and related costs.

Emission trading for carbon dioxide started in the EU on January 1, 2005. For details on the Emissions Trading Directive, applicable German legislation and effects on E.ON Ruhrgas, see Regulatory Environment.

Gas Storage. Natural gas underground storage facilities in Germany are subject to the 12th Ordinance on the Implementation of the German Federal Pollution Control Act (*12. Verordnung zur Durchführung des Bundesimmissionsschutzgesetzes,* or *Störfallverordnung*), which came into force in May 2000. Since then, all facilities operated by E.ON Ruhrgas have complied with all relevant requirements. Further compliance is continuously measured and reported by public authorities.

For information on E.ON Ruhrgas environmental management system, see Business Overview Pan-European Gas Transmission and Storage. For information on the German Environmental Liability Law, see Germany: Electricity above.

U.K.

While E.ON UK in the United Kingdom is subject to the same EU environmental legislation as is E.ON Energie (described above under Germany: Electricity), details of the implementation of that legislation as adopted in the United Kingdom differ from those implemented by the German government. E.ON UK is also subject to national legislation which includes the obligations of the United Kingdom and international conventions to which the United Kingdom adheres. These obligations relate principally to emissions from generating facilities to air, notably SO_2, NO_x and dust. Although historically such legislation has primarily affected coal-fired plants, all fossil-fuelled generation may be impacted in the future. E.ON UK is currently in compliance with all applicable emissions regulations.

As an alternative to setting rigid emission limit values, the EU Large Combustion Plants Directive allows each member state to include all its existing large coal and oil combustion plants within a single National Emissions Reduction Plan. Last year the U.K. government discussed using a combined approach with the European Commission, which would allow individual plants to elect to either to be subject to emission limit values, to be part of the National Emissions Reduction Plan or to opt out of the scheme (in which case the plant must shut by the end of 2015 and is limited to 20,000 hours of operation in the period from 2008 to 2015). The European Commission has accepted this approach and the U.K. government is expected to submit the U.K. plan to the European Commission during early 2006. E.ON UK has decided to opt out the Grain, Kingsnorth and Ironbridge power stations and to use the emission limit value option for the Ratcliffe power station. The scheme is scheduled to take effect as of January 1, 2008.

The U.K. government is implementing a greenhouse gas emissions allowance trading scheme, as required by the EU s Emissions Trading Directive. For more information on the Emissions Trading Directive, see

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Regulatory Environment. The trading scheme requires that each participating plant be covered by one or more CO_2 emission certificates, which initially were issued free of charge. E.ON UK has obtained the necessary certificates and is currently participating in the trading scheme. The draft regulations for implementing the trading scheme were initially published in January 2004, releasing for consultation a draft National Allocation Plan which includes the proposed allocation of CO_2 emissions certificates for E.ON UK s plants and for other power stations in the U.K. Following this, the U.K. government recalculated and increased the size of its requested allowance for CO_2 emission certificates, but the European Commission chose not to increase the allowance. The matter has been referred to the EU Court of First Instance, which asked the Commission to reconsider its position. The Commission has announced its is not prepared to change its position, which leaves the U.K. government with the option of launching an appeal to try to claim the additional allowances.

Each of E.ON UK s fossil-fuelled power stations in the United Kingdom is required to have an Integrated Pollution Control Authorization, issued by a government agency, which regulates releases into the environment and seeks to minimize their impact. The current system of authorizations is to be expanded via a new permit system to cover a wider range of matters such as noise, waste minimization and energy conservation, reflecting extended requirements now applicable to all new installations. Existing power stations are to be brought under the newly-expanded Integrated Pollution Prevention and Control regime during 2006. E.ON UK is currently in the process of applying for these permits for its generation sites.

Using the flexibility available to it, E.ON UK has responded to the requirements imposed by emission controls with a combination of actions, notably the increased use of gas-fired CCGT plants, the use of low sulphur content fuels, the installation of emission abatement equipment and the development of renewable energy systems.

E.ON UK has operated its own environmental management system since 1991. On January 1, 1999, E.ON UK achieved corporate certification to ISO 14001, the international standard for environmental management, for its electricity production, gas operations and associated services. The certificate was renewed on November 1, 2004 for a further three years.

E.ON UK is also subject to further environmental regulations affecting its business, including packaging waste regulations and oil storage regulations. In order to comply with the applicable packaging waste regulations, E.ON UK has joined an appropriate recycling scheme. The majority of the waste involved is paper. The oil storage regulations require E.ON UK to ensure that oil is appropriately stored and managed.

NORDIC

Air Pollution. The power and heat production plants of E.ON Sverige and E.ON Finland are subject to EU, international and/or national regulations, and are equipped where necessary with pollution removal devices. In Sweden and Finland, production plants are subject to emission limits for air pollutants such as SO_x, NO_x and dust.

In Sweden, there are taxes attached to emitting SO_x (for coal, oil and peat) and CO_2 (applicable primarily to heat production from coal, oil, natural gas and liquified petroleum gas). There is also a fee for emitting NO_x (applicable to large combustion plants). In Finland, excise taxes are applied to the different fuels according to their carbon content. There are also limits for the sulphur content of coal and oils to be used in energy generation.

The relevant emissions of E.ON Sverige s and E.ON Finland s power and heat production plants are continuously measured and reported.

Emissions trading for carbon dioxide started in the EU on January 1, 2005. For details on the Emissions Trading Directive, as well as information on the Swedish electricity certificate system, see Regulatory Environment.

The major subsidiaries within E.ON Sverige and E.ON Finland are operated according to certified environmental management systems (ISO 14001).

Nuclear Energy. In Sweden, the regulatory framework regarding nuclear power regulations is also governed by the international agreements discussed in Germany: Electricity above. In addition, Swedish

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nuclear power regulations are governed by Swedish law, mainly the Act on Nuclear Activities *(SFS 1984:3)*, the Nuclear Liability Act (*SFS 1968:45*) and the Act on Financing of Future Expenses for Spent Nuclear Fuel *(SFS 1992:1537)*. Under Swedish law, the owner of a nuclear power station is obliged to conduct operations in such a manner that the required safety standards are maintained and is responsible for nuclear waste management and decommissioning of nuclear facilities. A license is required in order to own or operate a nuclear facility, which is granted by the Swedish government on recommendation by the Swedish Nuclear Authority, which supervises all nuclear facilities in Sweden.

According to the Act on Financing of Future Expenses for Spent Nuclear Fuel, the owner of a nuclear facility in Sweden is under the obligation to pay an amount determined by the Swedish government for each kWh produced in the facility to the Swedish Nuclear Waste Fund. The amounts thus paid, together with any capital gains on the amounts, are to cover the costs for nuclear waste management and the decommissioning of nuclear facilities. In accordance with Swedish law, E.ON Sverige has also given guarantees to governmental authorities to cover possible additional costs related to the disposal of high-level radioactive waste and nuclear power plant decommissioning. See also Note 25 of the Notes to Consolidated Financial Statements.

For more information about E.ON Sverige s nuclear power operations, see Business Overview Nordic Power Generation. E.ON Sverige does not own interests in or operate any nuclear power facilities in any country other than Sweden, and E.ON Finland does not own interests in or operate any nuclear power facilities.

Liability. In Sweden, the owner of a nuclear facility is liable for damages caused by accidents in the nuclear facility and accidents caused by nuclear substances to and from the facility. As of December 31, 2005, the liability is limited to an amount equal to SEK3,401 million (362 million) per accident, which must be insured according to the Nuclear Liability Act. E.ON Sverige has the necessary insurance for its nuclear power plants.

Currently, a government investigation is ongoing regarding nuclear liabilities. To date, it is unclear to what extent this investigation will lead to an adjustment of the nuclear liability limit in Sweden.

U.S. MIDWEST

E.ON U.S. s operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates, governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety.

The Clean Air Act Amendments of 1990 imposed stringent SO_2 and NO_x emission limits on electric generating units located in the United States. LG&E had previously installed flue gas desulphurization equipment on all of its generating units, while KU met its Phase I SO_2 requirements primarily through installation of flue gas desulphurization equipment on Ghent Unit 1. E.ON U.S. s combined strategy for Phase II, which commenced on January 1, 2000, uses accumulated emissions allowances to defer additional capital expenditures and also includes fuel switching or the installation of additional flue gas desulphurization equipment. LG&E and KU met the initial NO_x emission requirements of the Clean Air Act through installation of low-NO_x burner systems. E.ON U.S. s compliance plans are subject to many factors, including developments in the emission allowance and fuel markets, future regulatory and legislative initiatives, and advances in clean air control technology. E.ON U.S. will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner.

In September 1998, the EPA announced its final NOSIP Call rule requiring reductions in NOemissions of approximately 85 percent compared with 1990 levels, in order to mitigate alleged ozone transport to the northeastern United States. In related proceedings in response to petitions filed by various northeastern states, in December 1999 the EPA issued a final rule directing similar reductions from a number of specifically named electric generating units, including all LG&E and KU power stations in the eastern half of Kentucky. To implement the new federal requirements, in June 2002 Kentucky revised its State Implementation Plan (SIP) to

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require electric generating units to reduce their NO_x emissions to 0.15 pounds weight per million British thermal unit (lb./ MMBtu) on a system-wide basis.

In order to achieve the NO_x emission reductions mandated by the NO_x SIP Call as enacted by the Kentucky SIP, E.ON U.S. has implemented a NO_x control plan for its LG&E and KU generating units. Installation of additional NO_x controls, including selective catalytic control technology, began in 2000. Appropriate NO_x control equipment was placed into service by the May 2004 compliance deadline. E.ON U.S. estimates that it will incur total capital costs of approximately $407 million through 2006 (of which approximately $405 million was incurred through year-end 2005) to reduce its NO_x emissions to the 0.15 lb./ MMBtu level on a company-wide basis. With respect to costs incurred at LG&E and KU, in April 2001 the KPSC granted recovery of these costs under their environmental surcharge mechanisms.

In March 2005, the EPA announced its final Clean Air Interstate Rule (CAIR) and Clean Air Mercury Rule (CAMR). CAIR requires additional SO_2 emission reductions of 70 percent and NO_x emission reductions of 60 percent compared with 2003 levels. CAIR provides for a two-phase cap and trade program, with initial reductions of NO_x and SO_2 emissions due by 2009 and 2010, respectively, and final reductions due by 2015. The closely related CAMR rule provides for mercury emission reductions of almost 70 percent compared with 2003 to be achieved in two phases, with initial reductions due by 2010 and final reductions by 2018. The 2010 CAMR mercury reduction targets are set at a level consistent with reductions that will occur as a co-benefit of the controls installed for purposes of compliance with CAIR. E.ON U.S. is carefully monitoring pending appeals of the CAIR and CAMR rules and related regulatory proceedings, including adoption of the rules at the state level, that could affect implementation of the rules.

In order to achieve the emissions reductions mandated by CAIR and CAMR, E.ON U.S. expects to incur additional operating and maintenance costs in operating new NO_x controls and expects to make additional capital expenditures to reduce SO_2 emissions totaling $743 million through 2009. In June 2005, the KPSC granted recovery of these costs incurred by LG&E and KU under their environmental surcharge mechanisms.

E.ON U.S. believes its costs in reducing SO_2, NO_x and mercury emissions to be comparable to those of similarly situated utilities with like generation assets.

Certain E.ON U.S. power plants are situated in or adjacent to counties which the EPA has designated as being in non-attainment with the 8-hour ozone and particulate matter 2.5 ambient air quality standards. Various state and local agencies are currently in the process of developing plans which may mandate emissions reductions from a range of air emissions sources in order to achieve compliance with the ambient air quality standards. Depending on the provisions ultimately incorporated into state and local implementation plans, certain E.ON U.S. power plants could potentially be subject to requirements for additional reductions in SO_2 and NO_x emissions. The effect on E.ON U.S. of such rules is not yet determinable, but could include increased capital expenditures and operating costs in the future.

E.ON U.S. is also monitoring several other air quality issues that may potentially impact coal-fired power plants. These include the appeal of the District of Columbia Circuit s remand of the EPA s revised air quality standards for ozone and particulate matter and measures to implement the EPA s Clean Air Visibility Rule.

From time to time, E.ON U.S. conducts negotiations with the EPA or various state or local regulatory authorities to resolve matters involving compliance with applicable environmental laws and regulations. Such matters include the effectiveness of remedial measures aimed at controlling particulate matter emissions at LG&E s Mill Creek Station, remediation obligations for former manufactured gas plant sites, liability under the Comprehensive Environmental Response, Compensation and Liability Act for various off-site waste sites, and settlement of the government s claims relating to a fuel oil discharge at KU s Brown Station. Based on negotiations to date, the resolution of such matters is not expected to have a material impact on the operations of E.ON U.S.

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OPERATING ENVIRONMENT

As Germany s second-largest industrial group on the basis of market capitalization, all social, political and economic developments and conditions in Germany affect E.ON. Labor costs, corporate taxes and employee benefit expenses in Germany are high and weekly working hours are shorter compared with most other EU member states, the United States and Japan. Nonetheless, many factors, including monetary and political stability, high environmental protection and standards and a well-educated, highly qualified workforce continue to positively affect Germany s competitive position in world trade.

By virtue of its operations outside the European Monetary Union (EMU), the Group is also subject to the risks normally associated with cross-border business transactions and business activities, particularly those relating to exchange rate fluctuations. In addition, because most of the Group s operations are based in Europe, both the development of the European market and the entry of new members into the EU will continue to create new opportunities and challenges for E.ON.

ECONOMIC BACKGROUND

Germany

During 2005, the general economic situation improved worldwide, although less dynamically than in 2004. German export performance was good as a consequence of improved worldwide economic conditions and the depreciation of the euro and despite the surge in oil prices. Domestic demand, however, remained unchanged compared with 2004. As a result, the German economy again had one of the worst performances in the Eurozone in 2005. The real gross domestic product increased by 0.9 percent, compared with an increase of 1.6 percent in 2004. Capital spending by businesses decreased by 0.3 percent, mainly due to the continuing recession in construction. Other investment grew by 1.4 percent. The German Council of Economic Advisers forecasts ongoing global economic growth in 2006, with a German growth rate of 1.0 percent in 2006.

Germany s competitive position in world trade continues to benefit from many factors, including monetary stability, a reputation for quality and recent productivity gains. In 2005, Germany achieved a surplus in exports and services in real terms of 109 billion. Due to weak economic growth and lack of structural reforms, however, unemployment remained high in Germany in 2005. The reasons for unemployment are predominantly of a structural nature and include, among other factors, extensive regulation of the labor market and high labor costs (compared with the rest of the EU and the United States).

For information on the tax regime applicable to German corporations, see Item 10. Additional Information Taxation Taxation of German Corporations. For information on changes in German tax regulation that have a material impact on the Company, see Note 7 of the Notes to Consolidated Financial Statements.

Europe

In 1992, the twelve original members of the former European Economic Community signed the Treaty on European Union (the Treaty), a significant step toward creating a single integrated market. The Treaty provided a working program for European integration, including the coordination of economic policies of the EU countries and preparations for the introduction of a single currency. On January 1, 1999, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland (the participating countries) adopted the euro as their single currency through the EMU, with fixed exchange rates for the participating currencies (the legacy currencies) against the euro. In the beginning of 2001, Greece also joined the EMU, becoming a participating country. On January 1, 2002, the euro became the official legal tender for cash transactions in all participating countries. The legacy currencies have been withdrawn from circulation. Not all EU member states participate in the EMU. The United Kingdom, Sweden and Denmark chose not to be initial participants in the euro.

Since the ratification of the Treaty, the EU has been enlarged from 12 to 25 member states, with the entry of Austria, Finland and Sweden in January 1995 and Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia as of May 1, 2004. As new countries join the EU, significant institutional reform within the existing EU member states will be necessary to enable the EU to integrate the new

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members. As a first step, an EU convention drafted a treaty establishing a European Constitution. The new Constitution, which includes significant institutional reforms of the EU Commission and the EU policy-making process, was defeated in national referendums in France and the Netherlands in 2005. Currently, the ratification process is at a standstill.

In addition to the countries which joined in May 2004, the European Council has invited Bulgaria and Romania to join the EU in 2007. Negotiations with Croatia to join the EU began in 2005, although further institutional reforms must be implemented in Croatia before it also may join the EU. In October 2005, the EU also started negotiations with Turkey to join the EU. Since these negotiations may take years, there is no fixed date for Turkey to join the EU.

Long-term interest rates in the Eurozone decreased by 0.16 percentage points in 2005 compared to December 2004. In December 2005 the European Central Bank raised its deposit facility and margin lending rates to 1.25 percent and 3.25 percent, respectively.

United Kingdom

The U.K. economy performed better in 2005 than in most other EU economies although household demand and public and private expenditures were weaker than in 2004. Monetary and fiscal policy provided a stable macroeconomic environment, so that prospects for 2006 are quite good. The U.K. economy is estimated to have grown at a rate of 1.7 percent in 2005 in real terms, according to the German Council of Economic Advisers. This is expected to increase to a growth rate of 2.4 percent in 2006. Inflation in 2005 is estimated to have been at 2.4 percent.

Sweden/Finland

In 2005, the Swedish economy again performed well above average compared with other EU member states, driven by a robust investment performance, although exports were weaker than in 2004. The Swedish economy is estimated to have grown at a rate of 2.5 percent in real terms, according to data from the German Council of Economic Advisers. This is expected to increase to a growth rate of 3.0 percent in 2006. Finland performed slightly better than the EU average, with an estimated real growth rate of 1.7 percent driven by strong domestic demand. Finland s growth rate is expected to increase to 4.1 percent in 2006, according to the German Council of Economic Advisers. Inflation remained low in both countries, with an annual rate of 0.7 percent in Sweden and 1.0 percent in Finland for 2005.

United States

Since 2003, the United States economic growth has increased, stimulated by expansive fiscal and monetary policies. In 2005, private consumption remained strong, but business investment weakened slightly. Despite tighter monetary policy, interest rates remained relatively low in 2005, supporting growth. The United States is estimated to have grown at a rate of 3.6 percent in 2005, with a slight decrease to 3.0 percent expected in 2006, according to the German Council of Economic Advisers. Inflation remained under control despite higher energy prices, with an annual rate of 3.4 percent for 2005.

RISK MANAGEMENT

While E.ON s market units have varying exposures to fluctuations in exchange rates, on an overall basis E.ON has certain exposures mainly to fluctuations between the euro and the U.S. dollar, the British pound, the Swedish krona and the Norwegian krona, respectively, that it seeks to manage through hedging activities. Foreign exchange rate risk management, along with liquidity management and interest rate risk management, is generally centralized on a Group-wide basis and is the responsibility of the Group treasury. The currency and interest rate risks of Group companies are hedged with Group treasury in conformity with E.ON s financial guidelines, or, in certain cases, with external counterparties with E.ON AG s approval. E.ON uses interest rate and currency derivatives only to hedge its risk positions deriving from underlying business transactions, and E.ON continually assesses its exposure to these risks resulting from the underlying exposures and the results of hedging

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transactions. Moreover, E.ON is exposed to risks from fluctuations in the prices of commodities and raw materials which are subject to commodity risk hedging activities. The market units also engage in the trading of energy-related commodity derivatives, which is also subject to guidelines for risk management. For a more detailed discussion of the current exchange rate, interest rate and commodity price risk exposures and risk management policies of the Group, see Item 5. Operating and Financial Review and Prospects Exchange Rate Exposure and Currency Risk Management, Item 11. Quantitative and Qualitative Disclosures about Market Risk and Notes 28 and 29 of the Notes to Consolidated Financial Statements.

ORGANIZATIONAL STRUCTURE

E.ON AG is the Group s Düsseldorf-based management holding company. E.ON AG provides strategic management for Group companies and coordinates Group activities. E.ON AG also provides centralized controlling, treasury, risk management (including hedging) and service functions to Group members, as well as communications, capital markets and investor relations functions. The Group s operating activities are organized into market units, each of which is responsible for managing its own day-to-day business. The following table sets forth certain information about each of the entities which served as a parent company of an E.ON market unit as of December 31, 2005:

Name of Subsidiary	Country of Incorporation	Percentage Ownership Interest held by E.ON	Percentage Voting Interest held by E.ON
E.ON Energie AG (energy)	Germany	100.0%	100.0%
E.ON Ruhrgas AG (energy)	Germany	100.0%	100.0%
E.ON UK plc (energy)	U.K.	100.0%	100.0%
E.ON Nordic AB (energy)	Sweden	100.0%	100.0%
E.ON U.S. LLC (energy)	U.S.A.	100.0%	100.0%

PROPERTY, PLANTS AND EQUIPMENT

GENERAL

The Company owns most of its production facilities and other properties. Some of E.ON s facilities are subject to mortgages and other security interests granted to secure indebtedness to certain financial institutions. As of December 31, 2005, the total amount of indebtedness collateralized by these facilities was approximately 0.8 billion. E.ON believes that the Group s principal production facilities and other significant properties are in good condition and that they are adequate to meet the needs of the E.ON Group. E.ON s headquarters are located at E.ON-Platz 1, D-40479 Düsseldorf, Germany. E.ON owns its headquarters.

PRODUCTION FACILITIES

Central Europe

E.ON Energie produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 36,400 MW, E.ON Energie s attributable share of which is approximately 27,800 MW (not including mothballed, shutdown and reduced power plants). Electricity is transmitted to purchasers by means of high-voltage transmission lines and underground cables owned by E.ON Energie. For further details, see Business Overview Central Europe. E.ON Energie believes that its power plants are in good operating condition and that its machinery and equipment have been well maintained. E.ON Energie s German base load nuclear power plants operated at approximately 90.1 percent of available capacity in 2005. E.ON Energie believes that average utilization data calculated on the basis of all of its international and German power stations would not reflect differences between base load and peak load requirements or differential costs of generation and would therefore dilute the significance of such a measure.

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Pan-European Gas

E.ON Ruhrgas owns, co-owns or has interests through project companies in gas pipelines in Germany totaling 11,273 km. In addition, E.ON Ruhrgas owns, co-owns or has interests through project companies in 34 compressor stations in Germany. The current installed capacity of these compressor stations totals 938 MW. E.ON Ruhrgas also owns, co-owns, leases or has interests through project companies in 11 underground gas storage facilities in Germany; E.ON Ruhrgas share in the usable working gas storage capacity of these facilities is approximately 5.1 billion m^3 Due to the number and complexity of factors influencing gas pipeline and storage utilization, E.ON Ruhrgas does not consider data on the utilization of the transmission system and gas storage capacity to be meaningful. E.ON Ruhrgas also owns interests in two project companies operating gas transmission systems and in another two project companies developing gas transmission systems outside of Germany. For further details, see Business Overview Pan-European Gas Transmission and Storage.

E.ON Ruhrgas believes that its transmission system (including transport compressor stations) and gas storage facilities (including storage compressor stations) are in good operating condition and that its machinery and equipment have been well maintained.

U.K.

E.ON UK produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 10,762 MW, E.ON UK s attributable share of which is approximately 10,547 MW. Electricity is transmitted to purchasers by means of the National Grid transmission network in the United Kingdom. For further details, see Business Overview U.K. E.ON UK believes that its power plants are in good operating condition and that its machinery and equipment have been well maintained. In 2005, E.ON UK s power plants operated at approximately 48 percent of theoretical capacity. This average utilization is calculated for all U.K. power stations and does not reflect differences between base load and peak load power stations.

Nordic

E.ON Nordic produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 14,982 MW, its attributable share of which is approximately 7,570 MW (not including mothballed and shutdown power plants). In Sweden and Finland, electricity is transmitted to purchasers via high voltage electricity grids, which are operated by state-owned companies, and through regional and local distribution networks. E.ON Sverige and E.ON Finland own and operate regional and local electricity distribution networks in Sweden (E.ON Sverige) and Finland (E.ON Sverige and E.ON Finland). E.ON Sverige also owns one-third of the Baltic Cable, an undersea electricity cable linking the Swedish electricity grid to the grid of E.ON Energie in Germany. In Sweden, E.ON Sverige also owns and operates high- and low-pressure gas pipelines. For more information, see Business Overview Nordic. E.ON Nordic believes that its power plants, electricity distribution networks and gas pipelines are in good operating condition and that its machinery and equipment have been well maintained. The Swedish base load nuclear power plants in which E.ON Nordic holds an interest operated at approximately 87 percent of available capacity in 2005. E.ON Nordic believes that average utilization data calculated on the basis of all of its power stations would not reflect differences between base load and peak load requirements or differential costs of generation and would therefore dilute the significance of such a measure.

U.S. Midwest

E.ON U.S. produces electricity at jointly and wholly-owned power plants. Its power generation facilities have a total installed capacity of approximately 8,300 MW, E.ON U.S. s attributable share of which is approximately 7,700 MW (not including mothballed and shutdown power plants). Electricity is transmitted to purchasers by means of E.ON U.S. s transmission network (operated by MISO) in the United States. For further details, see Business Overview U.S. Midwest. E.ON U.S. believes that its power plants are in good operating condition and that its machinery and equipment have been well maintained. In 2005, E.ON U.S. s

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power plants operated at approximately 53 percent of theoretical capacity. This average utilization is calculated for all U.S. power stations and does not reflect differences between base load and peak load power stations.

Other Activities

Degussa. On a global basis, Degussa operates 130 major production plants in 50 different countries.

Degussa believes that its production facilities are in good operating condition and that its machinery and equipment have been well maintained.

INTERNAL CONTROLS

E.ON s own financial controls indicate that E.ON is organized, and will continue to be operated, in a financially sound manner. E.ON s internal controls and procedures are integrated with its firm-wide risk management system. E.ON s integrated risk management and internal controls system have the following key elements: the planning and controlling process, the reporting structure, E.ON Group-wide guidelines, internal control and monitoring by E.ON s Management Board and Supervisory Board, the internal auditing process and the risk reporting system.

E.ON s internal control systems and procedures are used to monitor the Company s investments, obligations, commitments and operations. The internal control system is not restricted to identifying and monitoring balance sheet items, but also identifies and monitors off-balance sheet transactions. The formation of corporate or other business entities to hold, control or own any investment, asset or liability would also be controlled by the process to manage the risks associated therewith.

E.ON believes that appropriate internal controls are in place to achieve effective and efficient operations as well as reliable internal and external reporting, and to ensure compliance with applicable laws and regulations as well as internal policies and procedures. In addition, E.ON believes that its internal controls over financial reporting provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with applicable law and generally accepted accounting principles.

As a result of the listing of its ADRs on the NYSE, E.ON is also subject to the listing requirements of the NYSE and the U.S. federal securities laws, including the U.S. Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and the rules and regulations thereunder. For more information on E.ON s compliance with these requirements, see Item 10. Additional Information Memorandum and Articles of Association, Item 15. Controls and Procedures, Item 16A. Audit Committee Financial Expert, Item 16B. Code of Ethics, Item 16C. Principal Accountant Fees and Services, Item 16D. Exemptions from the Listing Standards for Audit Committees and Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers, as well as the certifications included as exhibits to this annual report.