high level of gas prices, power stations—especially those operated by UK utilities—made extensive use of hard coal, which produces higher emissions than gas. Therefore, market observers anticipate that CO_2 certificates will become more scarce in the first trading period (2005–2007).

Electricity price trend: no change in sight. Due to the aforementioned situation, power production costs are expected to rise above last year's level, which was already high. This is likely to be reflected in the development of prices on European wholesale markets. Besides generation costs, weather-related effects could also lead to a further increase in electricity prices. Last year was one of the warmest years in recent history. If temperatures return to normal levels, energy consumption could rise compared with 2005, causing generation capacity to become even more scarce. This type of weather change was already observed at the beginning of 2006.

We intend to strengthen our earning power again in fiscal 2006 above all through organic growth. Our highly competitive German power generation operations will play a central role.

Adding even more value to the company. In the last few years, we laid the groundwork for achieving continuous organic growth. We intend to increase the operating result organically by an average of at least 5% per year. Both in this financial year and the next one, the key to this accomplishment will be the competitiveness of our German power generation business. In addition, a variety of regulated activities in our core markets make stable contributions to our earnings. These include the UK and North American water operations which we intend to sell by the end of 2007. However, even without these water activities, we generate about one third of our consolidated operating result from regulated business above all in Germany and the Czech Republic. Cost-cutting measures will provide more positive stimuli. We want to realize €230 million in savings this year. This will bring us to the end of the programme underway since 2003 designed to reduce our annual cost position by €680 million. Burdens on earnings will continue to stem from the price of fuel purchased for our power plants. Moreover, we will be exposed to risks from political intervention. We emphasized this point repeatedly in both this and earlier publications. For instance, we anticipate negative effects will arise above all from the regulation of Germany's electricity and gas grids. The European emissions trading system continues to pose a challenge. We gained our first experience with it last year. However, we expect that risks will be manageable until the end of the first three-year trading period in 2007. We will continue to address them through the flexible deployment of power stations and optimized electricity and fuel procurement. In sum, we are optimistic about being able to achieve our value target for 2006: a return on capital employed (ROCE) of at least 14%. We already surpassed this goal in 2005.

Substantial capital expenditure on power plants and grid facilities. Both the German and UK power generation sectors are at the beginning of a long-term investment cycle. We started planning for the replacement of old power plants with more efficient and environmentally friendly technologies early on. At the end of 2005 we commenced the construction of a large-scale lignite-fired 2,100 MW power plant in Germany. This year, we will initiate preparatory work for another major project in Germany, involving a hard coal power station with an installed capacity of 1,500 MW. We are also investigating the possibility of modernizing our power plant portfolio in the UK. These projects will make a substantial contribution to improving the Group's emissions balance.

After the sale of our water activities, we will have more financial leeway for capital expenditure in the energy business.

Germany's power and gas grids also require extensive upgrades. However, we will not be able to implement any major measures until the details for German grid regulation have materialized further. We expect this to happen no later than next year. Our exit from the capital-intensive water business in the UK and North America will free up funds for our energy operations. Nevertheless, our investment budget will be lower than it is at present, including the water activities. We expect that RWE's capital expenditure on property, plant and equipment for 2006 to 2010 in the energy business will average €3.5 billion per year, give or take 15 %.

Divestment of UK and North American water activities. Besides concentrating on our operating targets, this year we have set our sights on preparing for the sale of RWE Thames Water and American Water. A public offering is likely as far as American Water is concerned. Options under consideration for RWE Thames Water include a sale to long-term financial investors as well as a placement on the stock market. The run-up to the sale of American Water will be lengthy due to the extensive approval process with water regulators in the US. In light of the favourable environment on the capital market, we are confident that we will be able to complete our exit from both activities at an appropriate price by the end of next year.

No major acquisitions are planned at present. The sale of our water activities has priority.

A measured acquisition strategy. Currently, we are not planning to make any major acquisitions. The planned divestments in the water sector have priority. Projects of interest to us are predominantly in Eastern Europe. We expect that the consolidation of the European electricity and gas sectors will become more intense in the medium term. However, there are still only a handful of investments available for sale, since the deregulation and privatization process in Eastern Europe is making slow headway. In light of the large number of interested potential buyers, prices are at the upper end of the range. We join bidding processes only if our strict profitability criteria are met. Acquired investments must earn their cost of capital no later than in the third full year following the date of their consolidation.

Excluding divestments and currency effects, revenue will grow by a single-digit percentage rate.

Group revenue expected to be stable. Revenue is expected to roughly match last year's level. This and the following prognoses are based on assumed exchange rates of US$ 1.20 / € and £ 0.70 / € in 2006. We assume that the planned sale of RWE Thames Water and American Water will not impact our consolidated financial statements before 2007. Minor divestments at RWE Energy and RWE Trading will eliminate about € 2 billion in revenue. Excluding consolidation and currency effects, however, we expect revenue to grow by a single-digit percentage rate. The main drivers will be rising procurement costs, which will be passed on in higher electricity and gas prices, and higher water tariffs, reflecting increasing investment in infrastructure.

Outlook	2005 € million	2006 Forecast
External revenue	**41,819**	→
Operating result	**6,201**	↗
RWE Power[1]	2,112	↗
RWE Energy	2,507	→
RWE npower	437	→
RWE Thames Water	1,416	→
Net income	**2,231**	↗

1 Including RWE Trading.

We expect our operating result to grow by 5 % to 10 %. Net income is expected to rise by between 10 % and 20 %.

Earnings expected to post further growth. We are confident that we will succeed in improving our key earnings figures. According to our forecast, EBITDA will rise by a single-digit percentage and the operating result will grow between 5 % and 10 %. Net income is expected to post a rise of between 10 % and 20 %. This will principally stem from an improvement in the non-operating result, which was characterized by considerable negative one-off effects in 2005.

Earnings trend by division:

We expect ***RWE Power*** to close 2006 with a marked improvement in its operating result. We anticipate that the growth will be in double-digit percentage territory. The rise will be driven by the Power Generation Business Unit. Price increases on the German wholesale market will be the main contributing factor. We have already sold most of the 2006 electricity production. Moreover, we expect to see a rise in the availability of generation capacity following the extensive maintenance carried out in 2005. The higher cost of procuring CO_2 emissions certificates and fuel will have a counteracting effect. Furthermore, margins on the market for balancing power to offset short-term fluctuations in supply and demand on the power grid are likely to shrink. Moreover, we do not anticipate that RWE Trading will be able to reproduce the high level of earnings it achieved in 2005. The RWE Dea Business Unit is expected to close the fiscal year up on the last one. Contrasting effects will be felt as persistently high oil and gas prices will be counteed by mounting production and exploration costs.

RWE Energy will probably achieve an operating result that matches the 2005 level. With stable earnings in the Continental European sales business, we believe earnings risks will arise especially from the new regulation of Germany's electricity and gas grids. We intend to largely offset the resulting negative effects in 2006 by taking additional measures to cut costs and enhance efficiency throughout the RWE Energy Group. Naturally, however, there is still some uncertainty as regards the extent of the impact of regulation.

We expect the operating result recorded by ***RWE npower*** to stabilize at the level achieved in 2005. We will lift earnings from the UK generation business by increasingly benefiting from higher wholesale electricity prices. However, we will not fully benefit from this rise for all of our power sales. This is because RWE npower had already sold forward part of 2006's electricity production several years previously, and we are therefore not able to entirely pass through the rise in fuel prices and the cost of CO_2 emissions certificates to customers. In addition, the failure of two power plant blocks in Aberthaw will have adverse effects. Although our market share in the supply business is developing positively, we anticipate that the UK sales business will see mounting pressure on margins. This is due mainly to increased costs for suppliers, resulting from rising wholesale gas prices. Another major driver of costs will be the UK Government Energy Efficiency Commitment initiatives to reduce household carbon emissions and alleviate fuel poverty. We anticipate that RWE npower will succeed in posting a substantial improvement in its results in 2007.

The operating result achieved by ***RWE Thames Water*** is expected to be roughly on par with last year's. Our regulated UK and North American activities are anticipated to experience opposing effects from tariff increases and higher operating costs.

We stand a good chance of exceeding our 14 % ROCE target for 2006.

Value management reflects good operating performance. Our improved earnings situation will also be clearly mirrored in our return on capital employed. We thus expect to exceed our ROCE target of 14 % once again. Most of the increase in value will come from the German energy business. According to our forecasts, RWE npower will be able to recover its cost of capital by 2007. The reasons for this were explained earlier in this report.

Depending on the progress of the sale of our water activities, we want to increase the dividend for 2006 to between 70 % and 80 % of recurrent net income.

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Dividend payment raise planned for fiscal 2006. In light of our solid earnings outlook, we are confident that the dividend will also fare well. Our dividend proposal for fiscal 2006 will be linked to a payout ratio for the first time. In so doing, we intend to show our shareholders that a certain percentage of earnings will be reserved for the dividend every year. We generally aim for a payout ratio of 50 %. The basis for the calculation will be recurrent net income*, which is already adjusted for one-off effects. This is how we want to link the dividend directly to the development of our operating activities. Depending on the progress of the sale of RWE Thames Water and American Water, we intend to increase the payout ratio to between 70 % and 80 % for the 2006 financial year.

Capital expenditure on property, plant and equipment up year on year. We will clearly step up capital expenditure on property, plant and equipment this year. The greatest rise is planned for RWE Power's German power plant business. The construction of a dual lignite block in Neurath is the main activity. Furthermore, preparatory work on the 1,500 MW hard coal power plant in Hamm will begin in 2006. More funds will be spent on our oil and gas production activities as well. RWE Thames Water will considerably expand its investment budget in order to meet the requirements of the five-year regulatory period that began in 2005. RWE Energy will maintain its sizeable capex budget. More than 80% of RWE Energy's capex will be earmarked to upgrade and expand our electricity and gas grids. RWE npower will modernize and enlarge its power plant portfolio, which will attract more spending than in 2005. In sum, we expect that capital expenditure on property, plant and equipment, including the RWE Thames Water Division, will be in the order of €4.5 billion.

We established a new cap of between €10 billion and €12 billion for net financial debt.

Net financial debt remains low. Based on our estimates, our net financial debt will again be in the order of €11 billion to €12 billion in 2006. We want to keep debt at this level even once we have sold our water business. We have defined a new cap ranging between €10 billion and €12 billion. Prior to the announcement of the planned divestment, it was €17 billion. The new cap takes into account major acquisitions which we would only make in the medium term. Furthermore, we want to maintain our current A1 and A+ credit ratings. Thanks to the good reputation we have as bond issuer, we always have access to short- and long-term financing sources. €0.7 billion in bonds, which we do not intend to refinance, will mature in 2006.

Employee headcount: decrease due to the sale of companies. In fiscal 2006 our workforce will continue to shrink principally due to the planned sale of RWE Solutions and of peripheral activities of RWE Thames Water. Excluding these effects, however, we expect the Group's labour force to increase.

Procurement: added cost owing to higher CO_2 prices. As mentioned earlier, we sold forward nearly all of our 2006 electricity production. In principle, our approach involves purchasing the fuel required to generate contracted amounts when the supply agreements are signed, hedging fuel prices at the same time. This also applies to the CO_2 certificates needed to produce this power. The hard coal and gas prices we will incur in 2006 will be high once again. We have no price risk exposure from our lignite-based generation of electricity since we produce this fuel in our own opencast mines. Uranium required to run our nuclear power stations has been secured under firm conditions via long-term purchasing agreements. Conversely, purchases of emissions allowances will generate higher costs than in 2005. This is due to the rise in the price of certificates. However, it is only possible to make limited forecasts for our procurement costs since the actual usage of fuel and demand for emissions certificates may deviate from our plans considerably. Unscheduled power plant outages and fluctuations in spot prices can lead to sudden adjustments in the capacity utilization of individual plants. We believe that savings can be realized when purchasing materials and services in 2006 again. We will expand pool purchasing and thus achieve price advantages.

Research and development: focus on reducing emissions. We stepped up our R&D budget for the current fiscal year to €68 million. Once again, in 2006, measures will centre on improving efficiency and reducing emissions in the power generation business. Since we are one of Europe's largest producers of CO_2 emissions, we believe we shoulder a special responsibility in the development of climate-friendly technologies. This year, we have set aside two thirds of our R&D budget for this task. As mentioned before, we support projects exploring ways of sequestering CO_2 produced in power plants either before or after the combustion phase. Our medium-term goal is to identify the most efficient technologies and test them in pilot plants. At the same time, we are looking into ways to store carbon dioxide safely. We want to take a proactive approach and establish the prerequisites for the construction of a "CO_2-free power plant." Since CO_2 sequestration reduces efficiency substantially, it is important to continually improve the efficiency of power plants beforehand. This is the objective behind the commissioning of a pilot plant with lignite drying methods upstream of the combustion process scheduled for 2007. We are currently building it in Niederaussem (Germany). Furthermore, we will continue our involvement in research for the "700 degree power station," which—similarly to lignite drying—enables efficiency enhancements of up to four percentage points.

In addition, we will again dedicate some of our research spending to distributed power generation in 2006. We also intend to make inroads in the usage of biomass. Renewables-based energy is one of the pillars of RWE's climate-friendly energy policy. Regardless of political requirements, we want to increase the share of electricity accounted for by biomass in our generation portfolio.

Forward-looking statements. This annual report contains forward-looking statements regarding the future development of the RWE Group and its companies as well as economic and political developments. These statements are assessments that we have made based on information available to us at the time this document was prepared. In the event that the underlying assumptions do not materialize or additional risks arise, actual performance can deviate from the performance expected at present. Therefore, we cannot assume responsibility for the accuracy of these statements.

Dr. Thomas R. Fischer
Chairman of the Supervisory Board of RWE AG

Supervisory Board Report

Dear Shareholders,

In fiscal 2005 the Supervisory Board oversaw and closely monitored the Executive Board's activities in line with the duties imposed on it by German law and the company's articles of association. The Supervisory Board convened six meetings, two of which were extraordinary, during which it received reports from the Executive Board on business trends as well as on issues relating to the RWE Group's strategic and operational development. All of the Supervisory Board members attended at least half of the meetings. The average participation rate per session exceeded 90%. When in session, the Supervisory Board passed all required resolutions on the basis of detailed information. Between meetings, the Supervisory Board was informed of projects and transactions that were especially important or urgent to the company in a timely manner. When necessary, it was asked for approval by circular. The Chairman of the Supervisory Board was constantly in touch with the members of the Executive Board in order to discuss as soon as possible events of material importance to the company's situation and development.

Focus on strategic issues. Our strategy of focus and constantly optimizing the RWE Group's portfolio is a major pillar of the company's past and future success. The exploration of a new strategy for the water business presented by the Executive Board in early November was a pivotal point. Another focal topic involved budgets for a far-reaching capital expenditure programme in RWE's power plant and grid business. As in 2004, some of the Supervisory Board's sessions dealt in depth with select aspects of RWE's strategy. Such discussions were held, e.g. regarding RWE Energy's sales operations and RWE Trading's strategy.

*Change of strategy in the water business.** On November 4, the Supervisory Board convened an extraordinary meeting to discuss the aforementioned plans to withdraw from the UK and North American water sectors. The Executive Board explained to the Supervisory Board that this step would allow the Group to follow its aim of focusing its core competencies above all on Europe's convergent electricity and gas markets. The Executive Board presented further reasons for the proposed move. The potential sale process was also explained. The Supervisory Board reviewed the proposals submitted by the Executive Board intensively and will continue to be kept informed on this topic.

Activities with €3.9 billion in revenue sold. In the period under review, the Supervisory Board held in-depth consultation sessions on the divestment of operations generating a combined €3.9 billion in revenue. It repeatedly discussed the sale of RWE Umwelt, which was initiated in 2004 and was largely completed in October 2005. Furthermore, RWE shed several small water investments outside RWE's core markets as well as some RWE Solutions subsidiaries.

Far-reaching investments in power plants and grids. Both the German and UK power generation sectors are at the beginning of a long-term investment cycle. The Executive Board involved the Supervisory Board early on in its plans to replace old power stations with more efficient and environmentally friendly technology. In its September 16 session, the board inspected the development area in Neurath in the vicinity of Cologne (Germany) where a second lignite power plant with optimized plant technology is being built. In its extraordinary meeting on November 4, the Supervisory Board approved the acquisition of a gas-fired power plant in Great Yarmouth, UK.

Following the blackouts caused by the natural disaster on November 25, 2005 in Greater Osnabrück and the Münsterland (both in Germany), the Executive Board informed the Supervisory Board at its December 8 session on all of the measures necessary to restore power and support people in the affected areas. The ongoing programme for overhauling old pylons was also discussed in this context. This programme was launched as far back as 2000. Measures mainly aim at ensuring grid safety. Required resources are at our disposal.

Other main topics of deliberation. Discussions regularly considered reports received on the Group's revenue and result trends as well as on measures to reduce costs. In addition, the Executive Board furnished information on the development of energy prices. The Supervisory Board also regularly discussed the Group's financial situation. In its December 8 session, the Supervisory Board dealt in detail with the medium-term budget for 2006 to 2008 submitted by the Executive Board. The Executive Board explained deviations from previous budgets and goals in detail.

Moreover, the plenum dealt repeatedly with the change in political conditions on the energy markets in which the company is active as well as the impact they could have on the development of the company's business. The main issues discussed in this context were the initial experience gained from the European CO_2 emissions trading scheme, the new German regulator's plans to regulate domestic electricity and gas grids, and the new federal government's concepts as regards energy policy.

Furthermore, during the reporting period, the *Supervisory Board often addressed* issues of corporate governance. Topics discussed in this context include the review of the Supervisory Board's efficiency set forth in the German Corporate Governance Code as well as the Code of Conduct for RWE employees.

Committees. *The Supervisory Board formed four* committees. Their members are listed in the chapter on "Boards and Committees.*" During the Supervisory Board meetings, committee chairmen delivered in-depth reports on the committees' work.

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The ***Executive Committee*** convened three times in the 2005 financial year. Its activity primarily consisted of preparatory work for the Supervisory Board debates. Two of the main subjects of the committee's deliberations were the corporate budget and the Group's strategy.

The ***Audit Committee*** convened four times in the same period. It discussed the interim reports and financial statements of the parent company (RWE AG) and the Group at great length and prepared the award of the audit contract to the independent auditor. The independent auditor was present at some of the meetings. Debates also centred on the impact of major divestments on the company's balance sheet and tax position, risk management, impairment test methods, the treatment of nuclear and mining provisions as well as internal audits.

The ***Human Resources Committee*** held five sessions. Debates primarily addressed the compensation system for members of the Executive Board including the long-term incentive plan (LTIP). Furthermore, it passed necessary resolutions regarding the employment contracts of Executive Board members.

Once again, in fiscal 2005, there was no reason to convene the ***Mediation Committee***, which complies with Sec. 27, Para. 3 of the German Co-Determination Act.

Financial statements for fiscal 2005. The financial statements of the parent company, which were prepared by the Executive Board in compliance with the German Commercial Code; the financial statements of the Group, which were prepared in compliance with International Financial Reporting Standards (IFRSs); the combined *review of operations* for RWE Aktiengesellschaft and the Group; and the accounts were scrutinized by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft and were issued an unqualified auditor's opinion. The auditors were elected by the AGM on April 14, 2005, and commissioned by the *Supervisory* Board to audit the financial statements of RWE AG and the Group. Documents supporting the annual financial statements, the annual report and the auditor's audit report were submitted to all the members of the Supervisory Board in good time. The Executive Board also commented orally on the documents in the Supervisory Board's balance sheet meeting of February 21, 2006. The auditors, who signed the audit report, attended the meeting, presented the material results of their audit, and were available to answer questions. In the run-up to the balance sheet meeting, during its session on February 20, 2006, the Audit Committee concerned itself in depth with the financial statements and audit reports and recommended that the Supervisory Board approve the financial statements as well as the appropriation of profits proposed by the Executive Board.

The Supervisory Board thoroughly reviewed the financial statements of RWE AG and the Group, the combined review of operations for RWE Aktiengesellschaft and the Group, and the proposed appropriation of distributable profit. No objections were raised as a result of this review. As recommended by the Audit Committee, the Supervisory Board approved the auditor's results of the audit of both financial statements, and they adopted the financial statements of RWE Aktiengesellschaft and the Group for the period ended December 31, 2005. The annual financial statements are thus adopted. Furthermore, the Supervisory Board concurs with the appropriation of profits proposed by the Executive Board, which envisions a dividend payment of €1.75 per share.

Changes in personnel on the Supervisory and Executive Boards. Mr. Ralf Hiltenkamp retired from the Supervisory Board effective April 10, 2005. Pursuant to a resolution adopted by the Essen District Court on April 11, 2005, Ms. Simone Haupt was appointed to succeed him as member of the Supervisory Board. Mr. Erwin Winkel vacated his seat on the Supervisory Board as of the end of the day on July 31, 2005. Mr. Dieter Faust was appointed Mr. Winkel's successor as of August 1, 2005. The Supervisory Board extends its appreciation to Messrs. Hiltenkamp and Winkel for their commitment and successful performance for the benefit of the company.

Mr. Alwin Fitting was appointed to the Executive Board of RWE Aktiengesellschaft as of August 1, 2005. He fulfils the duties of a labour director in accordance with Sec. 33 of the German Co-Determination Act.

The Supervisory Board thanks the Executive Board and the RWE Group's entire staff for their successful work. With their commitment and expertise, they laid the cornerstone for success in fiscal 2005.

Essen, February 21, 2006

The Supervisory Board

Thomas R. Fischer

Dr. Thomas R. Fischer
-Chairman-

Corporate Governance

Steady progress determines our corporate governance practices. This often keeps us a step ahead of adjustments made to the German Code. The ambitious standards that we impose on the transparency of corporate governance and the behaviour of our employees is set forth in the new RWE Code of Conduct.

We continue to fully comply with the German Corporate Governance Code's recommendations.

Unqualified statement of compliance. Several amendments to the Code passed by the German Government Corporate Governance Code Commission entered into force on July 20, 2005. They are primarily designed to strengthen the independence of supervisory board members. RWE fully complies with all of the recommendations of the new version of the Code. As in prior years, we can thus issue an unqualified declaration of compliance for 2005. In addition, RWE complies with the suggestions for voluntary action included in the Code with one exception. We do not envision electing or re-electing supervisory board members at different dates or for varying periods of tenure. Our current and past statements of compliance as well as past corporate governance reports can be found on the RWE website*. Information on the activities of RWE's Executive Board, Supervisory Board and other RWE AG committees as well as on the RWE Annual General Meeting are also included on this site.

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Other aspects of Code compliance. During our constant monitoring of corporate governance practices, we paid special attention to the relations between the Supervisory Board, the Executive Board and the company, even before the Code was amended. The following is a list of noteworthy issues in 2005:

- In the period under review, no material transactions were concluded between RWE AG or a Group company and an Executive Board member or related party. Furthermore, no contracts were concluded between the company and members of the Supervisory Board. Executive Board and Supervisory Board members had no conflicts of interest.
- In the year under review, the Supervisory Board of RWE AG debated the structure of the Executive Board compensation system in accordance with Item 4.2.2 of the Code.
- In 2005 the Supervisory Board performed another efficiency check pursuant to Item 5.6 of the Code. This examination looks, among other things, into the cooperation between the Executive Board and the Supervisory Board committees as well as the Supervisory Board itself and scrutinizes the work done during their meetings.
- All listed companies affiliated with the Group which are obliged to issue a statement of compliance again fulfiled this obligation in 2005. Details of the companies' affiliation with the Group and company size were taken into account.

- Securities dealings by Executive Board members reportable under Sec. 15a of the German Securities Trading Act were reported in an orderly fashion and published on RWE's website*. Obligatory stock purchases within the scope of the new BEAT long-term incentive plan introduced in 2005 are shown in the following table:

Transaction date	Name	Position	Financial instrument	ISIN	Purchase / Sale	Price per share in €	Number of shares
05/27/2005	Roels, Harry	CEO	RWE common share	DE 0007037129	Purchase	47.26	12,415
05/27/2005	Bonekamp, Berthold A.	EVP	RWE common share	DE 0007037129	Purchase	47.26	4,138
05/27/2005	Dr. Sturany, Klaus	EVP	RWE common share	DE 0007037129	Purchase	47.26	4,211
05/27/2005	Zilius, Jan	EVP	RWE common share	DE 0007037129	Purchase	47.26	4,138
07/26/2005	Roels, Harry	CEO	RWE common share	DE 0007037129	Purchase	55.58	4,600
07/26/2005	Bonekamp, Berthold A.	EVP	RWE common share	DE 0007037129	Purchase	55.58	475
07/26/2005	Dr. Sturany, Klaus	EVP	RWE common share	DE 0007037129	Purchase	55.58	2,150
07/26/2005	Zilius, Jan	EVP	RWE common share	DE 0007037129	Purchase	55.58	1,200

None of the board members held securities with a combined value high enough to fall under mandatory disclosure pursuant to Item 6.6 of the Code as of the balance-sheet date.

Service for our shareholders. Our capital market communications abide by the principle of informing investors as comprehensively and punctually as possible of the Group's developments at any given time. We have published our annual report in February for the third straight year, and thus continue to rank among the "fastest" DAX companies. Moreover, we have a long-standing practice of providing live webcasts of our analyst conferences, keeping them posted as recordings for three months after the event. By publishing our financial calendar in our financial reports and on the Internet early on, placing financial advertisements and posting far-reaching content on our website, we afford our shareholders the opportunity to stay abreast of all major events and news relating to RWE. Good AGM turnouts are also of importance to us. In 2005, 56.52 % of the company's voting stock and voting rights was represented. For several years, we have been providing our shareholders the option of voting by proxy in order to increase AGM turnout even more. Anyone who issues instructions via the Internet using our online proxy system can make changes until the end of the debate. As set forth in the new law on corporate integrity and modernization of the right of contestation (UMAG), we adapted and simplified the registration and verification process for the Annual General Meeting by passing an amendment to the company's articles of association at last year's AGM. This should encourage shareholders—especially foreign investors—to participate in the AGM and exercise their voting rights.

Breakdown of Supervisory Board compensation. RWE has already complied with the German corporate governance requirement to publish Executive Board remuneration by member for three years. The same applies to the compensation of the Supervisory Board. Pursuant to Sec. 12 of the bylaws, Supervisory Board members receive a fixed compensation of €40,000 for their services after the end of each fiscal year. The compensation increases by €225 for every €0.01 by which the dividend exceeds €0.10 per common share. Anyone who takes additional office on the Supervisory Board or any of its committees* receives one-and-a-half to three times the aforementioned sums, in accordance with the recommendations included in the Code. The following table shows how this affects the total compensation of each member.

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Supervisory Board compensation in 2005 € '000	Fixed component	Variable component	Total
Dr. Thomas R. Fischer, Chairman	120	111	231
Frank Bsirske, Deputy Chairman	80	74	154
Dr. Paul Achleitner	60	56	116
Carl-Ludwig von Boehm-Bezing	80	74	154
Wilfried Donisch	40	37	77
Dieter Faust (as of August 1, 2005)	23	21	44
Simone Haupt (as of April 11, 2005)	29	27	56
Ralf Hiltenkamp (until April 10, 2005)	16	15	31
Heinz-Eberhard Holl	60	56	116
Berthold Huber	40	37	77
Dr. Dietmar Kuhnt	60	56	116
Dr. Gerhard Langemeyer	60	56	116
Dagmar Mühlenfeld (as of January 4, 2005)	40	36	76
Dr. Wolfgang Reiniger	57	53	110
Günter Reppien	60	56	116
Bernhard von Rothkirch	60	56	116
Dr. Manfred Schneider	60	56	116
Klaus-Dieter Südhofer	60	56	116
Uwe Tigges	60	56	116
Prof. Karel Van Miert	40	37	77
Jürgen Wefers	40	37	77
Erwin Winkel (until July 31, 2005)	35	32	67
Total	**1,180**	**1,095**	**2,275**

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Executive Board compensation components.* The remuneration of RWE Executive Board members largely consists of a fixed and variable components. The fixed portion accounts for about 40 % of total cash compensation, with the performance-linked variable component accounting for the remaining 60 %. The variable portion consists of a company bonus (70 %) and an individual bonus (30 %). The amount of the company bonus depends on the development of value added and free cash flow. The amount of the individual bonus depends on the degree to which the goals agreed by the Chairman of the Supervisory Board and the Executive Board member at the beginning of the financial year have been met. In addition, in common with 1,000 other managers in the RWE Group, Executive Board members participate in a long-term incentive plan that rewards them based on performance over extended periods of time. In the fiscal year, we created a new programme called BEAT 2005, harmonized it throughout the Group, and adapted it to the more stringent corporate governance requirements. Exercise hurdles were raised once again. The waiting period was extended to three years and the redemption of the 2005 tranche was limited to three times the original value theoretically realizable at grant. For the 2006 tranche, the limit is double the original allocation value theoretically achievable on the capital market. Moreover, the BEAT Programme, which is based on virtual shares, requires Executive Board members to invest their own money in RWE shares to cover one third of the post-tax value at grant. These shares must be held for the entire waiting period of each respective BEAT tranche. The predecessor programmes had also adhered to the principle of rewarding sustained success in comparison to competitors in the company's peer group. The following provides an overview of the older programmes.

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- 2002 LTIP: This plan was initiated in 2002 pursuant to a Supervisory Board resolution for Executive Board members and about 1,050 additional managers through the issuance of stock appreciation rights* (SARs). The SARs issued in three tranches between September 20, 2002, and May 25, 2004, have a waiting period of two years and a total term to maturity of five years.
- 1999 AOP-F: The Executive Board of RWE AG was authorized to issue non-transferable subscription rights to members of the Executive Board and other managers in the RWE Group within the scope of AOP-F until March 8, 2004. A total of four tranches were initially issued. They have since been exercised by members of RWE AG's Executive Board or have been forfeited.

Our new Code of Conduct lays down the rules of behaviour for internal cooperation and external dealings.

Code of conduct for RWE employees. The Code of Conduct adopted in the autumn of 2005 establishes rules of behaviour in compliance with the principles of corporate governance for RWE staff throughout the Group. This set of rules ensures that employees behave within a pre-defined framework both when cooperating within the organization as well as in dealing with customers, shareholders, suppliers and consultants. In light of the public debate on the consulting activities of professional politicians, we decided to lay down some clear rules in this area as well. RWE welcomes its employees' occupying honorary political positions and becoming involved in social volunteering. However, anyone who holds a public office full-time or exercises a political mandate, is not eligible for employment with RWE as a staff member or consultant.

Statement of compliance in accordance with Sec. 161 of the German Stock Corporation Act. Following an orderly audit, the Executive and Supervisory Boards of RWE AG issued the following declaration of compliance:
RWE Aktiengesellschaft complies with all of the recommendations of the German Government Corporate Governance Code Commission issued in the July 20, 2005, version of the Code. Likewise, from the last statement of compliance on February 22, 2005, to July 20, 2005, RWE Aktiengesellschaft has complied with all of the recommendations of the version of the Code issued on July 4, 2003, and has complied with all of the recommendations of the July 20, 2005, version of the Code since July 21, 2005.

Essen, February 21, 2006
RWE Aktiengesellschaft

On behalf of the Supervisory Board	On behalf of the Executive Board
Dr. Thomas R. Fischer	Harry Roels Alwin Fitting

Securing talent for the long term

Both today and tomorrow, our employees are the most important asset our company has. We utilize and cultivate their potential through an ambitious personnel and executive development programme. Providing the next generation of professionals with certified training plays a central role. Only by making this investment can we secure talent in the face of demographic change.

About 1,000 young adults signed a training contract with RWE in 2005.

* G+

More than your run-of-the-mill professional training. We secure well-qualified budding professionals from within our own ranks by training 3,115 young people*, which also makes a contribution to professional qualification and job security in RWE's regions. RWE's training programmes impart knowledge and skills for more than 50 recognized training occupations groupwide, and has nearly 60 training centres in Germany. Some 1,000 young adults signed a training agreement in 2005. After the first year of training, some top performers attend a university of applied sciences or an academy during their training programme, enabling them to obtain two degrees in four-and-a-half years. This option is available for both technical and general commercial apprenticeable trades, depending on the location and company in question. The "Dream Team" contest targets the brightest of our trainees. Participants undertake their projects of choice on issues of relevance to the company autonomously, covering everything from planning to presentation before a panel of judges. This allows them to acquire key competencies such as team working, responsible action and time management at an early stage.

In 2004 we launched the "I'll Make It!" initiative that prepares people for training. The project admits up to 100 young people every year, who do not have the prerequisites for a successful apprenticeship, providing them with the competencies they need in the working world. At the same time, practical activity builds participants' confidence in their own skills and provides for exercises in teamwork. The high referral rate rewards us for this commitment: 70% of the participants in the class of 2004/2005 received apprenticeship positions, 52% of which were outside the RWE Group. In January 2006 the project received an award within the scope of the "Deutscher Förderpreis Jugend in Arbeit," the German competition for promoting young people in the working environment.

Employee survey 2005. In the year under review, we carried out RWE's first groupwide staff survey to gain insight into employee satisfaction as well as the company's strengths and weaknesses. Carried out locally in our various divisions, the opinion poll generated responses from two thirds of the eligible employees, who furnished information on work, development, relationships and leadership. The results were evaluated with the staff members in workshops, and change measures were derived from the discussions. The employee opinion poll is to be used as a management and controlling tool and become an integral component of our corporate culture.

* 138

Creating long-term performance incentives*. BEAT 2005, the new long-term incentive plan introduced in the fiscal year, provides a homogeneous, groupwide framework for long-term compensation incentives, promoting the development of a common leadership culture. Long-term incentives for executives have gained importance worldwide. They constitute an effective tool for bringing the interests of shareholders and management more in line with each other and for increasing the value of the company. Our new programme supports the alignment of management with this corporate goal by rewarding RWE's success when compared to its peers.

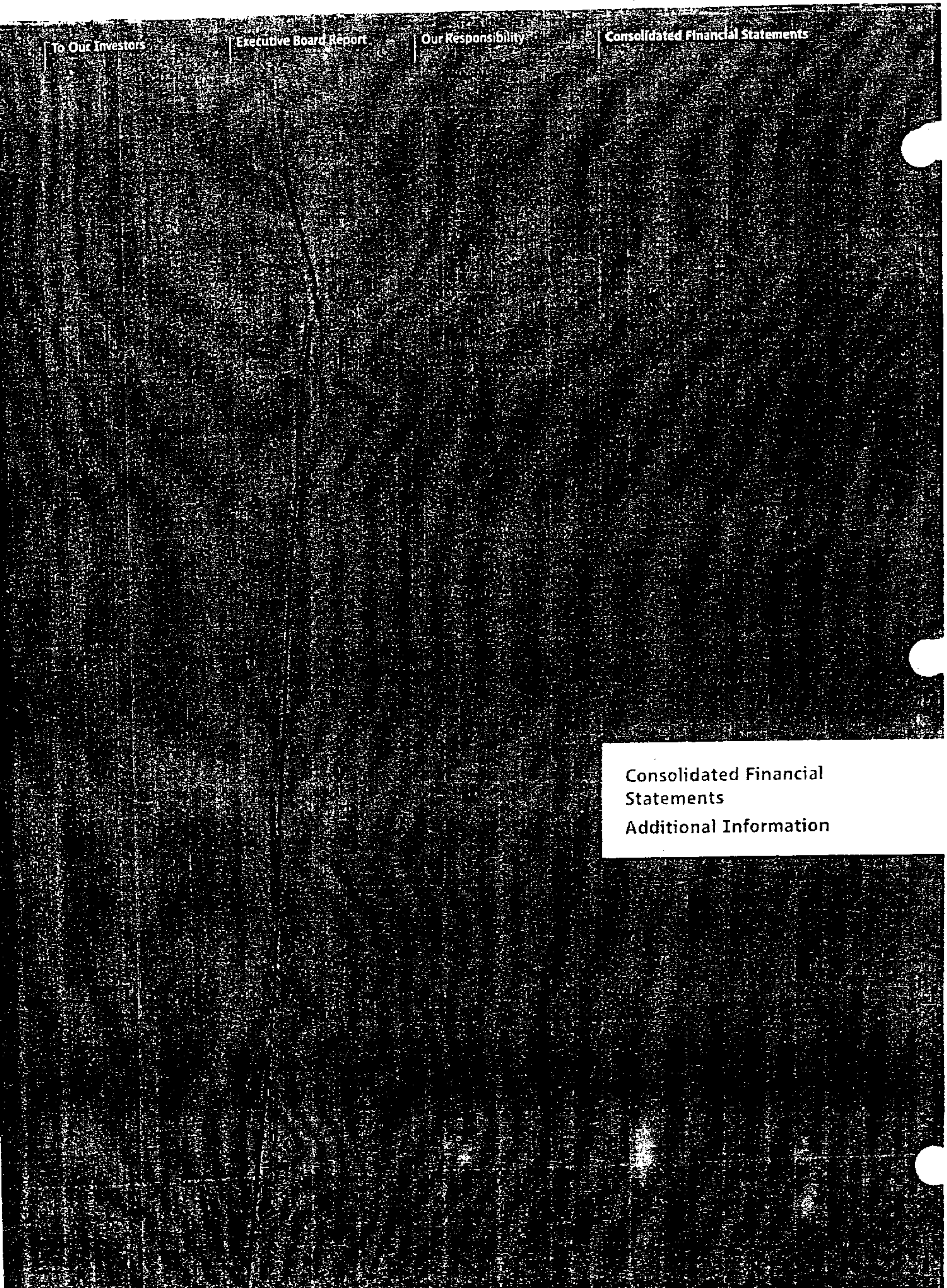
During the last round of collective bargaining negotiations, we were able to let our wage earners partake of the Group's success as well. By paying them an appropriate one-time bonus, we gave them an additional reward for the contribution they made to the company's positive development.

More than 19,000 RWE staff members purchased employee shares in 2005.

Employee shares are yet another tool we can use to let our employees directly reap the benefits of their company's success while promoting personal wealth building. Moreover, this gives our staff an additional performance incentive. In the year under review, 19,145 Group employees bought 419,413 common shares. Our workforce owns 2% of RWE's subscribed capital.

Generation change and succession management. Demographic change will have an incisive impact on our personnel structure. In addition, the early retirement regulations effective in recent years will have a major impact on the way our employee structure develops. This is why we are setting our long-term staffing needs against the development of employee demographics with a view to identifying shortages and excesses and balancing them in a timely manner.

Succession management, which has been integrated groupwide, is a topic of equal importance. One of the components is the potential assessment process introduced throughout the organization in 2004. This is how we ensure that every vacant management position is staffed on time and with the most suitable person. Potential candidates are prepared for promotions through tailor-made career development programmes, most of which take them through various areas throughout the Group. Studies have shown that strategic succession planning reduces undesired staff turnover and lowers the cost of external recruitment.



Consolidated Financial Statements

Additional Information

* Part of the Review of Operations.

Consolidated Income Statement of the RWE Group

€ million	Note	2005	2004
Revenue (including natural gas tax / electricity tax)	(1)	**41,819**	**42,137**
Natural gas tax / electricity tax	(1)	1,301	1,141
Revenue		**40,518**	**40,996**
Changes in finished goods and work in progress		38	-87
Other own work capitalized		264	321
Other operating income	(2)	2,437	3,260
Cost of materials	(3)	24,500	22,975
Staff costs	(4)	5,370	6,122
Depreciation, amortization, and impairment losses	(5)	3,762	3,765
of which: impairment losses on goodwill		(814)	(492)
Other operating expenses	(6)	4,879	6,054
Income from operating activities of continuing operations		**4,746**	**5,574**
Income from investments accounted for using the equity method	(7)	557	298
Other income from investments	(7)	210	548
Financial income	(8)	2,305	1,955
Finance costs	(8)	3,990	4,440
Income from continuing operations before tax		**3,828**	**3,935**
Taxes on income	(9)	1,221	1,521
Income from continuing operations		**2,607**	**2,414**
Income from discontinued operations		-20	-
Income		**2,587**	**2,414**
Minority interest		356	277
Net income / income attributable to RWE AG shareholders		**2,231**	**2,137**
Basic earnings and diluted per common and preferred share (€)	(28)	**3.97**	**3.80**
of which: from continuing operations (€)	(28)	(4.01)	(3.80)
of which: from discontinued operations (€)		(-0.04)	(0.00)

Consolidated Balance Sheet of the RWE Group

Assets € million	Note	12/31/05	12/31/04
Non-current assets			
Intangible assets	(10)	17,215	17,718
Property, plant and equipment	(11)	36,089	34,518
Investment property	(12)	476	507
Investments accounted for using the equity method	(13)	2,617	2,665
Other non-current financial assets	(14)	1,842	1,939
Financial receivables	(15)	1,500	1,301
Other receivables and other assets	(16)	6,815	3,515
Deferred taxes	(17)	3,790	3,243
		70,344	**65,406**
Current assets			
Inventories	(18)	2,257	2,043
Financial receivables	(15)	3,155	1,102
Trade accounts receivable	(19)	8,325	7,419
Other receivables and other assets	(16)	11,112	4,550
Current tax assets		276	311
Marketable securities	(20)	10,344	11,013
Cash and cash equivalents	(21)	1,431	1,526
Assets held for sale		878	0
		37,778	**27,964**
		108,122	**93,370**

Equity and Liabilities € million	Note	12/31/05	12/31/04
Equity	(22)		
RWE Group interest		11,474	9,656
Minority interest		1,643	1,537
		13,117	**11,193**
Non-current liabilities			
Provisions	(24)	28,064	27,830
Financial liabilities[1]	(25)	21,458	22,488
Other liabilities	(27)	9,907	5,869
Deferred taxes	(17)	4,873	4,134
		64,302	**60,321**
Current liabilities			
Provisions	(24)	4,784	5,330
Financial liabilities	(25)	5,994	4,895
Trade accounts payable	(26)	7,497	6,066
Current tax liabilities		86	128
Liabilities held for sale		533	0
Other liabilities	(27)	11,809	5,437
		30,703	**21,856**
		108,122	**93,370**

1 Including €21,255 million in non-current interest-bearing liabilities (previous year: €20,559 million).

Consolidated Cash Flow Statement of the RWE Group

€ million	Note (32)	2005	2004
Income from continuing operations		2,607	2,414
Depreciation, amortization, impairment losses, write-backs		3,795	3,780
Changes in provisions		-279	-307
Changes in deferred taxes		148	482
Income from disposal of non-current assets and marketable securities		-1,005	-720
Other non-cash income / expenses (mainly equity accounting method)		-34	-90
Changes in working capital		72	-623
Changes in other balance sheet items		0	-8
Cash flows from operating activities of continuing operations		**5,304**	**4,928**
Intangible assets / property, plant and equipment / investment property			
Capital expenditure		-3,667	-3,429
Proceeds from sale of assets		197	683
Acquisitions and investments			
Capital expenditure		-471	-308
Proceeds from sale of assets / divestitures		635	2,637
Changes in securities and cash investments		1,257	-1,157
Cash flows from investing activities of continuing operations		**-2,049**	**-1,574**
Net change in equity incl. minority interest		-3	-43
Dividends paid to RWE AG shareholders and minority interests		-1,070	-939
Issuance of financial debt		4,361	2,087
Repayment of financial debt		-6,672	-5,114
Cash flows from financing activities of continuing operations		**-3,384**	**-4,009**
Net cash change in cash and cash equivalents of continuing operations		-129	-655
Effects of changes in foreign exchange rates and other changes in value on cash and cash equivalents		34	0
Net change in cash and cash equivalents		**-95**	**-655**
Cash and cash equivalents at beginning of the reporting period		1,526	2,181
Cash and cash equivalents at end of the reporting period		**1,431**	**1,526**

Consolidated Statement of Changes in Equity of the RWE Group

Note (22) € million	Subscribed capital of RWE AG	Additional paid-in capital of RWE AG	Retained earnings and distributable profit	Accumulated other comprehensive income		RWE Group interest	Minority interest	Total
				Currency translation adjustment	Fair value measurement of financial instruments			
Balance at 01/01/04	**1,440**	**1,288**	**4,856**	**-756**	**185**	**7,013**	**2,052**	**9,065**
Repayment of equity							-43	-43
Dividends paid			-703			-703	-236	-939
Other comprehensive income				630	579	1,209	101	1,310
Income			2,137			2,137	277	2,414
Other changes							-614	-614
Balance at 12/31/04	**1,440**	**1,288**	**6,290**	**-126**	**764**	**9,656**	**1,537**	**11,193**
Repayment of equity							-3	-3
Dividends paid			-844			-844	-245	-1,089
Other comprehensive income				282	-110	172	56	228
Income			2,231			2,231	356	2,587
Other changes			259			259	-58	201
Balance at 12/31/05	**1,440**	**1,288**	**7,936**	**156**	**654**	**11,474**	**1,643**	**13,117**

Statement by the Executive Board

The Executive Board of RWE AG is responsible for the completeness and accuracy of the consolidated financial statements and the review of operations of the group, which has been combined with the review of operations of RWE AG.

The consolidated financial statements for the period ended December 31, 2005 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as applicable in the EU. The previous year's figures have been calculated according to the same principles.

Internal control systems, the use of uniform directives throughout the group, and our programmes for basic and advanced staff training ensure that the consolidated financial statements and combined review of operations are adequately prepared. Compliance with legal regulations, the internal guidelines as well as the reliability and viability of the control systems are continuously monitored throughout the group.

In line with the requirements of the German Corporate Control and Transparency Act (KonTraG), our risk management system enables the Executive Board to identify potential risks at an early stage and initiate countermeasures, if necessary.

The consolidated financial statements, the combined review of operations and the report of the independent auditors are discussed in detail by the Audit Committee and at the Supervisory Board's meeting on financial statements with the independent auditors present. The results of the Supervisory Board's examination have been included in the report of the Supervisory Board (pages 80 to 83) of this annual report.

Essen, February 14, 2006

The Executive Board

Roels Bonekamp Fitting Sturany Zilius

Basis of presentation

The consolidated financial statements have been prepared in accordance with the IFRSs, as applicable in the EU, as well as in accordance with the supplementary accounting regulations applicable pursuant to Sec. 315a, Para. 1 of the German Commercial Code (HGB). The consolidated financial statements also comply with all IFRSs effective up to the balance-sheet date.

Changes in equity have been disclosed in addition to the income statement, the balance sheet and the cash flow statement. Statements made in the notes to the financial statements also include segment reporting.

Several balance sheet and income statement items have been combined in order to improve clarity. These items are stated and explained separately in the notes to the financial statements. The income statement has been prepared using the nature of expense method.

The consolidated financial statements have been prepared in euros. All amounts (unless specified otherwise) are stated in millions of euros (€ million).

These consolidated financial statements were prepared for the 2005 fiscal year (January 1 to December 31).

Scope of consolidation

In addition to RWE AG, the consolidated financial statements contain all material German and foreign companies which RWE AG controls directly or indirectly. Principal associates and joint ventures are accounted for using the equity method.

Investments in subsidiaries, joint ventures or associates which are of secondary importance from a group perspective are accounted for in accordance with IAS 39. Subsidiaries which are not included in the scope of consolidation account for less than 1 % of the Group's revenue, income and debt. Subsidiaries with negative income or equity are generally fully consolidated.

A collective listing of the Group's investments in accordance with Sec. 313, Para. 2, Nos. 1 to 4 and Para. 3 of the German Commercial Code (HGB) will be filed in the Commercial Register of the Essen District Court. Material consolidated investments, investments accounted for using the equity method,* and other investments are listed on pages 173 to 175 of this annual report.

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Eighteen companies domiciled in Germany and 18 companies domiciled outside of Germany were consolidated for the first time in the year under review. One hundred and twenty-four companies, 46 of which are headquartered outside of Germany, were excluded from the scope of consolidation. Twelve companies, two of which are based outside of Germany, were merged. Six associates or joint ventures, including three outside of Germany, were accounted for using the equity method for the first time. Sixty-seven investments, which had been accounted for using the equity method in the previous year, including eleven outside of Germany, were sold, merged or were fully consolidated for the first time. First-time consolidation and deconsolidation generally take place when control is transferred.

	German 12/31/05	Foreign 12/31/05	Total 12/31/05	Total 12/31/04
Fully consolidated companies	161	328	489	589
Investments accounted for using the equity method	79	79	158	219

With regards to subsidiaries, the following share acquisitions or increases were significant:

- Great Yarmouth Power Ltd, United Kingdom, acquisition of a 100 % stake; €227 million in acquisition costs
- STOEN S. A., Poland; increased stake by 14.09 percentage points to 99.09 %; €52 million in acquisition costs
- Stredoceská plynárenská a. s., Czech Republic; increased stake by 30.96 percentage points to 82.14 %; €34 million in acquisition costs
- Severoceská plynárenská a. s., Czech Republic; increased stake by 20.21 percentage points to 72.03 %; €33 million in acquisition costs
- Harpen Aktiengesellschaft, Dortmund; increased stake by 4.94 percentage points to 100.00 %; €31 million in acquisition costs

A total of €227 million was used to acquire stakes in companies which were consolidated for the first time (previous year: €81 million).

Assets and liabilities held for sale. At RWE Thames Water, preparation for the sale of peripheral activities in 2006 was commenced, with the result that these are now classified as a disposal group and are disclosed as "Assets / liabilities held for sale":

€ million	12/31/05
Assets	878
Liabilities	533

Discontinued operations. RWE sold approximately 70 % of RWE Umwelt to Rethmann per contract signed on September 28, 2004. The German Federal Cartel Office approved the deal on February 24, 2005. Sale of the 30 % which initially remained with RWE was completed in October 2005. As a result, the former segment RWE Umwelt is disclosed in these statements as a discontinued operation, the key figures of which are presented in the following tables:

€ million	12/31/05
Assets	0
Liabilities	0

€ million	2005
Revenue	614
Expenses / Income	-585
Income from discontinued operations before tax	29
Taxes on income	-15
Income from the disposal before tax	-34

€ million	2005
Cash flows from operating activities	341
Cash flows from investing activities	-402
Cash flows from financing activities	19

Furthermore, with regard to subsidiaries and investments accounted for using the equity method, the following share disposals were significant:

Subsidiaries:

- SSM Coal B. V. Group, the Netherlands
- RWE Umwelt Ost GmbH, Halle (Saale), Germany
- RWE Umwelt West GmbH, Grevenbroich, Germany

Investments accounted for using the equity method:

- Stadtwerke Düsseldorf AG, Düsseldorf, Germany
- Severoceská energetika a. s., Czech Republic
- RWE SCHOTT Solar GmbH, Alzenau, Germany

All in all, a net -€761 million in non-current assets (including deferred taxes), -€712 million in current assets (excluding cash and cash equivalents), -€41 million in cash and cash equivalents and -€1,736 million in non-current and current liabilities were assumed or transferred as a result of the acquisition or disposal of consolidated enterprises.

The total selling price of divested subsidiaries amounted to €205 million (previous year: €1,180 million), which was paid in cash or cash equivalents.

Further information on major share disposals is provided on pages 34 to 36 in the review of operations.

Effects of changes in the scope of consolidation have been stated in the notes insofar as they are of particular importance.

Consolidation principles

The financial statements of German and foreign companies included in the scope of consolidation are prepared using uniform accounting policies. On principle, subsidiaries with a different balance-sheet date prepare interim financial statements as of the Group's balance-sheet date.

Business combinations are reported according to the purchase method. Pursuant to this method, at the time of acquisition, capital consolidation takes place by offsetting the purchase price against the acquired subsidiaries' revalued prorated net assets. Subsidiaries' identifiable assets, liabilities and contingent liabilities are measured at full fair value, regardless of the amount of the minority interest. Intangible assets are reported separately from goodwill if they are separable from the company or if they stem from a contractual or other right. No new restructuring provisions are recognized within the scope of the purchase price allocation. Acquisition costs not allocated to assets, liabilities, or contingent liabilities are capitalized as goodwill. Negative goodwill from first-time consolidation is included in income.

Capitalized goodwill is no longer amortized. It is tested for impairment once a year or more frequently if there are indications of impairment. In the deconsolidation, residual carrying amounts of capitalized goodwill are taken into account when calculating income from disposals.

Expenses and income as well as receivables and payables between consolidated companies are eliminated. Intra-group profits and losses are eliminated as long as they are not of minor significance.

The same consolidation principles apply to investments accounted for using the equity method, in respect of which recognized goodwill is reported on the balance sheet under investments. This goodwill is also not amortized. If necessary, impairment losses on the equity value are reported under income from investments accounted for using the equity method. The financial statements of all investments accounted for using the equity method are also prepared using uniform accounting policies.

Currency translation

Non-monetary foreign-currency transactions disclosed in companies' separate financial statements as of the balance-sheet date are valued at the exchange rate valid when they were recognized initially. Monetary items are converted using the exchange rate valid on the balance-sheet date. Exchange rate gains and losses from the measurement of monetary assets or monetary liabilities in foreign currency occurring up to the balance-sheet date are recognized in the income statement under other operating expenses or income.

Functional currency translation is applied when converting the currencies of foreign companies' financial statements. In the consolidated financial statements, the balance-sheet items of all foreign companies are translated into euros at the average exchange rate prevailing on the balance-sheet date, since principal foreign enterprises included in the consolidated financial statements conduct their business activities independently in their national currencies. When translating the adjusted equity of foreign companies accounted for using the equity method, the same procedure is followed. Differences to previous-year translations are recognized in other comprehensive income without an effect on the income statement. Goodwill is translated at year-end as an asset of the economically autonomous foreign sub-unit. For expense and income items, the annual average exchange rates are used for currency translation. Annual financial statements of Group companies based in a country with hyperinflation are translated according to IAS 29. No material entities were headquartered in a country with hyperinflation in the fiscal or previous year.

The following exchange rates (among others) were used as a basis for currency translations:

Exchange rates	Average		Year-end	
€	**2005**	**2004**	**12/31/05**	**12/31/04**
1 US dollar	0.81	0.80	0.85	0.73
1 British pound	1.46	1.47	1.46	1.42
100 Czech korunas	3.36	3.14	3.45	3.28
100 Hungarian forints	0.40	0.40	0.40	0.41
1 Polish zloty	0.25	0.22	0.26	0.24

Accounting policies

Intangible assets are accounted for at amortized cost. With the exception of goodwill, all intangible assets have finite useful lives and are thus amortized using the straight-line method. Software for commercial and technical applications is amortized over three to five years; concessions and other usage rights in the electricity and gas business generally have useful lives of up to 20 years. Concessions in the water business have terms of up to 50 years. Capitalized customer relations are amortized over a useful life of ten years. Useful lives and methods of amortization are reviewed on an annual basis.

Goodwill is not amortized; instead it is subjected to an impairment test once every year or more frequently if there are indications of impairment.

Development costs are capitalized if a newly developed product or process can be clearly defined, is technically feasible and it is the company's intention to either use the product or process itself or market it. Furthermore, asset recognition requires that there be a sufficient level of certainty that the development costs will lead to future cash inflows. Capitalized development costs are amortized over the time period during which the products are expected to be sold. Research expenses are recognized as expenses in the period in which they are incurred.

An impairment loss is recognized for an intangible asset, if the recoverable amount of the asset is less than its carrying amount. If the asset is part of a cash-generating unit, the impairment loss is calculated based on the recoverable amount of the cash-generating unit. If this results in the carrying amount of a cash-generating unit to which goodwill was allocated exceeding the recoverable amount, the allocated goodwill is initially written down by the difference. Impairment losses which must be recognized in addition to this are taken into account by reducing the carrying amount of the other assets of the cash-generating unit on a prorated basis. If the reason for an impairment loss recognized in prior years has ceased to exist, a write-back is performed, whereby the increased carrying amount resulting from the write-back may not exceed the amortized cost. Impairment losses on goodwill are not reversed.

Property, plant and equipment is stated at depreciated cost. The borrowing cost is not capitalized as part of the cost. If necessary, the cost of property, plant and equipment may contain the estimated expenses for the decommissioning of plants or site restoration. Maintenance and repair costs are recognized as expenses.

Exploratory drillings are accounted according to the successful efforts method, i.e. as a rule, the expenses for exploratory drillings are capitalized only in the event of commercial success.

With the exception of land and leasehold rights, property, plant and equipment is generally written down using the straight-line method, unless in exceptional cases another depreciation method is better suited to the usage pattern. The depreciation of typical property, plant and equipment is calculated according to the following useful lives, which apply throughout the group:

Useful life in years	
Buildings	12-80
Technical plants	
Thermal power plants	15-20
Electricity grids	20-35
Water main networks	20-100
Gas and water storage facilities	20-100
Gas distribution facilities	14-20
Mining facilities	4-25
Mechanical and electrical engineering facilities	4-15
Mining developments	33-35
Exploratory wells owned by RWE Dea	up to 28

Property, plant and equipment held under a finance lease is capitalized at the lower of the fair value of the leased asset or the present value of the minimum lease payments, and is depreciated using the straight-line method over its expected useful life or lease term, whichever is shorter.

An impairment loss is recognized for property, plant and equipment, if the recoverable amount of the asset is less than its carrying amount. If the asset is part of a cash-generating unit, the impairment loss is calculated based on the recoverable amount of the cash-generating unit. If this results in the carrying amount of a cash-generating unit to which goodwill was allocated exceeding the recoverable amount, the allocated goodwill is initially written down by the difference. Impairment losses which must be recognized in addition to this are taken into account by reducing the carrying amount of the other assets of the cash-generating unit on a prorated basis. If the reason for an impairment loss recognized in prior years has ceased to exist, a write-back is performed, whereby the increased carrying amount resulting from the write-back may not exceed the depreciated cost.

Investment property is all real property held to earn rental income or for long-term capital appreciation rather than for use in production or for administrative purposes. This property is measured at depreciated cost. Transaction costs are included in the initial measurement. Depreciable investment property is written-down over 12 to 80 years using the straight-line method. Fair values of investment property are stated in the notes and are determined using internationally accepted valuation methods such as the discounted cash flow method or are derived from the current market prices of comparable real estate.

An impairment loss is recognized for investment property, if the recoverable amount of the asset is less than its carrying amount. If the asset is part of a cash-generating unit, the impairment loss is calculated based on the recoverable amount of the cash-generating unit. If this results in the carrying amount of a cash-generating unit to which goodwill was allocated exceeding the recoverable amount, the allocated goodwill is initially written down by the difference. Impairment losses which must be recognized in addition to this are taken into account by reducing the carrying amount of the other assets of the cash-generating unit on a prorated basis. If the reason for an impairment loss recognized in prior years has ceased to exist, a write-back is performed, whereby the increased carrying amount resulting from the write-back may not exceed the depreciated cost.

Investments accounted for using the equity method. Shares of companies accounted for using the equity method are initially accounted for at cost and thereafter based on their amortized prorated net assets. The carrying amounts are increased or reduced annually by the prorated profits or losses, dividends distributed and other changes in equity. Recognized goodwill is included in the carrying amount and is not amortized. An impairment loss is recognized for companies accounted for using the equity method, if the recoverable amount is less than the carrying amount.

Other non-current financial assets. Shares in non-consolidated subsidiaries, in associates and joint ventures not accounted for using the equity method, as well as other investments and non-current marketable securities stated under other financial assets are nearly exclusively classified as "available for sale". Initially and in the following periods, they are measured at fair value as long as such can be determined reliably. They are initially valued on their settlement date. Unrealized gains and losses are stated as other comprehensive income, with due consideration of any deferred taxes. Gains or losses are recognized in the income statement at the time of sale. If there are substantive objective indications of a reduction in the value of an asset, an impairment loss is recognized with an effect on income.

Accounts receivable and other assets. Receivables are comprised of financial receivables, trade accounts receivable and other receivables.

With the exception of financial derivatives, accounts receivable and other assets are stated at amortized cost. Allowances for doubtful accounts are based on the actual default risk. Prepayments received from customers for consumption which is yet to be metered and billed are netted out against trade accounts receivable of the utilities.

Company loans reported under financial receivables are stated at amortized cost. Loans with interest rates common in the market are shown on the balance sheet at nominal value; as a rule, non-interest or low-interest loans are disclosed at their present value discounted using an interest rate that is commensurate with the risks involved.

Customer-specific construction contracts are recognized using the percentage of completion method. The capitalizable amount is disclosed under accounts receivable. Negative balances for construction contracts are carried as accounts payable from construction contracts. The percentage of completion is determined according to the ratio between costs incurred and estimated total costs (cost-to-cost method). Expected contract losses are covered with allowances or provisions and are determined taking the identifiable risks into account. Contract revenue comprises the amount of revenue agreed in the contract and is shown under revenue.

CO_2 emission allowances are accounted for as intangible assets and reported under other assets. They are stated at cost and are not amortized.

Deferred taxes result from temporary differences in the carrying amount in the separate IFRS financial statements and the tax base, and from consolidation procedures. Deferred tax assets also include tax reduction claims resulting from the expected utilization of existing loss carryforwards in subsequent years. They are capitalized when the realization of these loss carryforwards is guaranteed with sufficient certainty. Deferred taxes are assessed based on the tax rates that are applicable or expected in the individual countries at the time of realization, with due consideration of the tax regulations valid or adopted as of the balance-sheet date. The tax rate used to calculate German deferred taxes is 39.4 %. The Group's average local trade tax rate in Germany has been taken into account, in addition to the 25.0 % corporate income tax rate and the 5.5 % solidarity surcharge. Deferred tax assets and deferred tax liabilities are netted against each other for each company and / or tax group.

Inventories include all assets which are held for sale in the ordinary course of business (finished goods and goods for resale), which are in the process of production (work in progress—goods and services) or which are consumed in the production process or in the rendering of services (raw materials including nuclear fuel assemblies and excavated earth for lignite mining).

Inventories are carried at the lower of cost or net realizable value. Production costs include full costs directly related to production and are determined based on the normal capacity. Specifically, in addition to directly allocable costs, production costs include adequate portions of required materials and production overheads, including production-related depreciation. The borrowing cost is not capitalized as part of the cost. Assessment is generally based on average values. The usage of excavated earth for lignite mining is calculated using the FIFO method.

If the net realizable value of inventories written down in earlier periods has increased, the resulting reversal of the write-down is recognized as a reduction of the cost of materials.

Nuclear fuel assemblies are stated at depreciated cost. Depreciation is determined by operation and capacity, based on consumption and the reactor's useful life.

Marketable securities. The securities classified as current marketable securities essentially consist of marketable securities held in special funds as well as fixed-interest securities with a maturity of more than three months and less than one year from the date of acquisition. All of these securities are classified as "available for sale" and are stated at fair value. Upon initial recognition, the transaction costs directly associated with the acquisition of the financial asset are taken into account. These securities are initially valued on their settlement date. Unrealized gains and losses are stated as other comprehensive income as part of equity, with due consideration of any deferred taxes. Gains or losses are recognized in the income statement at the time of sale. If there are substantive objective indications of a reduction in the value of an asset, an impairment loss is recognized with an effect on income.

Financial assets are derecognized when the contractual rights to cash flows from the assets expire or the entity transfers substantially all the risks and rewards of ownership of the asset or the entity no longer has control of the asset.

Cash and cash equivalents consist of cash on hand, demand deposits and fixed-interest securities with a maturity of three months or less from the date of acquisition.

Assets and liabilities held for sale. Assets are stated as "held for sale" if they can be sold in their present condition and if their sale is highly probable. Such assets may be certain non-current assets, asset groups ("disposal groups") or operations ("discontinued operations"). Liabilities intended to be sold in a transaction together with assets are a part of a disposal group or discontinued operations, and are reported separately under "liabilities held for sale".

Non-current assets held for sale are no longer amortized; they are recognized at fair value less costs to sell, as long as this is lower than the carrying amount.

Results from the valuation of specific assets held for sale and of disposal groups are stated under income from continuing operations until final completion of the sale.

Gains or losses on the valuation of discontinued operations at fair value less costs to sell and profits or losses from operating activities or from the sale of such operations are reported under income from discontinued operations.

Share-based payment. The groupwide stock option plans are accounted for as cash-settled share-based payment transactions. At each reporting date, a provision is recognized in the amount of the prorated fair value of the payment obligation; changes in the fair value are recognized with an effect on income. The fair value of options is determined using generally accepted valuation methodologies.

Provisions are recognized for all legal or constructive obligations to third parties which exist on the balance-sheet date and relate to past events, and with regard to which it is probable that an outflow of resources will be required and the amount of which can be reliably estimated. Provisions are carried at the individually most likely outcome and are not offset against reimbursement claims. Provisions based on a large number of similar events are stated at expected amounts.

All non-current provisions are recognized at the most likely outcome that is discounted as of the balance-sheet date. The settlement amount also includes the cost increases to be taken into account as of the balance-sheet date. For decommissioning, restoration and similar provisions, changes in the estimated timing or amount of the payments and changes in the discount rate are taken into account at the same amount in measuring the existing provision as well as the respective asset, for example a power plant. If the decrease in the provision exceeds the carrying amount of the underlying asset, the excess is recognized immediately in profit or loss. Releases of provisions are credited to the same expense account on which the provision was originally recognized.

Provisions for pensions and similar obligations are recognized for defined benefit plans. These are obligations of the RWE Group to pay future and ongoing post-employment benefits to entitled current and former employees and their surviving dependents. In particular, the obligations refer to retirement pensions in the form of both basic and supplementary benefits. Individual commitments are based on the differing industry and country-specific benefit arrangements and are generally calculated according to the employees' length of service and compensation.
As benefits, the obligations of US group enterprises for their employees' post-retirement medical expenses are also disclosed under provisions for pensions and similar obligations.

Provisions for defined benefit plans are measured according to the projected unit credit method. This benefit/years-of-service method not only takes into account the pension benefits and benefit entitlements known as of the balance-sheet date, but also increases in salaries and pension benefits to be expected in the future. The calculation is based on actuarial reports, taking into account appropriate biometric parameters. The provision is reduced by the amount of the plan assets. The service costs are disclosed in staff costs, and the interest cost and expected return on plan assets in the financial result.

Actuarial gains and losses exceeding 10 % of the greater of the benefit obligations or the fair value of plan assets are amortized over the entitled employees' average remaining working lives with an effect on income.

In addition to the defined benefit plans, the company pension plan also consists of defined contribution plans. In the case of defined contribution plans, the enterprise's obligation is limited to the amount it contributes to the plan. The contributions to the plan are recognized as expenses and disclosed under staff costs.

Waste management provisions in the nuclear energy sector are based on obligations under public law and restrictions included in operating licenses. The amount recognized for the disposal of spent nuclear fuel assemblies covers the expected costs, in particular reprocessing costs on the basis of contractual agreements and costs for direct final disposal. The cost of transporting, treating and taking back waste, including the cost of temporary storage are included accordingly.

The amount recognized for the decommissioning of nuclear power station facilities is also based on the expected costs. The calculation of expected costs for the post-shutdown phase and dismantling is based on outside expert opinions working on the assumption that the facilities are dismantled completely.

Furthermore, provisions are created for other waste management measures (management of radioactive operational waste).

Waste management provisions also include the cost of final storage and associated pre-financing costs calculated based on data from the German Federal Office for Radiation Protection. It is expected that these provisions will be used up by 2080.

Provisions for mining damage are recognized to cover obligations to restore mining damage that has already occurred or been caused. Such risks and obligations are those that exist as of the balance-sheet date or are identifiable when the balance sheet is being prepared. They must be recognized due to obligations under public law that are based, among others, on the German Federal Mining Act and formulated, above all, in operating schedules and water law permits. Provisions are generally recognized based on the increase in the obligation, e. g. in line with lignite production. Such provisions are measured at full expected cost or according to estimated compensation payments.

Furthermore, provisions are made owing to obligations under public law to dismantle production facilities and fill wells. The amount of these provisions is based on total cost estimates derived from past experience and comparative rates determined by the German Association of Oil and Natural Gas Production Industry. Similar assumptions for foreign subsidiaries are also taken into account.

Liabilities consist of financial liabilities, trade accounts payable and other liabilities.

Upon initial recognition, liabilities are stated at fair value. In the periods thereafter, liabilities (except for financial derivatives) are carried at amortized cost. Liabili-